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Paper 12-01
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ASAF paper on research on pensions – hybrid plans
Issues Paper

Objective

1 At the July 2018 ASAF meeting, ASAF members will discuss a paper (prepared by the Accounting Standards Board of Canada (AcSB) on hybrid pension plans ('the Paper'). The purpose of this session is to receive CFSS members' comments on the questions included in that paper.

Background

2 In addition to EFRAG[1], a group consisting of the standard setters of Canada, Germany, Japan, the U.K. and the U.S. ('the Group') is considering how to account for certain pension plans ('hybrid pension plans').

The ASAF paper

3 The Group has analysed pension plans in the members' jurisdictions. It found an increasing prevalence of hybrid plans, which in the Paper is defined as "pension plans that are neither defined contribution plans nor defined benefit plans. They have elements of both traditional defined contribution plans and traditional defined benefit plans and have evolved in order to reduce the risks to which plan sponsors are exposed from defined benefit plans".

Issues identified

4 The analysis of the group identified the following issues with regards to these hybrid plans:

(a) Some similar plans are classified inconsistently (as defined contribution ('DC') or defined benefit ('DB') plans both across the five jurisdictions and within specific jurisdictions.

(b) Different risk sharing elements may result in different classification (e.g. plans were classified differently depending on whether the risk of the sponsor related to providing a minimum guaranteed return on assets or an additional contingent contribution based on a target benefit).

(c) It may be challenging to determine the portion of risks and costs retained by the plan sponsor for some plans when measuring the pension obligation.

(d) It may be challenging to decide on the appropriate discount rate for certain plans. For example, in some of the jurisdictions, an amount was contributed to a pension plan each period and invested in assets. The plan promised the

[1] EFRAG is currently doing a research project on a sub-set of hybrid plans. As part of this project EFRAG is developing some of the solutions mentioned in paragraph 5 of this paper.

employee the higher of (a) the actual return on these assets (plus the invested amount) and (b) a fixed return on these assets (plus the invested amount). IAS 19 *Employee Benefits* requires that the expected return (if higher than the fixed return) should be used when projecting the total pension promise. However, when this amount is discounted to measure the current pension obligation, the market yields on high-quality corporate bond should be used. This could result in the pension obligation being measured at a higher amount than the assets that would be sufficient for fulfilling the obligation.

Ideas to explore

5 To deal with some of the issues identified above for some of the plans in the jurisdictions, the Paper mentions the following ideas to explore:

(a) Splitting plans into a DC plan and a DB plan. For example, the plans mentioned in paragraph 4(d) could be split into a DC plan (the promise related to the return on the assets) and a DB element (the minimum return promise).

(b) Treating as DC plans hybrid pension plans for which the likelihood of the plan sponsor absorbing (additional) risk is low. For the plan outlined in paragraph 4(d) above, it would mean that if the fixed return is sufficiently low, the entire plan could be accounted for as a DC plan).

(c) Introducing specific measurement methodology for benefits linked and not linked to a return on assets and measuring the liability either:

(i) At a buy-out amount when benefits are not linked to a return on assets, or

(ii) Discounting the liability using a related asset return when they are linked (see paragraph 4(d)).

(d) Exploring how to define and measure a guarantee (e.g. the fixed return in the example in paragraph 4(d) above).

(e) Modifying or finding alternatives to the projected unit credit method. In the example in paragraph 4(d), the application of IAS 19 would mean that when calculating the pension obligation, the entity shall attribute benefit to periods of service on a straight-line basis if an employee's service in later years will lead to a materially higher level of benefit than in earlier years. This would increase the difference between the measurement of the plan assets and the pension obligation.

(f) Applying a fulfilment value approach similar (but not identical) to the model used in IFRS 17 *Insurance Contracts*. This model takes the linkage in the example in paragraph 4(d) between the plan assets and the pension obligation into account.

(g) Measuring the effect of risk-bearing arrangements that represent purely financial risks on a net rather than gross basis. These risks could then be measured at the cost of the derivative that would effectively neutralise the net risk. Risks other than purely financial risks would continue to be reflected in the obligation at the best estimate of the cash outflows.

(h) Combining (a) and (d). Sometimes, a hybrid pension plan includes a feature that obliges the entity to make further payments to the employee benefit fund if the fund does not hold sufficient assets to pay all employee benefits. Such a feature is often a guarantee. If unbundling the plan into a DB part and a DC part, the DB part would often be the guarantee. The DB element could then be measured at fair value. The model proposed in the IFRIC Draft Interpretation D9 *Employee Benefit Plans with a promised Return on Contributions or Notional Contribution* could be subsumed by this idea.

(i) Measuring pension obligations by reference to the underlying assets when benefit linked to specified assets (see (c) above). In the plan mentioned in paragraph 4(d), it would mean that the pension obligation related to the variable return would be measured by reference to the underlying asset or the present value of the fixed return promise using the projected unit credit method, if the latter is higher.

Proposal

6 The Group proposes that the IASB considers the research performed to date (by the Group) and either add it as another dimension to the feasibility study *Pension Benefits that Depend on Asset Returns* in its research pipeline, or takes on a project to address hybrid pension plans.

Next steps

7 The Group proposes that the next steps in the project should be to:

(a) Expand research to other jurisdictions by summarising and analysing the data from IFASS member jurisdictions;

(b) Expand outreach to financial statement users and academics within several jurisdictions; and

(c) Continue to monitor related activities.

Questions for EFRAG CFSS

8 Are there recent developments in your jurisdiction that reflect the ongoing evolution of hybrid pension plans?

9 Do you think the research of the Group has merit? If not, why not?

10 Do you agree with the proposal of the Group (see paragraph 6)?

11 Do you agree with the next steps (see paragraph 7)? Do you have additional activities to suggest?

Papers for the session

12 In addition to this paper, the following papers have been made available for the session:

(a) Agenda Paper 12-02 The Paper for the ASAF meeting prepared by the AcSB - for background only.

(b) Agenda Paper 12-03 Presentation for the ASAF meeting prepared by the AcSB – for background only.