AVIVA

Aviva plc
St Helen's
1 Undershaft
London EC3P 3DQ
Tel +44 (0) 207 283 2000

EFRAG
13-14 Avenue des Arts
1210 Brussels
Belgium

Tim Harris
Group Chief Accountant

Direct line: +44 (0)20 76622118
Direct fax: +44 (0)20 76622144
e-mail: hugh.francis@aviva.com

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Dear Sirs

RESPONSE TO THE DISCUSSION PAPER: THE FINANCIAL REPORTING OF PENSIONS

As the world's fifth largest insurance company and the largest in the UK, with a significant number of employees and substantial staff pension commitments around the world, we welcome the publication of the discussion paper "The Financial Reporting of Pensions". We have provided input to the response letter from the Association of British Insurers, but wished to highlight some key issues.

We support the discussion paper's aim of improving the accounting for, and reporting of, employee benefits. This is an important issue and much can be achieved through clear narrative and disclosures to enable users of financial statements to understand these arrangements. Indeed, we have already adopted disclosure recommendations from the ASB in this regard.

It is acknowledged that pension accounting is a controversial area. In the UK context, pension accounting reform has been seen by some as a much needed improvement to increase transparency and show the 'real' company obligation and by others as overly onerous, ultimately disadvantaging employees by pension schemes closure. In this context it is essential, and consistent with the 'European Public Good' objective, to fully understand and examine the wider consequences of any proposed changes to pension accounting.

The recognition of differences between the 'long-term' nature and characteristics of pension schemes (involving long-term benefit planning and appropriate long-term investment strategies) and the "snapshot" presentation in financial statements is to be welcomed. It is important that the financial statements do not present such an unrealistic picture that the user could misinterpret the headline figures and force management into inappropriate decisions about the longer-term viability of such schemes. The inter-action of investment risk, longevity risk and inflation needs to be properly recognised, so that measurement and disclosure is appropriate.

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It is important that any proposals are not too theoretical and in this regard we support the settlement approach to pension obligations, ie that measurement of the liability should be based on the "going concern" run-off of liabilities which should be stated at our best estimate of fulfilment value, rather than on a theoretical market price more appropriate to a forced sale which has enhanced risk priced into this.

The discussion about the nature of pension promises and the treatment of scheme assets and liabilities is welcomed. This depends on the exposure of the employer to any residual liability or surplus, and the link with funding commitments agreed with the trustees. This is particularly important in the identification and measurement of the entity's obligations, and in the choice of discount rate used.

For 'independent' funded schemes with substantial investments intended to match liabilities, we do not believe that discounting using a risk-free rate reflects the economics of pension settlement, and would favour the use of appropriate alternatives. This is consistent with the view that the employer should report a liability only in respect of any guarantee it has given and this future funding commitment would incorporate some expected return on assets above the risk free rate. Not to do so would overstate the company liability.

We welcome the opportunity to comment on the discussion paper and would be happy to discuss any matters further if this would be helpful.

Yours faithfully,

Tim Harris

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Group Chief Accountant