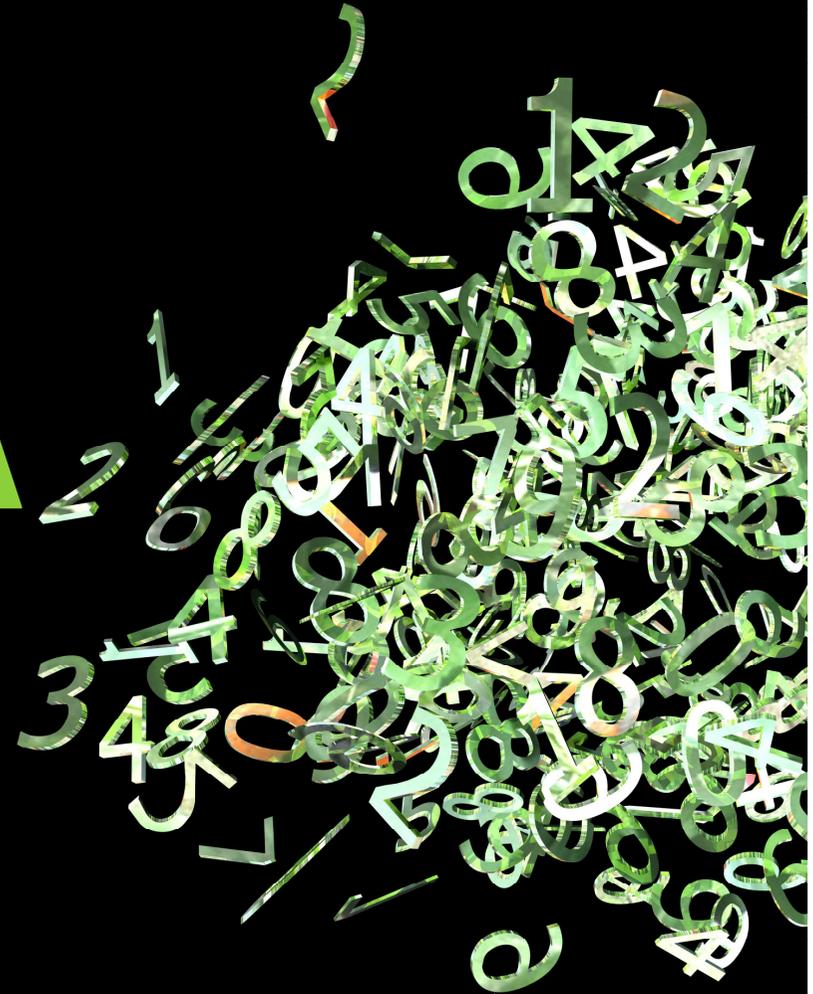


# IAS 19 Risk-Sharing Swiss Pension Plans



## Swiss Pension Plans: Active employees (1)

- Plans are cash-balance plans
- There are minimal requirements, typical plans are much richer
- Only benefit accrued for active employees is the cash-balance account
- Annuity rates can be changed without any guarantee by the foundation board
- Interest credit rate can be lowered ( $\geq 0\%$ )
- Employer has to pay at least 50% of the necessary contributions, other contributions are paid by the employees

## Swiss Pension Plans: Active employees (2)

- In case of a structural problems, benefits can be reduced and contributions increased (employee and employer) | minimal has to be guaranteed
- In case of underfunding, interest credit rates and other benefits can be reduced or recovery contributions requested (at least 50% have to be paid by the employer)
- Typical contribution split is 60% employer and 40% employee

## Swiss Pension Plans: Pensioners (1)

- Pensions are guaranteed for life
- In underfunding actives might have to pay contributions for pensioners

## Swiss Pension Plans: Valuation

- Discount rate for local valuation is based on some sort of expected return: currently 2.25%
- IAS 19 Discount rate is based on AA corporate bonds: currently 0.3% (15 years duration)
- Delta between these two rates is high
- Plans are typically >100% funded under local valuation and about 50% to 70% funded under IAS 19

## IAS 19 Allocation of Deficit Opinion of some big Companies (1)

- Current valuation method and the corresponding deficit do neither reflect
  - future contribution payments of the company  
(in line with IAS 37, IAS 19 BC 53)
  - the ultimate cost of the benefit to the entity
- Valuations do not reflect Risk-Sharing between employer and employee correctly if they just take into account the employee contributions currently set out in the formal terms of the plan and no reduction in benefits or changes in contributions (IAS 19 Para. 93). Such changes will be necessary under the IAS 19 discount rate.

