Norsk RegnskapsStiftelse

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
UK

Cc: EFRAG

Oslo, November 4th, 2012

IAS 19 Discount rate
We would like to draw your attention to certain issues and effects of the current regulation of how to determine the discount rate under IAS19 Employee Benefits.

The issue
The concern that we share with you in this letter is that under current market conditions the difference between determining the discount rate with reference to high quality corporate bonds versus determining the discount rate with reference to government bonds has become substantial, to the extent that it reduces comparability of reported liabilities for post employment benefits. This is a topic of significant concern to Norwegian companies reporting under IFRS given the lack of a deep market for high quality corporate bonds, large indicated relative spreads between corporate bond rates and government bond rates and low interest rates prevailing in Norway compared to other comparable countries.

Regulation
IAS19R.8 states that *Net interest on the net defined benefit liability (asset)* is the change during the period in the net defined benefit liability (asset) that arises from the passage of time. IAS19R.83-86 discusses how to determine the discount rate. Of particular interest is paragraph 84, which states that "The discount rate reflects the time value of money …".

The concept of "time value of money" is not defined in the standard or discussed in the Basis for Conclusions. However, a common understanding of this concept is the degree to which a person prefers current consumption to future consumption. The time value of money clearly indicates a risk-free interest rate which is not sensitive to technical attributes of a specific market, such as the degree of liquidity in that market.

The direct regulation of how to determine the discount rate is found in paragraph 83, which requires reference to market yields at the end of the reporting period on high quality corporate bonds. In countries where there is no deep market in such bonds, the market yield on government bonds shall be used. There is no reference to deep market for government bonds. The data that we present below shows that the two methods that both are supposed to provide an expression of the time value of money, result in significantly different rates.

With the current market conditions the obligation to use government bond rates seems inconsistent with the objective of discounting for the time value of money.

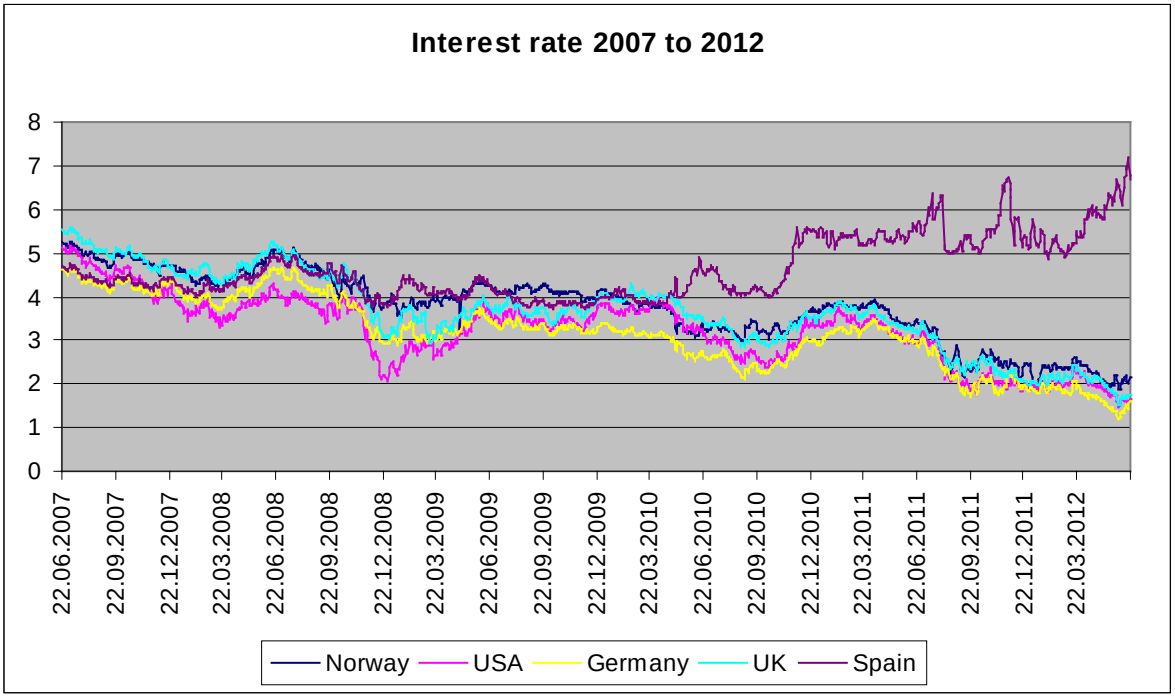
The current market conditions
During the financial crises starting in 2008 and the current Euro crisis, we observe that spreads are increasing, previous well established relationships are changing and differences in rates and prices previously considered immaterial are increasing to material levels. Our concern is that the differences in discount rate between countries have increased in the

current unsettled market, and the differences do not seem to reflect primarily the differences of time value of money, but rather different perception of risk in the instruments and liquidity issues. Some governments run with deficit and have large outstanding bond volumes while other governments run with significant surplus and keep outstanding bond volumes partly as a kind of service to the public.

We have observed that the spread between yields on bonds issued by different governments reflects significant risk elements. This is the case within the Euro zone, where strong economies such as Germany have relatively stable interest rates while weaker economies have experienced significant increases in interest rates. Further, economies considered safe havens such as the US and certain other countries have experienced low rates. Some economies such as Denmark and Switzerland even experience negative rates on their long-term government bonds. Our understanding is that the market is willing to pay a premium to avoid the risks and costs associated with alternative investments. There may be several reasons for this, including an unusually low time value of money. However, regulatory issues such as capital requirements for insurance companies may also influence the rate.

