

ROUNDTABLE

**APPLICATION OF IAS 19 TO THE CLASSIFICATION OF COMPULSORY INDUSTRY-WIDE
MULTI-EMPLOYER PENSION SCHEMES IN THE NETHERLANDS**

BRUSSELS, 18 OCTOBER 2007

ISSUE PAPER

NOTICE TO THE PUBLIC

This paper has been compiled using written contributions from individual participants to serve as a basis for the discussions at the meeting of 18 October 2007. Any opinions or recommendations expressed in these paragraphs are those of the proposer(s) concerned and not the views of the Roundtable or of the Commission.

No interpretations of IFRS should be inferred from the contents of this paper.

A. Brief overview of the issue

With the adoption of IFRS in 2005, a significant debate ensued in the Netherlands on the classification of compulsory industry-wide multi-employer pension schemes under IAS 19.25-27 as either defined contribution (DC) plans or defined benefit (DB) plans, when under previous GAAP these were accounted for as DC. This debate is still ongoing. For that reason both the Royal Dutch Institute of Chartered Accountants (Koninklijk NIVRA) and the Confederation of Netherlands Industry and Employers (VNO-NCW) requested the Dutch Accounting Standards Board (DASB) to raise this issue with the EU Roundtable for the purpose of determining whether this issue should be put before IFRIC for resolution.

In the annex, the case in question is discussed in more detail including a description of the basis for and the operation of such schemes as well as the arguments of the supporters of the differing views.

B. Request to the EU Roundtable

Given the importance of such schemes in the Netherlands and, depending on the view taken, the significance of the impact on the financial statements of those companies reporting under IFRS, DASB respectfully requests the EU Roundtable to:

- Deliberate the issue as described in the annex; and

- Advise DASB on the way forward by:
 - Concluding on the merits of the case and the respective views expressed and considering support for this case to be put before IFRIC; or
 - Suggesting other available options to resolve this issue.

It is realized that comparable issues may exist in other EU member states, but it is believed that in view of the significance in the Netherlands of this issue both in terms of its size and the impact on the financial statements of the companies concerned that this subject deserves to be discussed on the basis of the principles in question.

Amsterdam, 23 May 2007

Annex:

Application of IAS 19 to the classification of compulsory industry-wide multi-employer pension schemes in the Netherlands.

Application of IAS 19 to the classification of compulsory industry-wide multi-employer pension schemes in the Netherlands

General

With the adoption of IFRS in 2005, a significant debate ensued in the Netherlands on the classification of compulsory industry-wide multi-employer pension schemes under IAS 19.25-27 as either defined contribution (DC) plans or defined benefit (DB) plans, when under previous GAAP these were accounted for as DC. This debate is still ongoing. For that reason both the Royal Dutch Institute of Chartered Accountants (Koninklijk NIVRA) and the Confederation of Netherlands Industry and Employers (VNO-NCW) requested the Dutch Accounting Standards Board to raise this issue with the EU Roundtable for the purpose of determining whether this issue should be put before IFRIC for resolution.

In the Netherlands, such pension schemes have been around for a long time and cover a very significant part of all pension schemes in the country. The related pension plans are administered in separate legal entities (pension funds). Nearly all of these funds (around 80) are members of the Dutch Association of Industry-wide Pension Funds ('Vereniging van Bedrijfstakpensioenfondsen' - VB). A total of 4.7 million active employees (75% of Dutch employees participating in a group pension plan) are covered under these schemes. In addition, they pay pension benefits to some 1.2 million retirees. Also, a substantial number of those, no longer employed in the industries participating in these schemes, still retain certain levels of entitlements. Almost 350,000 employers participate in these funds, ranging from listed multinationals to small and medium-sized enterprises. Investments held by these funds aggregate more than EUR 400 billion. In comparison, plan assets in the Netherlands of other company pension funds, occupational pension funds and pension schemes administered by insurance companies total some EUR 200 billion.

This memorandum discusses this issue on the basis of:

- A description of the characteristics of a typical industry-wide pension fund;
- The accounting rules under IFRS; and
- The different views on the classification of such schemes.

For this memorandum we have also drawn on information supplied by the VB referred to above.