## IAS 19 Allocation of Deficit Opinion of some big Companies (2)

- IAS 19 does have to give a relevant and fair representation of the financial information
- Valuation has to reflect limits on employer contributions

a)	An entity shall measure its defined benefit obligations on a basis that reflects the effect of ... <b>any limit on the employer's share of the cost</b> of the future benefits	§87(c)
b)	Some defined benefit plans <b>limit the contributions</b> that an entity is required to pay. The <b>ultimate cost</b> of the benefits takes account of the effect of a limit on contributions.	§91
c)	If <b>any limits</b> exist on the legal and constructive obligation to pay <b>additional contributions</b> , the present value of the defined benefit obligation should reflect those limits.	B143(d)
d)	The measurement of the defined benefit obligation takes account of the effect of <b>any limit on contributions</b> by the employer (§91). In the Board's view, this is consistent with the <b>objective</b> of determining the <b>ultimate cost of the benefits</b> .	B150(d)

## IAS 19 Allocation of Deficit Opinion of some big Companies (3)

- Valuation has to reflect that employees will have to pay higher contributions in the future or accept benefit reductions

e)	An entity shall measure its defined benefit obligations on a basis that reflects the effect of ... contributions from employees .... that <b>reduce the ultimate cost</b> to the entity of those benefits.	§87(d)
f)	The terms of the plan may ... require <b>additional contributions from employees</b> if the plan assets are <b>insufficient</b> .	§88(c)
g)	Contributions by employees or third parties are ... set out in the formal terms of the plan (or arise from a <b>constructive obligation that goes beyond those terms</b> ).	§92
h)	Some defined benefit plans include features that <b>share the .... cost of a deficit between the employer and the plan participants</b> . ... Such features share risk between the entity and the plan participant and affect the ultimate cost of the benefits. .... The present value of the defined benefit obligation should reflect the <b>best estimate</b> of the effect of <b>risk-sharing</b> .... features.	B144

## IAS 19 Allocation of Deficit

### Opinion of some big Companies (4)

- Valuation has to reflect that employees will have to pay higher contributions or accept benefit reductions (continued)

j)	Some defined benefit plans provide <b>benefits</b> that are conditional to some extent on whether there are <b>sufficient assets</b> in the plan to fund them. Such features <b>share risk</b> between the <b>entity</b> and the <b>plan participants</b> and affect the <b>ultimate cost</b> of the benefits... The defined benefit obligation should reflect the best estimate of the effect of <b>risk-sharing</b> .... features.	B144
k)	An entity would apply <b>judgement</b> in determining whether a <b>change in an input</b> is a change in the <b>terms of the benefit</b> (resulting in past service cost) or a change in an <b>assumption</b> (resulting in actuarial gain or loss).	B150(b)
l)	The best estimate of the ultimate cost of the benefits reflects the <b>best estimate</b> of the effect of terms of the plan that <b>require or allow a change to the level of benefit</b> , or that provide other benefit options, regardless of whether the benefits are adjustable by the entity, by the managers of the plan, or by the employees.	B150(c)

## Opinion of Auditors (1)

- Risk-Sharing can be applied
- Recovery contributions can not be considered in calculating the DBO

(not linked to service, IAS 19 Para. 93)

*Contributions from employees or third parties set out in the formal terms of the plan either reduce service cost (if they are linked to service), or reduce remeasurements of the net defined benefit liability (asset) (eg if the contributions are required to reduce a deficit arising from losses on plan assets or actuarial losses). **Contributions from employees or third parties in respect of service are attributed to periods of service as a negative benefit in accordance with paragraph 70** (ie the net benefit is attributed in accordance with that paragraph).*

## Opinion of Auditors (2)

- Supplemental contributions of the employees to finance the current plan might be considered :
  - Question is under what basis
    - local valuation with expected return (EROPA) assumption and higher discount rate (no further contributions might be necessary at all)
    - IAS 19 assumptions (discount rate = EROPA)
- Benefit reductions might be considered :
  - Question is again under what basis

## What are Actuaries doing?

- They currently struggle to find a common model...
  - **Terms of the plan rules is the basis**
  - **Local valuation has to be considered**
  - **Local valuation might be projected in the future to see if there is an underfunding**
  - **If underfunding: benefit reductions could be considered ev. also an increase in employee contributions**
- There is a certain pressure from auditors....and clients....

## Model of Big Swiss Company (1)

- Total Benefit obligation less market value of assets less the sum of the annuity of the employer contributions and the annuity of the employee contributions set out in the formal terms of the plan = Delta
- Delta will be allocated to the employer and employee based on a key that the company estimates that it represents its future contribution outflow (ultimate cost concept)

## Model of Big Swiss Company (2)

- Part 1 employees share will be remeasured as negative benefit payments (see IAS 19 Para 93 Risk-Sharing) based on past practice (reduction in annuity factors)
- Part 2 employees share will be set out in further employee contributions
- These negative benefits or employee contributions will then be considered in the DBO calculation

## Impact for a plan of a Big Swiss Company

- Classical DBO valuation: DBO 11,6 Billion
  - Reduction to current Risk-Sharing -0,2 Billion
  - Market value of assets -9,0 Billion
  - *Liability* 2,4 Billion
  - Part 1 -0.8 Billion
  - Part 2 -0.5 Billion
  - **Remaining net liability 1,1 Billion**
- Significant reduction of liability (and also cost)**