A photograph of an astronaut in a white spacesuit floating in space. The astronaut is wearing a helmet with a dark visor and has a large white backpack. The background shows the Earth's blue and white clouds and the blackness of space with stars. The astronaut's right arm has a small American flag patch.

# "International accounting standards and their influence on pension funds in Switzerland"

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## BSV/OFAS performed a research study on this topic in 2014

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### Why this study?

- **As a consequence of accounting standards there was a public debate demonstrating the **FEAR** that companies would reduce their pension liabilities and costs by:**
  - transferring risk to employees,
  - reducing level of the benefits,
  - and thus having a negative influence on pension funds

### Results of this research study:

- **Consideration of international accounting standards impacts cannot be denied**

#### **But**

- **No systematic evidence that companies performed changes only due to international accounting standards (other reasons might drive a change)**
- **Even if companies are keen to reduce risks, they are cautious to maintain the level of benefits**
- **Some companies moved away from international accounting standards (pension accounting was not the only reason)**

#### **But**

- **Closer look at Pension Board's decisions especially when plan changes**
- **Sometimes “tensions” between Swiss entities and their foreign head office have been observed**

BSV/OFAS performed a research study on this topic in 2014 (2)

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**Conclusion of the research study:**

***No obvious evidence that International Accounting Standards have a big influence but the risk cannot be excluded***

- **Many, including myself, were quite surprised at such a conclusion:**

***Professional experience was that there was a growing interest of companies in their pension fund***

- **Today, I must acknowledge that the conclusion of the research study was not so unrealistic:**

- As main plan sponsor, it is normal that companies have a closer look at their pension fund (past practice was perhaps wrong)
- Pensions funds have anyway to consider the financial and economic environment for their financial sustainability and amend their plan accordingly
- Not only companies reporting under international accounting standards have amended their plans
- Plan amendments are often accompanied by grandfathering measures that result in a cost under international accounting standards

## Why do International Accounting Standards have an impact?

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### According to Swiss GAAP FER 16, financial consequences for a company are based on the financial situation of the pension fund

- Only an economic advantage or liability has to be reflected
- At the end of 2017, virtually no liability is reflected in the financial statements of the companies (source: OAK/CHS):
  - average coverage ratio is +/- 110%
  - +/- 1% of the pension funds are underfunded

### International Accounting Standards have special provisions regarding pension liabilities. They are classified either as

- Defined contribution plans
- Defined benefits plans
- Swiss pension plans are defined benefit plans subject to a valuation
- Estimated funded status (Assets ./ Pension liabilities) is around 80% - 85%

### Difference between Swiss GAAP FER and International Accounting Standards arise mainly from:

- Valuation methodology
- Assumptions

## International Accounting Standards vs Swiss GAAP FER

	<b>INTERNATIONAL ACCOUNTING STANDARDS</b>	<b>SWISS GAAP FER</b>
<b>CONCEPT</b>	Economic view, matching of cost and revenues	Legal view based on the financing
<b>ACTUARIAL APPROACH</b>	Dynamic	Static
<b>P&amp;L</b>	Final cost spread over the employee service	Contribution according to plan rules
<b>B/S</b>	Funded status	Benefit or liability



## International Accounting Standards vs Swiss GAAP FER (2)

	<b>INTERNATIONAL ACCOUNTING STANDARDS</b>	<b>SWISS GAAP FER</b>
<b>DISCOUNT RATE</b>	Yield of corporate bonds	Technical interest rate
<b>FINANCIAL ASSUMPTIONS</b>	Salary, Pension increase, Interest credit	Usually N/A
<b>DEMOGRAPHIC ASSUMPTIONS</b>	Mortality (generational), disability, turnover, retirement, lump sum, ...	Differently considered

## International Accounting Standards vs Swiss GAAP FER (3)

	<b>INTERNATIONAL ACCOUNTING STANDARDS</b>	<b>SWISS GAAP FER</b>
<b>ACTIVE LIABILITY</b>	Projected Unit Credit Method	Sum of account balance
<b>INACTIVE LIABILITY</b>	Present value	Present value
<b>TECHNICAL PROVISION</b>	Implicit (included in assumptions)	Explicit, according to funding plan rules

