2020 Review

Employee benefits accounting at

31 December 2019

A forward-looking analysis of trends under IAS 19, ASC 715 and IPSAS 39

Highlights of reporting as at 31 December 2019

1. Despite the high levels of investment return over 2019, funding levels remained stable at 81%, on average. This is because of discount rates falling, on average, from 0.84% to 0.24% per year. This fall in discount rates increased liabilities by around 10%.

2. The trend to refine the turnover assumption continued with 67% of companies now applying an adjustment, up from 62% a year earlier.

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Expectations for 2020

Investment returns for 2020 have been poor so far. With discount rates unchanged, funding levels for accounting are expected to deteriorate for the majority of Swiss occupational benefit plans. Therefore, we expect many companies will review the suitability of their accounting methodology and assumptions for the current economic climate in advance of year end.

Where they are not already doing so, we expect companies to:

1. Apply IAS19 **risk sharing** provisions. Swiss occupational pension plans are Defined Benefit ("DB") as there is a risk that employers will need to make additional contributions for deficits relating to benefits employees have already earned. However, unlike most countries, the DB risks do not rest solely on the employer in Switzerland: the employees may also have to make additional contributions and/ or their benefits may be reduced.

   Modelling this shared risk is complex, but companies are increasingly doing this in light of accounting deficits that rarely materialize in the form of additional contributions and hence seem unrealistic. For more detail, please see the later section on "**Methodology**".

2. Review their **turnover** assumption. We expect the trend of companies refining their turnover assumption to continue. In part this will be driven by companies' desire to refine downwards their costs and liabilities where they have higher-than-average turnover.

   Conversely, our survey shows just 6% of companies reflecting lower-than-average turnover. This suggests that some companies with low turnover are applying standard tables without adjustment. Therefore, we expect there will also be a push from auditors for turnover analysis to be conducted for all sizeable companies that currently assume average turnover.

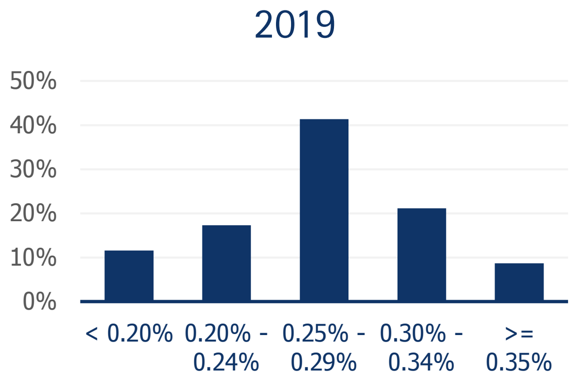
3. Review their **mortality** assumption. There is a continuing trend to project rates of mortality using the UK actuarial profession's Continuous Mortality Investigation ("CMI") model. This is more sophisticated in its use of past experience, but also requires additional parameters which are subjective. These are becoming increasingly popular now that it's clear that they are accepted by the major audit houses because they generally reduce the accounting cost and obligations.

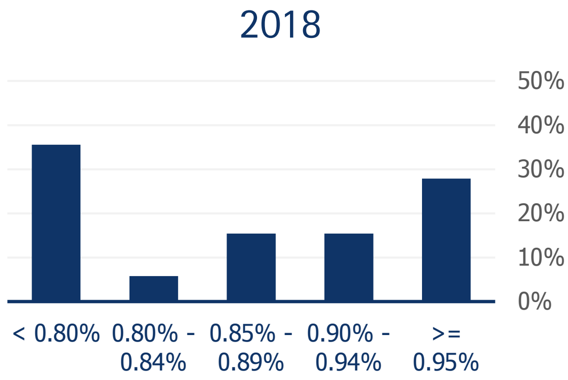
4. Refine their **disability** assumption. Historically, market practice has been to treat all disability cases as being cases of full disability due to the limited data available on extent of disability. However, it is increasingly recognized that a subjective allowance for the mix of full and partial disability is a better estimate than assuming all cases relate to full disability. There is also a lack of data on the recovery from disability before retirement. Increasingly, companies are making an adjustment to the tables on disability incidence to make allowance for these two considerations.

Financial assumptions

Discount rate

The charts below show the distribution of discount rates each 31 December.





For 2019, the range of discount rates narrowed such that 15 basis points covered 80% of the market, whereas in 2018 it only covered 37% of the same companies.

See https://www.allea.ch/en/discount-rates/ for the latest discount rates.

Interest credit rate

We saw an increase from 38% to 52% in the proportion of companies expecting that interest credits would average less than the BVG minimum rate. In both years one-third of companies surveyed set their interest credit rate equal to their discount rate (subject to BVG minimum requirements). This approach reduces interest rate volatility in both balance sheet and pension expense.

