allea Ltd

Consultants and Actuaries

2023 Review

Employee benefits accounting at 31 December 2022

Highlights at 31 December 2022

1. Average funding levels under accounting standards improved over the year from 86% to 94% for the companies in our survey despite heavy investment losses, typically around 15%. The main driver for this was the increase in discount rates from 0.29% to 2.21% per year, on average.

2. Our survey of 184 companies shows a "set-and-forget" approach to accounting assumptions is highly prevalent. This is particularly true for demographic assumptions.

Expectations for 2023

Investment markets rebounded in January 2023 and have remained stable in subsequent months. However, with discount rates some 40bps lower than at the beginning of the year, most companies will see a reduction in their funding level on an accounting basis. Therefore, we expect many companies will review their accounting methodology and assumptions for the current economic climate to ensure that their approach is best estimate and not excessive.

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

1. Refine their **disability** assumption. Large companies should review their experience instead of assuming their incidence is in line with the Swiss average. Small and medium sized companies reporting under IAS 19 should consider reporting their disability benefits as an “Other long-term employee benefit” as this will reduce their accrued Defined Benefit Obligation.

2. Increase their assumption for the **proportion of retirement benefit taken as cash**. Whilst retirees are taking increasing proportions of benefit as cash, our survey shows that few companies have updated their assumption.

3. Review their **mortality** assumption. Five out of nine companies surveyed still use the FSO (Federal Statistical Office) model for projecting retirement improvements into the future. The UK actuarial profession’s Continuous Mortality Investigation (“CMI”) model is more sophisticated. Typical, widely accepted parameters for this model predict slower mortality improvements placing a lower value on liabilities and costs.

4. Review their **turnover** assumption. There are still two out of five companies who assume their voluntary turnover is in line with Swiss average. Companies with a workforce of the order of 100 employees have sufficient exposure to analyse their own experience.

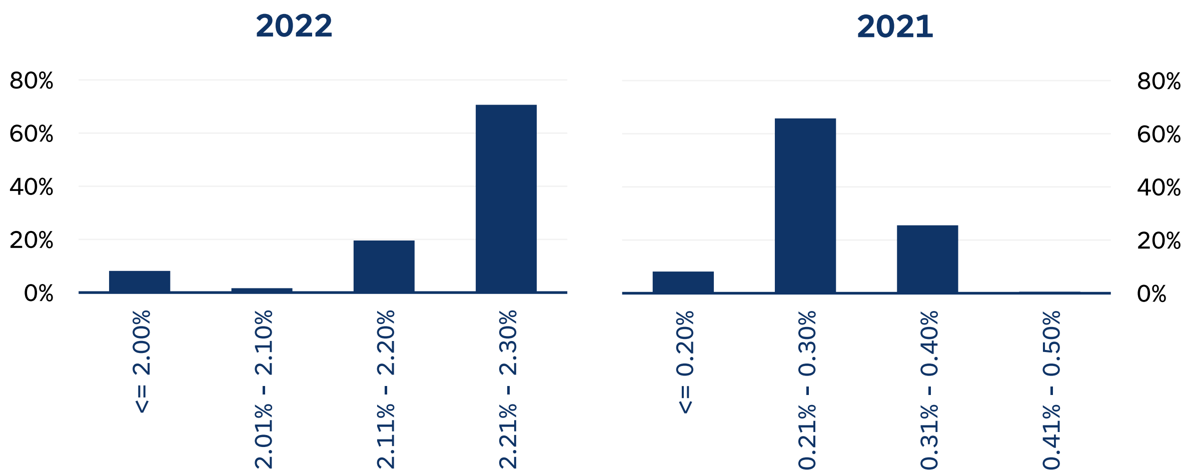
5. Apply IAS19 **risk sharing** provisions. Swiss occupational pension plans are Defined Benefit (“DB”) as there is a risk that employers will need to make additional contributions for deficits relating to benefits employees have already earned. However, unlike most countries, the DB risks do not rest 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**”.

Financial assumptions

Discount rate

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



The charts reflect the marked increase in interest rates during the first semester of 2022. These increases reduced liabilities faster than the investment losses reduced assets over the year, resulting in an improvement in funding levels on an accounting basis.

The extensive accounting rules for determining discount rates result in a narrow range of assumptions such that 10bps cover most market practice at each year-end.

Please see **allea.ch/discount-rates** for the latest discount rates as well as a chart documenting their evolution over time.