# International Accounting Standards: “CFO’s nightmare”

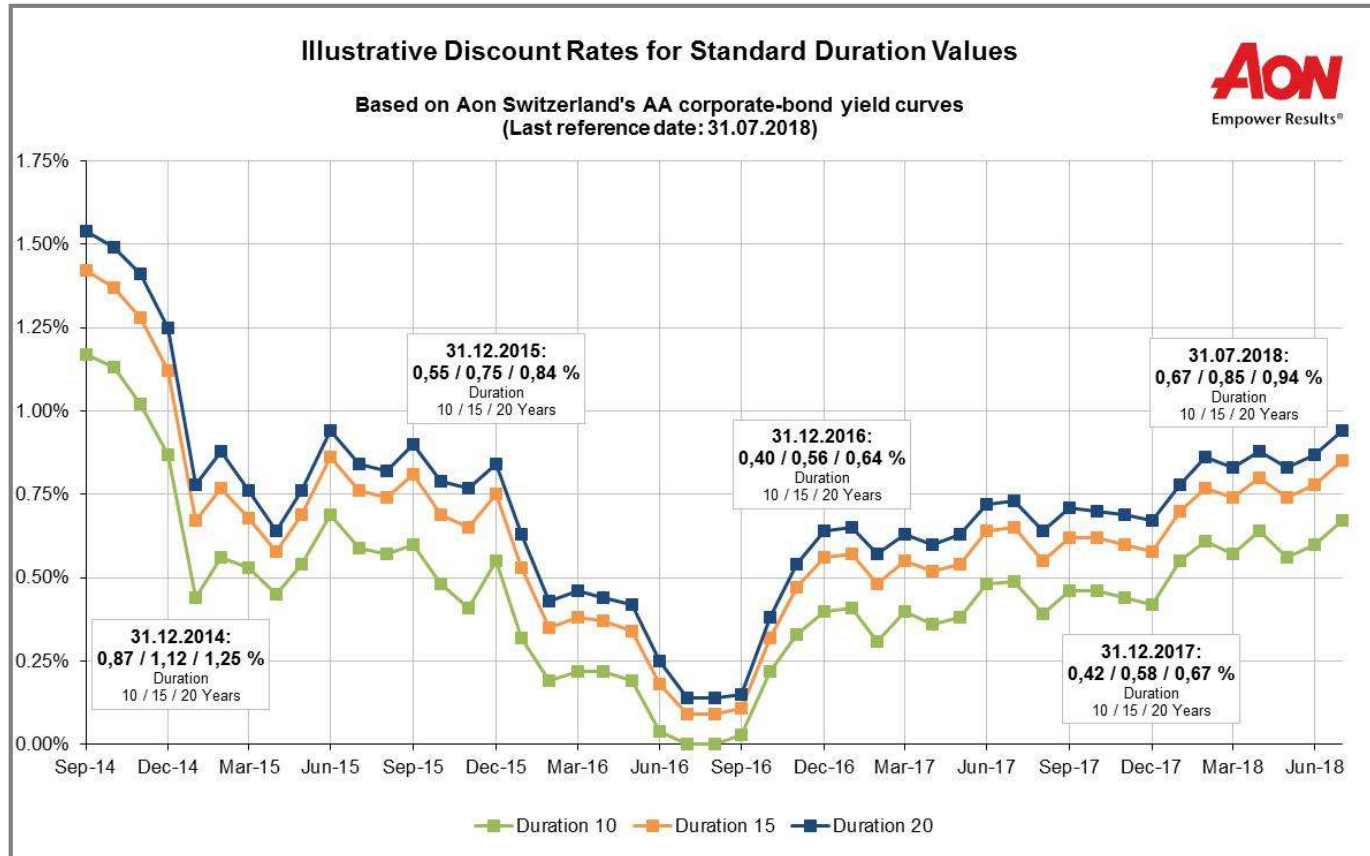
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## Critics

- **Projected Unit Credit method not appropriate for Swiss DC plans**
- **Balance sheet volatility**
  - Change in demographic and financial assumptions
  - Experience of the plan participants
  - Capital markets swings
  - Special events (plan change, restructuring, ...)
  - For some financial entities solvency issues
- **P&L predictability**
  - Unexpected results
  - Budgeting
- **No “direct” control over Pension Fund’s decision**



## (Very) low discount rates



- Discount rates decreased materially 50-60bp with a low point in summer 2016
- As a result, the defined benefit obligation increased depending on duration of plan liabilities by 5%-12% from 2014 to 2017
- A different trend is observed recently

## Trends

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### **Pension Board and CFOs are almost systematically looking at the impact of International Accounting Standards**

