European Association of Co-operative Banks
Groupement Européen des Banques Coopératives
Europäische Vereinigung der Genossenschaftsbanken

EACB Comments
on the DP on "the impact on the volatility of own funds of the revised IAS 19 and the deduction of defined pension assets from own funds under Article 519 of the CRR" – EBA/DP/2014/01

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Introduction

The European Association of Co-operative Banks (EACB) appreciates the European Banking Authority (EBA) initiative to discuss the impact on the volatility of own funds of the revised IAS 19 and the deduction of defined pension assets from own funds under Art. 519 of the CRR. We gladly provide our comments in order to contribute to the discussion.

General comments

1) *Deduction of net pension assets from own funds.*

The regulatory requirement to deduct net pension assets from own funds was already established in the reform package of the Basel Committee (para. 76 – 77, Defined benefit pension fund assets and liabilities) and implemented the Capital Requirements Regulation (CRR) in Art. 36(1)(e), definition in Art. 4(109). According to para. 22 of the DP, the deduction of net pension assets from own funds improves the quality of own funds recognised by institutions. The deduction also addresses the concern that assets arising from pension funds may not be withdrawn and used for the protection of depositors and other creditors of a bank (DP, para. 12).

We doubt that deducting net pension assets from own funds would improve the quality of own funds. Changes in the amount of plan assets and defined benefit obligations to our experience are rarely exactly correlated. A complete netting of the changes in the amount of the prudential deduction with the amount of changes in plan assets and defined benefit obligations as described in different paragraphs of the DP in our view is rather an exception than the rule.

Changes in the amount of the net pension assets may result from changes in plan assets and defined benefit obligations which are reflected in own funds in some cases and which do not influence own funds in other cases. A complete netting would, however, require that changes of plan assets and defined benefit obligations are reflected in own funds in any possible case.

We believe that, due to the fact that the amount of the prudential deduction is affected by both types of changes, own funds would be eliminated to a certain extent even though a dotation of own funds has not occurred before. We consider such an elimination of own funds as not justified. There would be no improvement in the quality of the own funds because of such treatment.

The purpose of plan assets is to secure pensions. To our consideration the prudential deduction would create an incentive to avoid excess funding or even accept a deficit funding and that way endanger the pensions (see also the comments of the German Banking Industry Committee on the consultation paper 'Strengthening the Resilience of the Banking Sector" issued by the Basel Committee, 2010, page 20.).

Since we are convinced of the quality of our plan assets and of the general prudential rules to provide for an appropriate level of the quality of own funds we clearly argue against deducting net pension assets from own funds. We propose to keep up capital charges for exposures (net amount of pension assets) as risk weighted assets with prudential capital as a prudential risk measurement instead.

2) *Volatility of own funds.*

An aim of the DP is to identify inappropriate volatility of own funds. A complete assessment in our view is only possible, if the underlying assumptions are clear at all times. We would thereby differentiate the following scenarios:

a) Existence of a net pension asset and changes in the amount of plan assets and defined pension liabilities which are reflected in own funds,
b) Existence of a net pension asset and changes in the amount of plan assets and defined pension liabilities which are not reflected in own funds,
c) Existence of a net pension asset with changes of plan assets and defined pension liabilities which are partially reflected in own funds and partially not.

Considering the listed combinations of scenarios, we believe that the volatility of own funds is not predictable for the following reasons:

to a) A complete netting of the changes in the amount of the prudential deduction with the amount of changes in plan assets and defined benefit obligations as described in different paragraphs of the DP is to our consideration rather an exception than the rule as pointed out above.

to b) The formation of a Contractual Trust Arrangement (CTA) by funding plan assets directly with available cash changes the plan asset and thus the prudential deduction without a reflection in own funds. Because of the change of the prudential deduction there is resulting volatility of own funds.

to c) For the portion of changes which are reflected in own funds there is a complete netting of the changes in the amount of the prudential deduction with the amount of changes in plan assets and defined benefit obligations as described in the DP. For the portion of changes which are not reflected in own funds there is resulting volatility of own funds because of the change in the amount of the prudential deduction.

The changes of IAS 19 (2011) and their possible effects on the prudential own funds have been described in the DP (sections 4.3.2. and 4.5.). The investigation of the volatility of own funds has, however, not taken into consideration the different combinations of facts explained above and therefore appears incomplete to us. The variety of the possible combinations shows clearly that general statements can not be made.

