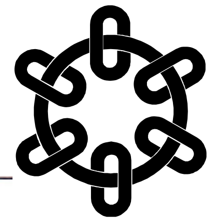
Norsk RegnskapsStiftelse



6 November 2019

EFRAG
Email: commentletters@efrag.org

Dear Sir/Madam

Accounting for pension plans with an asset-return promise

Norsk RegnskapsStiftelse (the Norwegian Accounting Standards Board - the NASB) is pleased to respond to your invitation to comment on the discussion paper "Accounting for pension plans with an asset-return promise".

We welcome EFRAG's effort and contribution to the accounting for hybrid plans.

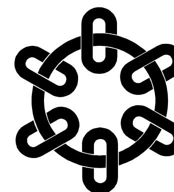
The discussion paper explores different alternative models to account for a "hybrid" plan under which the final benefit depends on the higher of return of plan assets or a minimum guarantee returned. We think the discussion paper is a useful input to the debate on accounting for hybrid pension plans, and that it illustrates the issues relating to accounting for such plans.

However, we question whether it is appropriate to introduce specific measurement rules for one specific type of hybrid plan. There are a wide range of hybrid pension plans, and the use of such plans seems to be growing. Most of these plans, will be classified as defined benefit plans under IAS 19, and for many plans it is not obvious that defined benefit accounting provides the most relevant information. Further, also for the "classic" defined contribution plan and defined benefit plan, it can be questioned whether the current different treatment of expected salary increases and increases in benefits in later years, which is normally straight lined under defined benefit accounting ("backload correction"), but not under defined contribution accounting, is sufficiently theoretically founded. Thus, we think it should be further considered, whether there is a need for a fundamental rethinking of the IAS 19 distinction between defined contribution plans and defined benefit plans, before introducing specific measurement rules for one or more specific type of hybrid plans.

We would also like to point out that introducing specific measurement rules for a specific hybrid pension plan, in substance is to introduce a new category of pension plans.

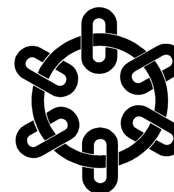
When it comes to the different approaches described in the discussion paper, we find the fulfilment approach generally difficult to understand. Our comments below, therefore mainly relates to the capped asset approach and the fair value approach.

Postboks 2914 Solli, 0230 Oslo
Telefon +47 23 36 52 00 – Organisasjonsnummer: 975 550 753 MVA
E-mail: nrs@revisorforeningen.no – Web: www.regnskapsstiftelsen.no



Our detailed comments to the question ask, is included in the appendix. You are welcome to contact us if you would like to discuss any specific issues addressed in our response further.

Yours faithfully,
Karina Vasstveit Hestås
Chair of the Technical Committee on IFRS of Norsk RegnskapsStiftelse



Appendix

Responses to specific questions

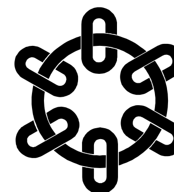
QUESTION 1 - SCOPE
The Discussion Paper addresses only those pension plans that have an asset-return based promise and hold the assets upon which the benefits are dependent. Do you think that the approaches could also be applied to those plans with an asset-return promise, where the plan does not hold the reference assets?

Firstly, we would like to emphasize that we understand the proposed scope of the discussion paper to be pension plans that with exception of the minimum guaranteed return, fulfils the definition of defined contribution plans. We have also assumed that the minimum guaranteed return is a fixed percentage. Going forward, we think it should be considered to try to find a more precise term to use for these plans, as the term "pension plans with an asset return-promise" in itself is a wide term, although narrowed through the definition in paragraph 2.2. Also, we think it should be clarified in further research whether the minimum guaranteed return has to be a fixed percentage, or could refer to return according to an index, for example CPI or a salary index.

We agree with EFRAG that more work is needed to assess whether the approaches explored in the Discussion paper could also be applied to plans where the asset do not hold the reference asset. We believe, as EFRAG, that there is a difference risk exposure in the two cases. A plan with an asset-return promise has a risk related to the return on the portfolio of the underlying asset. If the underlying portfolio of asset is held, this in substance hedge this risk. (In financial instruments terms; the portfolio of asset would be the hedge instrument, and the pension obligation the hedged item). In general, we tend to believe hedging can be relevant to take into account also outside the scope of IFRS 9 *Financial Instruments,* and that a different accounting treatment could be warranted depending on whether the underlying assets are held or not.

