**IVS - Institut der versicherungsmathematischen**
**Sachverständigen für Altersversorgung e.V.**
(German Institute of Actuaries)
Lindenallee 53
D-50968 Cologne
Jochen.bode@bode-ag.de

**Munich, 24 March 2002**

**Comment and suggestion on:**

## Exposure Draft of a Proposed
## AMENDMENT TO IAS 19, EMPLOYEE BENEFITS: THE ASSET CEILING

Paragraph 58 and the new proposed paragraph 58A regarding the asset ceiling seem to be quite complicated.

The proposed amendment certainly reaches its aims, although the loss recognition of (5) in the example 3 is still hard to explain.

**We would suggest the following very simple method, avoiding the loss recognition in example 3:**

> **Paragraph 58new:**
>
> **If the fair value of plan assets (if any) at the balance sheet date exceeds the DBO (present value of the defined benefit obligation) at the balance sheet date (as calculated in paragraph 64) (surplus situation), the DBO shall be increased (formally) by that part of the surplus, which is <u>not</u> available to the employ<u>er</u> (through refunds from the plan or reductions in future contributions to the plan).**
>
> **Such DBO increase should be disclosed.**

(That is: Instead of limiting the assets the DBO should be increased!)

**Reasons for our suggestion:**

The basis for our considerations is that surpluses of a defined benefit plan (equal to the excess of fair value of plan assets over DBO at the balance sheet date) may be

a) available to the employ<u>er</u> (recoverable through refunds or reductions in future contributions)
b) available to the employ<u>ees</u> (through increases of their benefit claims)
c) <u>undecided</u> at the balance sheet date (the "tie situation"), who may benefit from the surplus (because the fund itself does not have a surplus in its own accounting rules, so that there was no need for the fund to decide, who should benefit from the surplus)

The employer only "controls the assets" of type a), so that only that part of assets should be considered as a "real employer asset".
Remark: If the amount under c) is nil, then the DBO is increased by that part of surplus which is available to the employees (which makes sense anyway).

**The practical work of the actuary is simple:**

| | |
|---|---|
| 1 | Calculate the DBO (as usual) |
| 2 | Look whether there is a surplus (fair value of plan assets minus DBO) |
| 3 | Increase the DBO by that part of the surplus, which is not available to the employer. |

**Big advantages:**

| | |
|---|---|
| 1 | Unexpected asset losses (gains) are netted (to a big part) against gains (losses) of the DBO. |
| 2 | The net total of 1) remains (often) within the corridor and recognition will be deferred; no surprising volatility!! |
| 3 | This method is more close to US-GAAP (FASB statement 87). |

**Additional Example:**

Let us assume that surpluses are to be spread 40% : 35% : 25% among a:b:c. Let us assume that at the end of year 1 the surpluses are 100 (= 40 : 35 : 25), so that the calculated DBO is increased by 60. In the year 2 we have unexpected asset losses of 50. Then the additional increase of the DBO is not 60 (as in year 1) but only 30, so that big part of the asset loss is counter-balanced against actuarial gains (due to decrease of DBO).

**Example 1 of the Exposure Draft:**

| | **A** | **B** | **C= max(A,0)-B** | **D= A-C** | **E** | **F= D+E** |
|---|---|---|---|---|---|---|
| Year | Initial surplus in plan | Economic benefits available to employer | Increase DBO by | Final surplus in plan | Unrecognized losses (gains) | Recognized Asset |
| 1 | 100 | 0 | 100 | 0 | 0 | 0 |
| 2 | 70 | 0 | 70 | 0 | 0 | 0 |

The asset loss of 30 is netted with a DBO gain of 30, so that unrecognized losses remain nil.

**Example 2 of the Exposure Draft:**

| | **A** | **B** | **C= max(A,0)-B** | **D= A-C** | **E** | **F= D+E** |
|---|---|---|---|---|---|---|
| Year | Initial surplus in plan | Economic benefits available to employer | Increase DBO by | Final surplus in plan | Unrecognized losses (gains) | Recognized Asset |
| 1 | 60 | 30 | 30 | 30 | 40 | 70 |
| 2 | 25 | 20 | 5 | 20 | 50 | 70 |

The asset loss of 35 is netted with a DBO gain of 25, so that unrecognized losses increase by 10 (from 40 to 50).

**Example 3 of the Exposure Draft:**

| | **A** | **B** | **C= max(A,0)-B** | **D= A-C** | **E** | **F= D+E** |
|---|---|---|---|---|---|---|
| Year | Initial surplus in plan | Economic benefits available to employer | Increase DBO by | Final surplus in plan | Unrecognized losses (gains) | Recognized Asset |
| 1 | 60 | 30 | 30 | 30 | 40 | 70 |
| 2 | 110 | 25 | 85 | 25 | 45 | 70 |

The asset gain of 50 is netted with a DBO loss of 55, so that unrecognized losses increase by 5 (from 40 to 45). **There is no loss recognition of 5 in year 2 !!**

**Example 4 of the Exposure Draft:**

| | **A** | **B** | **C= max(A,0)-B** | **D= A-C** | **E** | **F= D+E** |
|---|---|---|---|---|---|---|
| Year | Initial surplus in plan | Economic benefits available to employer | Increase DBO by | Final surplus in plan | Unrecognized losses (gains) | Recognized Asset |
| 1 | 60 | 25 | 35 | 25 | 40 | 65 |
| 2 | (50) | 0 | 0 | (50) | 115 | 65 |

The asset loss of 110 is netted with a DBO gain of 35, so that unrecognized losses increase by 75 (from 40 to 115).

**Important Note concerning some types of pension arrangement in Germany:**

The asset ceiling only comes into force, when there is a surplus (in the IAS-world)!
But it may also be a problem to overestimate available plan assets in an underfunded situation!
Our suggestion also solves this following quite frequently arising problem in Germany:
The employer has a funded pension plan (with relatively low benefits to the employees) and an unfunded plan with a gross pension formula, where the benefits of the funded plan are deducted (fully or partly). Surpluses of the funded plan may be partly to the benefit of the employee and partly to the benefit for the employer. We consider such a pension arrangement as one single pension plan; we calculate the DBO for the gross benefit formula and evaluate the plan assets at their fair value. Of course, we are always in an (overall) underfunded position. But we should not overestimate the plan assets (and underestimate the financial status of the plan), because parts of the plan assets will probably be used for increasing the benefits of the employees. In such a situation it is wise to increase the DBO by probable increases in the funded arrangement.

End of Statement