For the reasons given above we argue against the implementation of prudential filters for the accounting for defined pension plans under IAS 19 (2011). The unfiltered application of the IFRS Rules for recognition, measurement and disclosure is the only appropriate treatment in that context.

Answers to specific questions

1. Is the scope of the report appropriate? Are there additional elements to include in the scope of the report based on this mandate?

We agree that the scope is mainly appropriate, assessing the volatility of own funds as a consequence of a change in prudential and accounting rules. Only the amendments of IAS19 on post employment benefits have a consequence on own funds including post employment medical care. An overall impact should include all post employment schemes and not only defined benefit pension funds.

We recommend to align or to differentiate the following definitions, in the sake of clarity:

"net pension assets vs. net pension liabilities", "net benefit pension fund assets/ liabilities" and "defined benefit pension funds".

We also recommend to introduce the topic in accordance with different situations: patterns with prudential deduction (net pension asset) and patterns without prudential deduction (net pension liability) and defined benefit liabilities which are not funded by plan assets. This would increase the understanding and the clarity of the conclusions.

2. Do you agree with the proposed methodology for the objective of the report to be met? Please indicate whether additional areas need to be considered.

In principle we agree with the chosen approach (qualitative, quantitative and additional considerations). We would welcome recommendations for legislative action.

3. Do you agree with the identified prudential requirements relevant to the scope of the report? Are there additional elements to include in the analysis of the prudential requirements?

We do not consider a prudential deduction as useful (compare our general comments).

Especially, the funding of plan assets directly with cash which does not have an effect on equity is an argument against a prudential deduction.

It could also be mentioned that the Art. 26 of the CRR, Common Equity Tier 1 (CET1) items include *(d) accumulated other comprehensive income,* which included actuarial gains and losses.

4. Do you agree that the main drivers of the change in the amount of net defined benefit pension funds would be items for which a corresponding gain or loss is recognised on own funds (such as actuarial gains and losses)?

We do not believe that the main drivers of the change in the amount of net defined benefit pension funds would be items for which a corresponding gain or loss is recognised on own funds. In fact, as already outlined before, considering the listed combinations of facts the volatility of own funds in our opinion is not predictable. In fact, the formation of a Contractual Trust Arrangement (CTA) by funding plan assets directly with available cash changes the plan asset and thus the prudential deduction without an reflection in own funds. Because of the change of the prudential deduction there is resulting volatility of own funds.

Moreover, we think that the main impact on own funds results from entities which applied the corridor approach under the previous IAS 19. This approach was cancelled in IAS 19 (2011) and all actuarial gains and losses are accounted for in other comprehensive income (OCI). In our view the deduction of net defined benefit assets from CET1 could be not as important because of the asset ceiling mechanism.

5. Do you agree with the analysis performed on the amendments to IAS 19? Do you agree that the changes in IAS 19 relevant to the scope of this report are the immediate recognition of actuarial gains and losses and past services costs?

Please provide input on additional changes in IAS 19 that need to be taken into consideration in assessing the impact on own funds at initial application and application in subsequent periods under the scope of the report.

We agree that the main impact of IAS 19 (2011) results from the immediate recognition of actuarial gains or losses under other comprehensive income (OCI) and of all past service costs.

6. Do you agree with the analysis performed for the changes of IAS 19 that are not expected to have an impact on own funds with regards to the scope of this report?

The analysis of the changes by IAS 19 (2011) appears to be complete. The examination has, however been made without regard to the different scenarios (see general comments) and therefore, from our point of view, is incomplete and not sufficiently clear.

7. Do you agree with the methodology of the analysis performed and the interpretation of the qualitative and quantitative data? Please provide additional data that need to be taken into account.

We agree with the methodology but we consider that the results is not presented clearly.

The main conclusion for us is dealt in para. 76 of the discussion paper.

The institutions that suffer the main impact are those who applied the corridor approach and had significant amounts of unrecognised actuarial gains and losses and pas service costs.

8. Do you agree with the elements included in the additional qualitative assessment for the possible developments that could impact the volatility of own funds?

We agree that the discount rate and the inflation rate are significant actuarial assumptions (external elements). Salary increases and turn over rates are also significant (internal elements).

Do you have any particular consideration with regard to the impact of the discount rates used for the measurement of the defined pension plans under the requirements of the revised IAS 19? Is there any difference compared to the previous IAS 19?

There is no difference between the two standards about the discount rates. The differences come from the market corporate bonds and the appreciation of what is a deep liquid market in euro zone.