Interest credit rate

The low interest rates at the beginning of 2022 saw three out of five companies assuming that the interest credit on BVG savings would be no more than the BVG minimum rate – widely estimated as 1.00% per year on average. As this was higher than the discount rate at that time, this increased liabilities above the current savings value, justifying the need for the Defined Benefit reporting of Swiss Defined Contribution plans. Nine out of ten of these companies assumed that the interest credit on excess savings would also be equal to the BVG minimum rate.

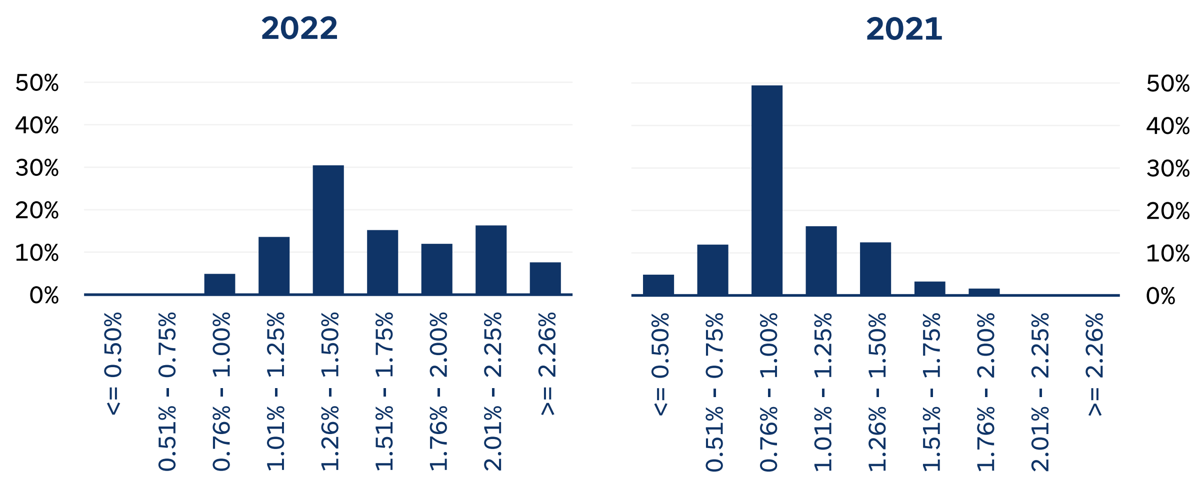
The marked increase in interest rates over the year saw a change in methodology for setting the interest credit rate assumption at the end of the year. Three out of four companies surveyed assumed an interest credit rate on excess savings equal to the discount rate. The interest credit rate assumed on BVG savings was also set equal to the discount rate unless the foundation had historically provided a different interest credit rate on BVG savings. In the latter case, the interest credit rate on BVG savings was assumed at 1.00% per year.

With continued high discount rates, we expect the methodology of setting interest credit rate equal to discount rate to continue. As well as being more objective, it ensures that accounting results are reasonable, unlike some other methodologies. Most auditors accept this simplified approach.

Rate of pension increase in payment

At the end of 2022, only 2% of companies assumed there would be increases to pensions in payment. The assumption of “no increases” has been widespread for many years. However, this assumption should be kept under review as continued high interest rates and further falls in conversion rates at retirement make increases to pensions in payment affordable once investment fluctuation reserves have been restored.

Salary Increases



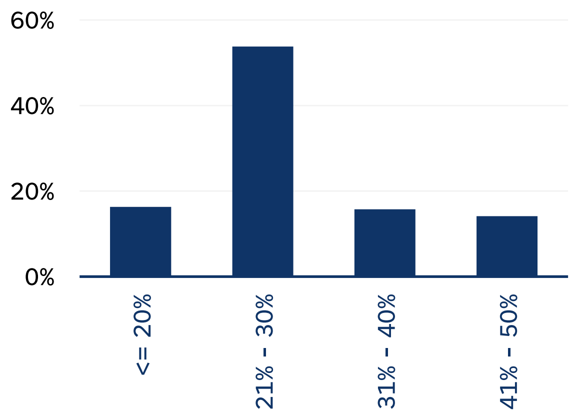
Inflation expectations increased during 2022, pushing the average assumption for salary increases (including promotion) up from 1.07% per year at the beginning of the period to 1.73% per year at the end of the period. allea’s analysis suggests that inflation has peaked, expecting inflation and salary increase assumptions to fall for the 2023 year-end.

For more information, please see: **allea.ch/inflation** and **allea.ch/discount-rates**.