When it comes to the specific approaches, our initial thought is that the capped asset approach does not seem appropriate if the underlying assets are not held. This applies also to plans with an asset-return promise only and without a minimum guaranteed return. We struggle to see the difference between a notional plan (ie: a plan not holding underlying assets) where the notional contribution is adjusted with the return on an underlying portfolio of assets (ie: a stock index) and a notional plan where the notional contribution is adjusted with changes in salary.

When it comes to the fair value approach our initial thought is that this approach seems equally appropriate whether the underlying assets are held or not. Under this approach the gross obligation would be equal to the sum of the contributions to date, the return on the contribution and the fair value of the minimum return guarantee. The fair value of contribution to date and the return on contributions, reflects the fair value of the underlying portfolio of asset. This measurement seems equally relevant whether the underlying assets are held or not. It the assets are not held, they could be acquired for the fair value at the balance sheet date.



QUESTION 2 – ASSESSMENTS OF APPROACHES – ASPECTS TO CONSIDER
Do you agree with the aspects of qualitative characteristics considered in the assessment of the various approaches in Chapter 5? If not, which aspects do you think should/should not have been considered? Do you agree with the assessments of the various approaches made in Chapter 5?

Chapter five considers whether:

- the information is relevant
- the information is a faithful representation
- the information is understandable
- the pension plan is accounted for similar to other plans outside scope
- the requirement can be applied retrospectively
- implementation will be costly

We generally agree with the aspects of qualitative characteristics considered.

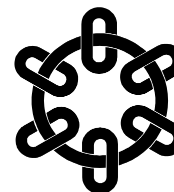
When it comes to the overall assessment of the various approaches, we have the following comments to the fair value approach

- We believe the approach has a high (not medium) fulfilment of the understandable characteristic
- We believe the approach has a medium (not low) fulfilment of the cost to implement the approach as we believe the valuation would be quite straightforward for a valuation expert or an actuary.

QUESTION 3 - ASSESSMENT OF APPROACHES – ASSESSMENT OF COMPLEXITY
The assessment in Chapter 5 of the costs related to the various approaches presented in this Discussion Paper, only considers implementation costs. Do you think that the complexity related to preparing financial information in accordance with the approaches would differ significantly? If yes, which approaches would be the most complex and least complex to apply?

We believe that applying the capped asset approach and the fair value approach is of similar complexity. The fulfilment approach seems quite more complex than both the capped asset approach and the fair value approach.

Application of the capped asset approach will require an actuarial computation. The complexity and cost of applying the capped asset approach is likely to be the same as applying the current IAS 19, as the approach is very similar to the current IAS 19 requirements.



Application of the fair value model would require a fair value estimation of the minimum return guarantee. While the first-time application may be more costly that the capped asset approach, on an ongoing basis we do not think that the fair value estimation will be more complex or costly than an IAS 19 actuarial computation.

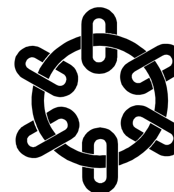
QUESTION 4 – CHOICE OF APPROACH
Which of the three alternative approaches, presented in this Discussion Paper, do you support? How should it be further developed?

On an overall level we question whether it is appropriate to introduce a specific approach for pension plans with an asset-based promise.

We do not support the fulfilment approach. The approach relies on concepts from IFRS 17 *Insurance contracts.* Although there are some similarities between a pension obligation and insurance obligation, there are also fundamental differences. For an issuer of insurance contracts, IFRS 17 is a standard both for measuring insurance obligations and revenue recognition. For pension promises to employees, revenue recognition is not relevant. We struggle to see that taking out the contractual service margin, makes the approach suitable for pension promises. Also, we find the application of the fulfilment approach difficult to understand, for example we struggle to understand the principle of the approach illustrated in the discussion paper paragraph 4.49 (where estimated contributions from both the employee and the employer is a cash inflow). We also struggle to see the link between the principle of the approach as described in paragraph 4.49 and the actual measurement of the obligation under this approach as shown in the appendix that is available on the EFRAG website. In the example the pension obligation is simply equal to the fair value of the minimum return guarantee.

In general, we do not find the capped asset approach appropriate, as we do not think it properly reflects the minimum guarantee. In a plan with the same contribution level for all years, and where no backload correction is required, and the expected return on the underlying assets exceeds the minimum guarantee, the net pension obligation will be zero. The net obligation will thus be the same as for a defined contribution plan offering the same benefit, with exception of the minimum guarantee. While this may be reasonable if any payment under the minimum guarantee is remote (i.e. the minimum guarantee is materially/significantly lower than expected return), we do not find it appropriate if the minimum guarantee is substantial. A pension plan with a higher of promise, is not the same as a defined contribution plan without a minimum guarantee. The minimum guarantee introduces an additional obligation that should be reflected.