Description of a typical industry-wide pension fund

The main characteristics that form the basis for such a fund are the following

- 1 Pursuant to the Compulsory Participation Industry-wide Pension Fund Act ('Wet verplichte deelneming in een bedrijfstakpensioenfonds'), employers and employees can jointly request the government to declare participation in a multi-employer pension scheme for a particular industry compulsory. This usually results from a "CAO" (collective labour agreement) negotiated on a regular basis within an industry, which typically would include a pension agreement as part of

- the overall agreed compensation package. Pension agreements under a CAO are nowadays normally based on average pay;
- 2 Under certain conditions, it is possible for a participating employer to opt out of the scheme, but only if there is a company pension fund or insurance scheme that offers terms that are at least equal to those of the compulsory scheme;
 - 3 The fund administering such a compulsory pension scheme is an independent legal entity, constituted under Dutch law as a “Stichting” (foundation or trust). The board of trustees of such a fund is composed of an equal number of representatives from both employers and employees in the industry. The board of trustees is required to act in the interest of the fund and of all relevant participants in the scheme, i.e. active employees, inactive employees, retirees, employers and other stakeholders. The fund centrally administers the plan assets that are generated by the contributions of participating employers, and uses these assets to provide benefits to the employees of the participating employers;
 - 4 Pursuant to the Dutch Pensions Act (‘Pensioenwet’), employers are required to separate funds under a pension scheme by placing it with a pension administrator. The details of such a scheme need to be included in a written pension agreement with employees. No separate written agreement is required in the case of the scheme being administered by a compulsory industry-wide pension fund, as long as the employer is bound by the CAO to comply with the articles of association of the fund, which codify the details of the pension scheme agreed between employers and employees in a particular industry and the pension fund in question has a generic or specific administration agreement;
 - 5 The administration agreement of a fund must at least include the following
 - The basis for the determination of premiums;
 - Payment conditions of premiums levied;
 - Criteria for decisions on the consequences of deficits and surpluses; and
 - Procedures for amending and redrafting pension terms;
 - 6 Pension terms are agreed by the board of trustees of a fund in accordance with the contractual arrangements of the pension scheme and the administration agreement. Pension terms cover the following:
 - Determination of pension benefits;
 - Conditions and procedures for value transfer; and
 - Reduction of pension entitlements (under certain strict conditions);
 - 7 Once declared compulsory, a fund cannot refuse admittance by any potential participating employer. There is no entrance fee for a new participating employer. Exits are rare and there are in principle no exit fees on leaving the fund (e.g. by opting out). Nor, in that case, is there an entitlement to a share of a surplus, if any, in the fund;
 - 8 The overall premium is determined by the total population covered by the fund. The composition of the workforce of any specific employer does not affect the premium due by an individual employer. Premiums levied by a fund are pro-rated on the basis of a percentage of the wage sum of any employer in relation to the total wage sum for all employers participating;
 - 9 If there is a deficit, a variety of strategies and remedies can be applied by the fund, such as:
 - Reduction of entitlements, with part of the future premiums being used to cover the deficit;
 - Capping indexation;
 - Changes in the investment policy (this may free up required investment reserves);

- Increases in premiums for employers and employees; and
- A one-off supplementary premium (although the majority of VB members state that they are unable to use this due to restrictions in the contractual arrangements of pension schemes and/or administration agreements; in many cases there is a maximum annual contribution).

The accounting rules under IFRS

IAS 19.7 defines multi-employer plans as plans that:

- pool the assets contributed by various entities that are not under common control; and
- use those assets to provide benefits to employees of more than one entity, on the basis that contribution and benefit levels are determined without regard to the identity of the entity that employs the employees concerned.

With reference to the characteristics identified before, compulsory industry-wide pension schemes in the Netherlands are classified as multi-employer plans.

In accordance with IAS 19.29, a multi-employer plan should be classified as a DC plan or a DB plan depending on the terms of the plan.

IAS 19.7 defines DC plans as follows: Defined contribution plans are post-employment benefit plans under which an entity pays fixed contributions into a separate entity (a fund) and will have no legal or constructive obligation to pay further contributions if the fund does not hold sufficient assets to pay all the employee benefits relating to employee service in the current and prior periods.