**Some companies (especially in the financial sector) have made, or are in the process of making, big changes to their plan rules often described as the consequence of International Accounting Standards**

**In general, companies rather intend to reduce the risk of their pension liabilities and this not only by considering plan adjustments like:**

- **Reduction of conversion factors**
- **Pension cap and more lump sum**
- **Sometimes 1e plan**

**BUT** also by considering

- **Assumption optimization**
- **Methodology adjustments**

## Assumption optimization: Risk Sharing (enhanced)

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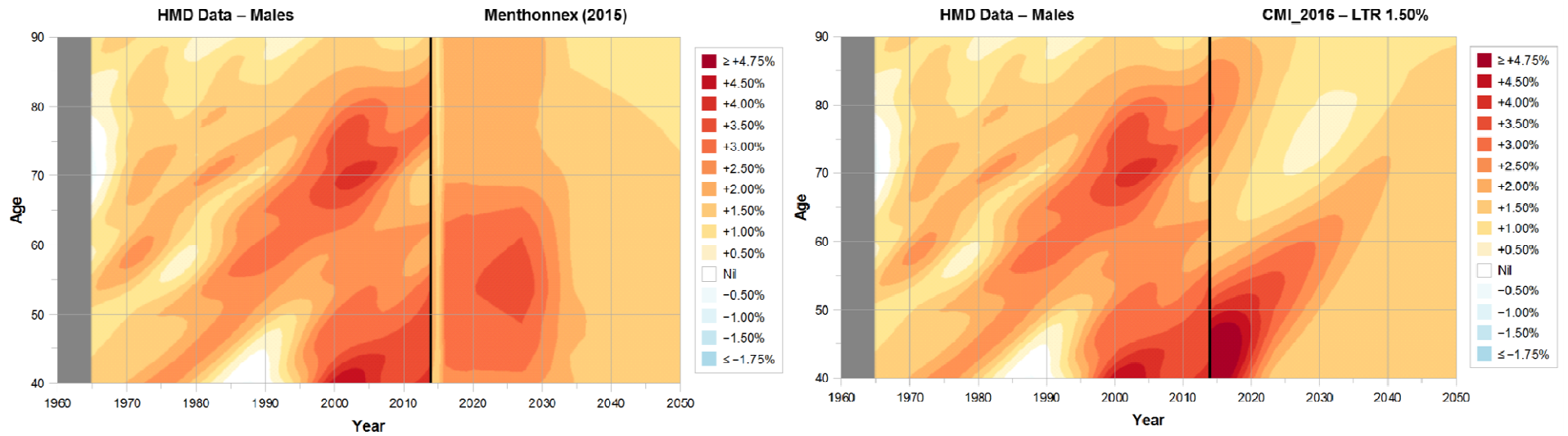
### Risk Sharing (classical), IAS19.93a :



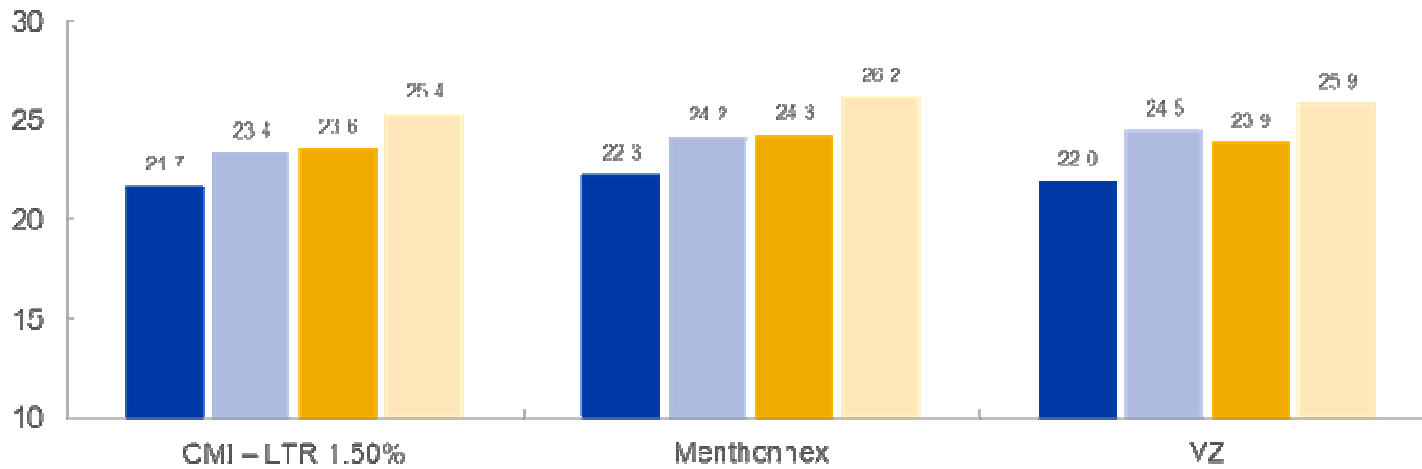
### New Risk Sharing (enhanced)