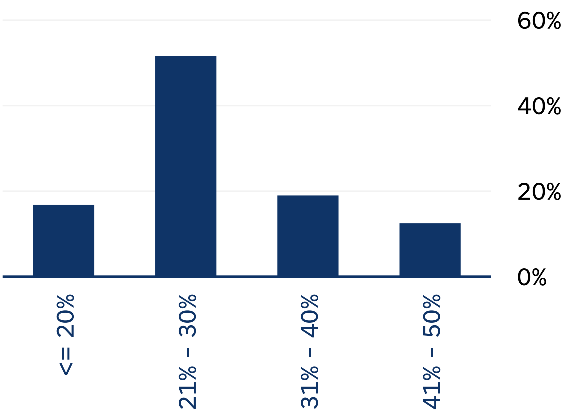
Proportion of retirement benefit taken as cash

The charts below show very little change in the assumed proportion of benefits taken as cash instead of pension at retirement. However, the trend for employees taking increasing proportions of savings as cash continues with the Swiss average now standing at 33%. In part this is driven by falling conversion rates at retirement. Wealthier employees, as well as foreign nationals are also likely to take more of their benefit as cash. Companies should review their assumption considering these factors.

2022



2021



Demographic assumptions

Disability

Nine out of ten companies surveyed assumed that their incidence of disability is in line with the Swiss average. We recommend that large companies, with a workforce of the order of one thousand employees, analyse their disability experience as this often shows that the assumption of average is an overstatement with corresponding overstatement of liability and cost. This is more likely to be the case for companies in Consumer, Financials, Health Care, Technology and Telecommunications sectors.

Small and medium sized companies reporting under IAS 19 can opt to treat their temporary disability benefits as an “Other long-term employee benefit” if the benefit is defined independently of service. This reduces the accrued amount of Defined Benefit Obligation. Only two out of five companies surveyed are exploiting this option.

Valuations need to allow for the waiting period before disability benefits start, as well as recovery from disability and the extent of disability resulting in partial disability benefits. allea’s study of these factors allows us to value these impacts separately from disability incidence resulting in more robust valuations.

Mortality

The vast majority of the Swiss market relies on the BVG 2020 tables for their baseline mortality assumption. These are derived from the experience of fourteen of the largest Swiss occupational pension schemes for the years 2015 to 2019 inclusive. Divergence in mortality assumptions arises from how mortality is projected to change in the future.

The UK actuarial profession’s Continuous Mortality Investigation (“CMI”) has produced a more sophisticated model for future improvement which acknowledges that different cohorts or generations are experiencing different rates of mortality improvement. It assumes that all cohorts will trend to the same long-term rate of improvement, with the time taken to converge depending on how far each cohort’s current rate of improvement is from that long-term rate.

This Swiss market most commonly assumes that the long-term rate of mortality improvement will by 1.25% per year. This gives shorter life expectancies than the older, FSO model of mortality improvement, resulting in lower liabilities and cost valuations. Yet five out of nine companies surveyed still use the FSO model for their mortality assumption.

Turnover

Large and medium sized companies, with a workforce of the order of one hundred employees, have sufficient exposure to measure their experience of voluntary turnover. Our survey shows that two out of five companies have yet to refine their assumption, instead assuming Swiss average turnover.

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”. Four out of five companies surveyed apply this approach.

Some foundations 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 2022, one in six companies was applying this approach.

Survey data

The survey is based on participating international accounting clients of allea Ltd. The survey has been restricted to the 184 Swiss companies with reporting year end of 31 December 2022 to enable a fair comparison of market-based assumptions. Whilst most 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 its 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.

200	40	230 000
Companies	Pension funds	Insured members

Our experts

Zurich

Dr Urs Barmettler

Chairman & Partner
Swiss pension expert SKPE/ CSEP
Fluent in German, English and French

+41 44 287 80 89
urs.barmettler@allea.ch

Lionel Candaux

Senior Manager
Swiss pension expert SKPE/ CSEP
Fluent in French, German and English

+41 44 287 80 86
lionel.candaux@allea.ch

Lausanne

Christophe Steiger

Partner and Office Head
Swiss pension expert SKPE/ CSEP
Fluent in French, English and German

+41 21 614 80 62
christophe.steiger@allea.ch

Paul Grinnell

Senior Manager
Fellow of the Institute of Actuaries
Fluent in English and French

+41 21 614 80 64
paul.grinnell@allea.ch

allea Ltd

Consultants and Actuaries

allea AG
Lavaterstrasse 65
CHF-8002 Zürich
+41 44 287 80 80
info@allea.ch
www.allea.ch

allea SA
Rue Louis-Curtat 4
CH-1005 Lausanne
+41 21 614 80 60
info@allea.ch
www.allea.ch