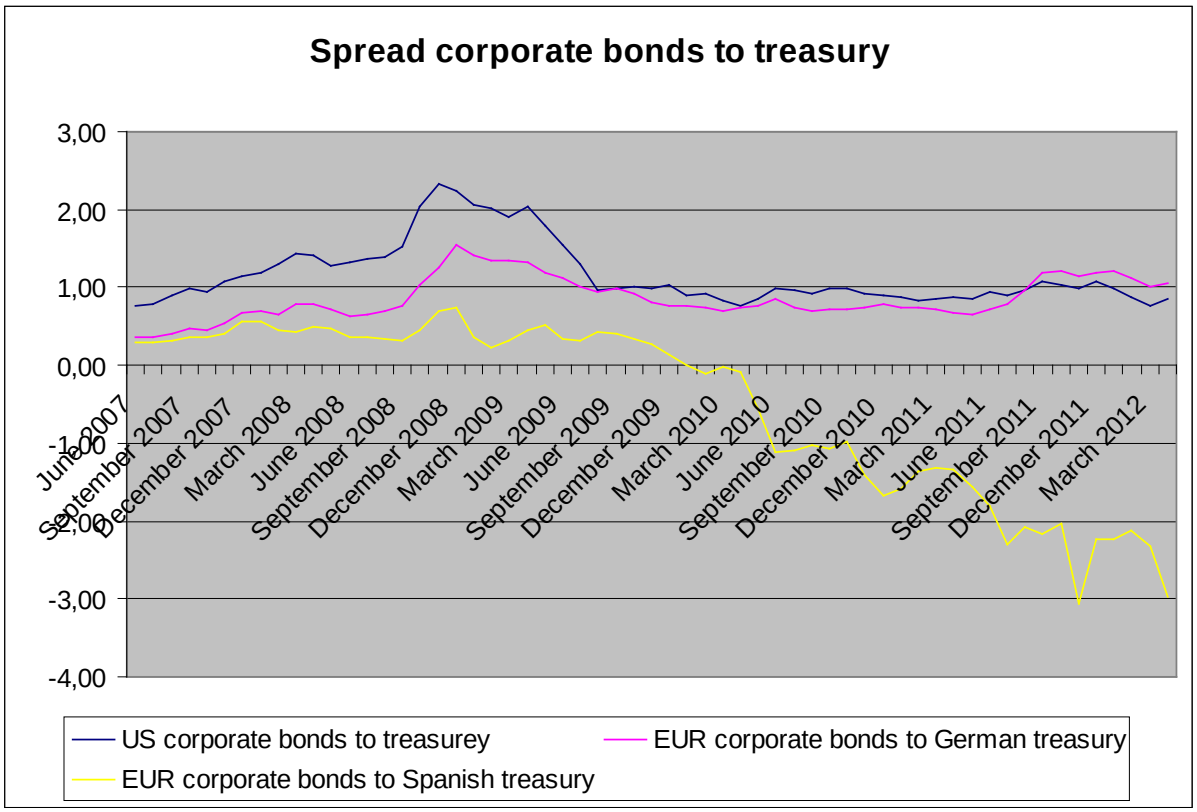
We believe that this yield does not always represent a relevant expression for time value of money from a corporate reporting perspective. This view is supported by the big difference between the Norwegian government bond interest rate and the swap interest rate used in the Norwegian interbank market. The swap spread (10 years swap rate vs 10 years government bond rates) is currently 1.38% in Norway compared to a historic average level of about 0.4%. For comparison the swap spread is 0.74% in Germany and 0.31% in the US.

Yield on 10-years government bonds from June 2007 to June 2012 for some countries is shown in the chart below (source: Reuters)



Although IAS 19 gives no guidance as to how to define High quality corporate bonds, such bonds have over time been perceived to be bonds from issuers with at least AA rating from recognized rating agencies. The spread between the rates for such bonds and government bonds in the same currency is quite different in the period after 2007 compared with previous periods. As a result, the difference between liabilities discounted with reference to yield on

high quality corporate bonds and liabilities discounted with reference to yield on government bonds has increased. (Data sources: Reuters and Bloomberg)



The chart shows that the US spread increased to a level above 200 basis points in the autumn of 2008, and came down to a level around 100 basis points during the summer of 2009. Looking at the Euro spreads we see quite different patterns. Corporate bonds in Euro are compared to government bonds from German treasury and Spanish treasury to illustrate. We see that through 2008 the spread compared to both countries' treasury is within a band of around 100 basis points. However, during 2009 the spread over German treasury increased slightly, while the development in Spanish interest rates resulted in negative spread from 2010.

Suggested actions

We believe that the paragraphs dealing with how to determine the appropriate discount rate should be revisited. However, we acknowledge that this will be a long time effort that cannot be expected to give immediate relief. As an urgent measure we suggest that the Board takes on a project to address the differences in measurement of post-employment benefits that results from atypical conditions or changes in the financial markets that are not relevant for measuring individual entities liabilities. A possible solution that may be considered is making changes to guidance in IAS19R. An application guidance reflecting how market imbalances should be factored into the discount rate to achieve the stated objective, i.e. to reflect time value of money, could also be envisaged.

Yours faithfully,

Erlend Kvaal
Chairman of the Technical Committee on IFRS of Norsk RegnskapsStiftelse