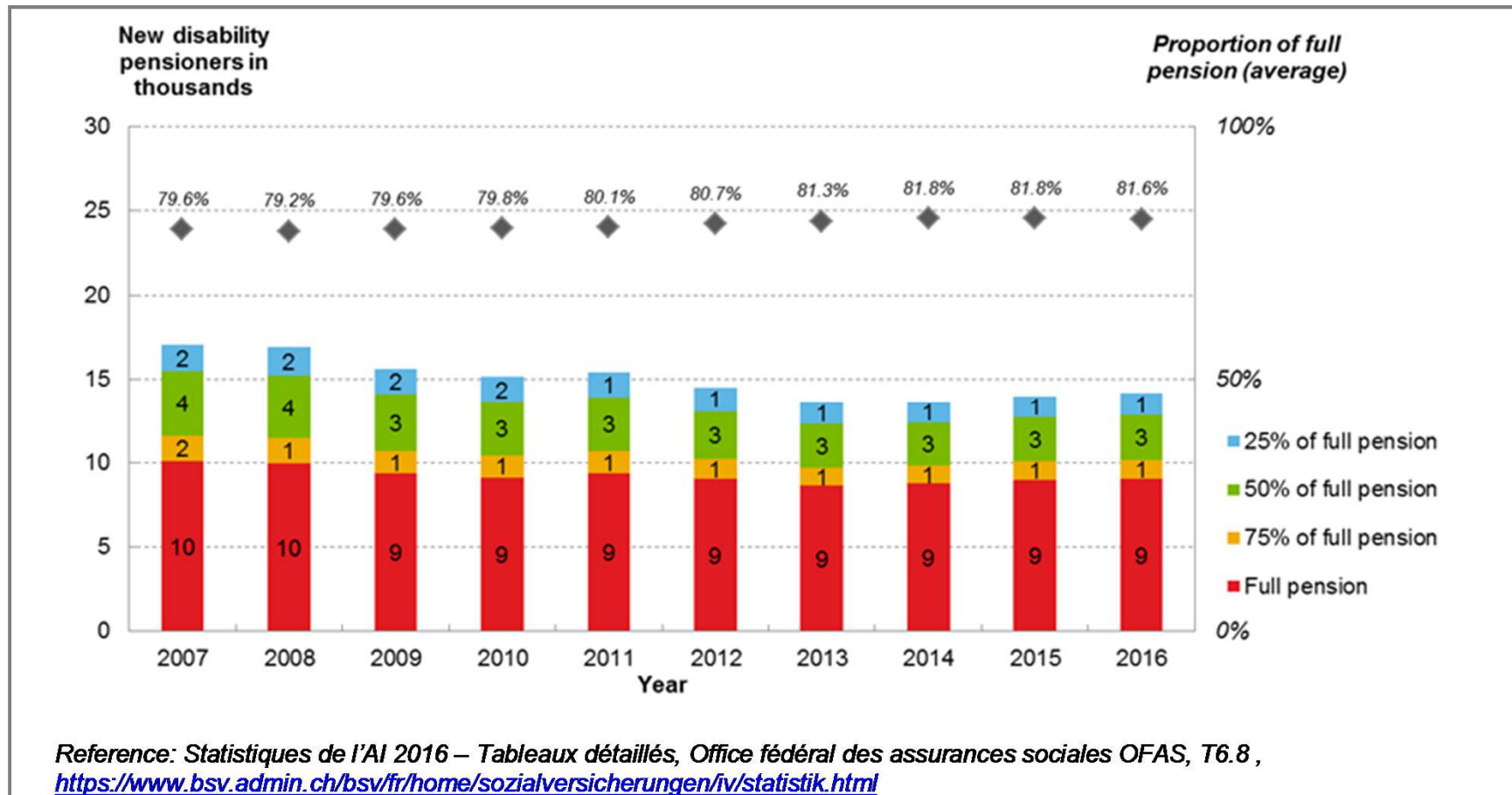
# Assumption optimization: projection of mortality “CMI”