At their December 2018 meeting, the Accounting Standards Advisory Forum to the International Accounting Standards Board considered a proposal for the evaluation of, "*Pension Benefits that Depend on Asset Returns*". The ASAF agreed that liabilities should be modelled assuming that asset returns are at most equal to the discount rate. This approach for setting the interest credit rate assumption is consistent with the rationale behind the proposal put to the ASAF.

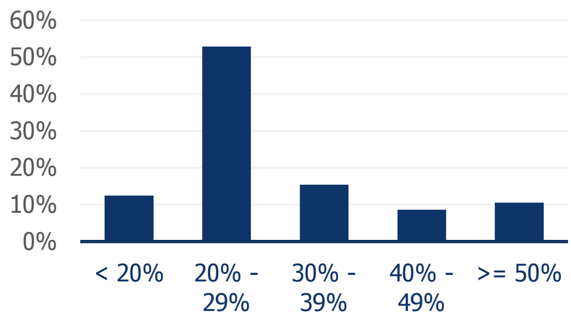
Rate of pension increase in payment

In 2019 approximately 90% of companies surveyed assumed there would be no increases to pensions in payment. This is unchanged from 2018. Foundation Boards refer to the cross subsidy in recent years from active members to pensioners: active members' interest credits have averaged lower than the technical interest rate underlying the conversion rates of savings to pension at retirement. The latter is the pensioner equivalent of the interest credit rate for actives. Consequently, there is pressure to keep pensions unchanged until interest credits for active members have caught up.

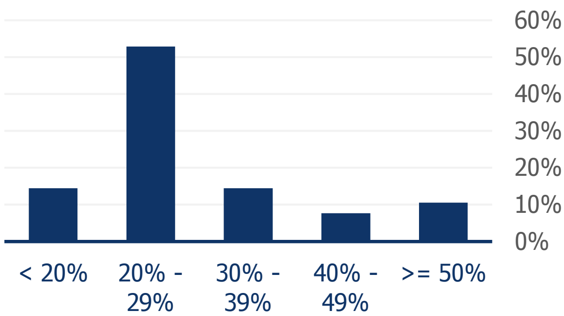
Proportion of retirement benefit taken as cash

The charts below show very little change in the assumed proportion of benefits taken as cash rather than pension at retirement. With more plans reducing their conversion rates of capital to pension at retirement, we would expect to see an increase in the proportion of benefits taken as cash. This is something that should be monitored closely over the next years.

2019



2018



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Demographic assumptions

Turnover

There continues to be a steady trend in companies analysing their specific rates of turnover. In 2018, half of the companies surveyed used a Swiss average table; in 2019 only 15% were still using a Swiss average table.

In almost all cases where the assumption was refined, this was done by scaling the Swiss average tables, thereby retaining the age and gender dependent shape of the average Swiss table.

Methodology

The simplest approach for applying the risk sharing provisions of IAS 19 is to make allowance for future contributions from employees that reduce the cost. We call this "Risk Sharing 1". 62% of companies surveyed apply this approach.

Many companies have a written and past practice of limiting their share of the total contributions. Allowing for this ("Risk Sharing 2") is more controversial where this limit has not been tested by a deficit occurring under Swiss measurement rules. We have seen several companies rewording their plan rules to make their limited commitment explicit. At the end of 2019, 27% of companies were applying this approach.

Survey data

The survey is based on the international accounting clients of allea Ltd. The survey has been restricted to the 104 Swiss companies with reporting year end of 31 December 2019 so as to enable a fair comparison of market-based assumptions. Whilst the majority of participants report under IAS 19, it also includes companies reporting under ASC 715 and IPSAS 39. We did not observe a material difference in any assumption between the different standards.

About us

allea Ltd is an occupational benefits consultancy operating independently of banks and insurers. It was established in 2004 with the spinoff of a profit centre that had been in existence since 1998. The joint stock company allea Ltd is wholly owned by the active partners. We serve our clients from offices in Zurich and Lausanne.

We take the needs and challenges of our clients seriously – they are what motivates us on a day-to-day basis. allea Ltd is committed to finding flexible, individual and practicable solutions to complex issues relating to the entire field of occupational benefits. With our team of actuaries, mathematicians, lawyers and IT professionals we can draw on the longstanding experience of experts with a proven track record, both locally and internationally. Our corporate culture is designed to foster the development and delivery of innovative ideas and solutions for our clients.

100	50	200 000
Companies	Pension funds	Insured members

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