DB plans are pension plans that are not DC plans.

Pursuant to IAS 19.25, under DC plans, the entity's legal or constructive obligation is limited to the amount that it agrees to contribute to the fund. In consequence, actuarial risk and investment risk fall on the employee. IAS 19.26-27 includes a more detailed description of this.

Different views on classification

Based on the interpretation of IAS 19 in relation to the characteristics of the Dutch compulsory industry-wide multi-employer pension schemes, there is significant debate in the Netherlands on the classification of these schemes.

Pension entitlements are determined on the basis of the average pay of a particular employee. However, premiums which employers are obliged to pay are not related to the characteristics of the individuals employed but are pro-rated on the basis of the aggregate wage sum. Due to the composition of the board of trustees, employers have no direct influence on decisions related to the levels of premiums charged in any year. The premium levied for any year is based on a variety of strategies and remedies that are available to the board of trustees. Those may or may not include coverage for any past or potential deficits. Employers are required to pay the annual premium under the compulsory pension scheme and as such cannot avoid any ensuing risks. On the other hand, when joining or opting out under certain conditions, in principle no settlement of any past, present or future risk or reward is required.

The arguments for each of the views are detailed below.

‘It is a DC plan’

Apart from the obligation to pay annual premiums, it would, in practice, not be very easy to conclude that there is any further constructive obligation. These schemes, after all, relate to CAO-linked pension agreements, compulsory affiliation, with the fund administering pension entitlements for an entire industry with the approval of the CAO parties, and a premium level set by the equal representation on the board of trustees of the fund.

To the extent that there would be a risk, this will only express itself in contribution adjustments over the years and not in a single supplementary payment. In the not too distant past, when share prices were down, many of these funds have applied a variety of strategies and remedies to ensure a long-term appropriate level of coverage. In the last 25 years, there has been only one instance in the Netherlands where a fund required employers to contribute a supplementary one-off premium in addition to the regular annual premium. In addition, none of these funds has ever reimbursed its participating employers for any surpluses in the past, and as stated before there are no entrance fees and in the rare case of an exit in principle no exit fees. In addition, many of the schemes have premium contribution caps.

In practice, the premium level set for any year is based on a number of components. It would be impossible for an individual employer to determine what portion of its annual premium would relate to past risks. That determination is made even more difficult by the fact that the premium is pro-rated on the basis of the employer’s wage sum versus the total wage sum covered by the fund and that as a consequence there is no relationship between the composition of the work force of any individual company versus the composition of the total work force covered by the fund.

Some would argue that this issue only exists because these schemes are administered by distinct legal entities. They believe that in substance these schemes should be viewed as “state plans”, because in essence their characteristics are the same.

State plans are normally classified as DC plans because the individual companies’ obligation is restricted to paying the required annual contribution and participants have no further actuarial and investment risk.

‘It is a DB plan’

For the pension scheme to qualify as a DC plan, the participating employer must pay no more than a fixed annual contribution. There should be no further legally enforceable or constructive obligation with respect to the fund, i.e. when the fund has insufficient reserves to meet the commitments to present and past employees in terms of current and past service years. If these conditions are not satisfied, for example, because the annual premium includes adjustments to cover past deficits, under IAS 19 such schemes are classified as a DB plan for the company in question, requiring the company to recognize this as a DB plan in its accounts.

Some of the funds believe that participating employers can classify these schemes as a DC plan because the affiliated employers can only be required to pay the annual contributions due. They argue that there is no legally enforceable right or constructive obligation to cover any deficits, nor is there any entitlement to any accrued surplus.

However, the view of the proponents of this interpretation is that, although those risks may be remote, the condition that there is no legally enforceable or constructive obligation to pay additional contributions if the fund has insufficient reserves, is not satisfied.

The past has shown that these funds use different strategies and remedies simultaneously. Since employers are legally obliged to be affiliated, they have no option to leave the fund when they wish, and as a consequence are exposed to paying for their share in any deficit through the increases in contributions.

The proponents would argue that surpluses and deficits are settled over time as well by adjustments to the annual premiums. Despite capping mechanisms and other restrictions, a certain level of exposure remains with the participating employers. As a result, they believe that these schemes should be classified as DB plans under IAS.