■ Males – 2016   ■ Males – 2036   ■ Females – 2016   ■ Females – 2036



## Assumption optimization: disability rate



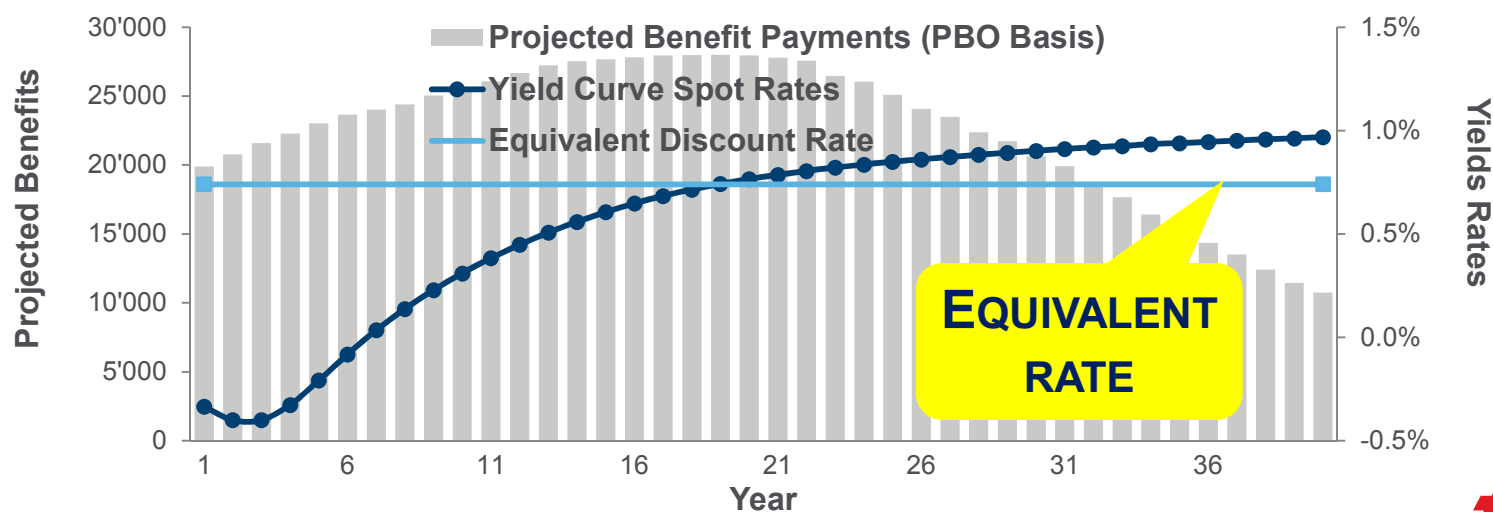
## Methodology adjustment

**IAS 19.157 permits removal of disability benefits from the liability when they are non-service related**

### Assets from insurance contract

- Historically it was not accepted to consider an asset for non-realized risk benefits resulting from the reinsurance of disability and death benefits
- It has recently been accepted that such an asset would be possible for the remainder of the insurance contract

### Discounting with a yield curve instead of a fixed discount rate



## Final words

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**International Accounting Standards are on the radar screen, being often accused of “destroying” the 2nd Pillar**

**Such accusation might find some evidence in some isolated cases but seems exaggerated in the general case**

- **Low yield environment and increasing longevity are not caused by International Accounting Standards**
- **Not only pension funds of companies reporting under International Accounting Standards have adjusted their parameters**
- **Companies are also interested in providing competitive benefits to their employees**
- **Companies are also looking at opportunities other than the reduction of benefits**
- **Companies are almost systematically looking at the impact of International Accounting Standards but it does not mean that they always influence the Pension Board’s decision**



## Final words

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### **It must also be acknowledged that**

- the actuarial methodology does not fit well with the characteristics of Swiss pension plans
- International Accounting Standards might also help the financial sustainability of pension funds by accelerating decisions that anyway must be taken
- they produce high accounting liabilities and volatility in the company reporting

### **In my opinion, the International Accounting Standards have an influence on pension funds but not so important as it is sometimes reported publically**

- do they not have the scapegoat role?
- would pension plans not be adjusted anyway?

**Thanks you !**