We see (some) merit in the fair value approach. This approach generally seems to reflect the economic substance of the promise of a pension benefit being the higher of (i) the contribution and the actual return and (ii) the contribution and the minimum return guarantee. However, we question whether this method should be implemented for one specific type of pension plans. This method in substance bifurcates the pension promise into a defined contribution component and a minimum return component, although they would not be



presented separately in the statement of financial position. The minimum return component is in substance a financial instrument (derivative). Similar could many other pension plans be bifurcated into a defined contribution component and an embedded derivative. What with a plan where the return on the contribution is based on changes in CPI? Should such plans also be bifurcated into a defined contribution component and an embedded derivative? And what if the return on the contribution is the change on a salary index[1]? Should these plans also be bifurcated? While we see some merit in the approach, we think it should be considered in a broader context, which would probably require a fundamental review of the IAS 19 defined contribution/defined benefit distinction.

QUESTION 5 - PRESENTATION OF REMEASUREMENTS UNDER THE FAIR VALUE BASED APPROACH AND THE FULFILMENT VALUE APPROACH
This Discussion Paper assumes that remeasurements under the Fair Value Based approach and the Fulfilment Value approach are presented in profit or loss. Do you agree with this approach? If not, how would you present components of defined benefit costs other than service costs?

We have no comments to this question.

QUESTION 6 - RISK ADJUSTMENT FOR FULFILMENT VALUE APPROACH
As stated in paragraphs 4.56 to 4.57, this Discussion Paper proposes that a risk adjustment for non-financial risks is made when discounting the pension obligation under the Fulfilment Value approach. Do you agree? Which risks do you consider such an adjustment should cover?

The description of potential risk adjustments (both for cash flows and interest rate) in the paper are not precise enough and not sufficiently illustrated through examples to evaluate.

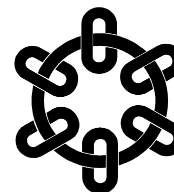
QUESTION 7 – DISCLOSURE
Do you think that additional disclosure requirements about pension plans, included in scope of this Discussion Paper, should be added to the requirements of IAS 19?

We agree that current disclosure requirements are appropriate for plans with an asset-return promise under the current IAS 19. Additional disclosures are needed if IAS 19 is amended in accordance with one of the approached explored in the discussion paper.

QUESTION 8 – ALTERNATIVE APPROACHES
Do you think there are other approaches to account for the pension plans within the scope of this Discussion Paper that should have been considered? If so, which approaches?

---

[1]For example, in Norway we have some pension plans where the return on the contribution is the increase in the general salary level in Norway.



We have not identified any other approaches to account for pension plans within the scope of the discussion paper that we think should be further considered.

However, we question whether it is appropriate to introduce specific measurement rules for one specific type of hybrid plan. There is a wide range of hybrid pension plans, and the use of such plans seems to be growing. We believe the accounting for hybrid pension plans should be more broadly addressed.

We question whether it is possible to find appropriate approaches to account for hybrid pension plans without a fundamental rethinking of the current defined benefit and defined contribution distinction for several reasons:

- Some hybrid pension plans are very similar to defined contribution plans, while others are more similar to a "classic" defined benefit plan based on average or final salary. This could even be the case for the same hybrid plan depending on the specific regulation. For example, a pension plan with an asset return promise, where the minimum return guarantee is very low (i.e. zero or even negative) is similar to a defined contribution plan, a plan where the minimum guarantee is close to the expected return, is not so similar to a defined contribution plan. It will not be feasible on a case-by-case basis to consider whether a specific plan is more like a defined contribution plan or a classic defined benefit plan.

- Implementing specific measurement guidance for a specific type of hybrid plan, for example introducing the fair value approach discussed in the discussion paper for pension plans with an asset-return promise, is in substance introducing a new category of pension plans thus removing the current distinction between defined contribution and defined benefit plans. It is not feasible to introduce specific measurement rules for all the different types of hybrid pension plans.

- The current IAS 19 requires "backload correction" for defined benefit plans, but not for defined contribution plans, however if the plan introduces a minimum return guarantee, backload correction will usually be required. We question whether the different requirements for backload correction in defined contribution plans and defined benefit plans, is sufficiently theoretically founded. We believe the issue of backload correction should be assessed on a principle basis, disregarding the current distinction between defined contribution plans and defined benefit plans.