EFRAG Research Project
Pensions Plans with an Asset-return Promise
Cover Note

Objective

1 The objective of the session is twofold:

(a) To discuss the feedback received from constituents in response to EFRAG's Discussion Paper *Pensions Plans with an Asset-return Promise* ('the DP'); for this discussion a feedback statement with a summary of the comments and responses received has been prepared;

(b) To provide an update on the IASB's project, which has recently been revitalised; for this discussion a summary issues paper has been prepared, and the IASB's agenda paper have been made available for background purposes.

Background

2 Concerns have been raised about the application of the accounting requirements in IAS 19 *Employee Benefits* for post-retirement plans that some refer to as 'hybrid pension plans' - i.e. plans that share characteristics of both defined contribution and defined benefit plans. Some of the concerns expressed are:

(a) When the benefits are linked to the return of the plan assets, IAS 19 requires projecting the benefits using the expected rate of return and to discount them back using the rate of high-quality corporate bonds. This is perceived to create an accounting mismatch.

(b) In some cases, entities provide minimum guarantee returns that are below the level of returns on the plan assets. IAS 19 requirements may result in recognising a liability even in those cases when an outflow of resources is highly unlikely. Also, the requirements are perceived to be too costly and complex to apply.

3 The IASB has been considering the issue of hybrid pension plans but has found it difficult to define an appropriate scope that would result in improvements for a sufficiently wide range of plans without creating unintended consequences. However, the IASB is currently considering whether introducing a cap on promises on returns on assets in defined benefit plans. For such promises, the IASB is considering capping the expected return to the rate of high-quality corporate bonds.

4 In 2017 - 2019, EFRAG considered different alternatives, including the approach currently being examined by the IASB, to account for pension plans promising the higher of the return on assets held by the plan and a minimum guaranteed return. A discussion paper was issued on 15 May 2019. In addition to a capped asset return

approach, similar to the approach considered by the IASB, the main alternatives considered in the discussion paper were:

(a) a fair-value based approach;

(b) a fulfilment value approach.

5 EFRAG requested comments on the DP by 15 November 2019.

Comment letters received

6 EFRAG received 13 comment letters, which are available on EFRAG's web site in the Documents / Consultation section. The list of respondents is provided in Agenda Paper 08.02 – Feedback Statement.

High-level summary of comments received on the DP

7 Respondents generally welcomed the DP published by EFRAG as an input to the debate on accounting for hybrid plans.

8 The DP addressed only those pension plans that have an asset-return based promise and hold the assets upon which the benefits are dependent. However, six of the thirteen respondents thought that the three approaches suggested in the DP could also be applied when the underlying assets are not held by the plan.

9 Of the three approaches included in the DP, most respondents (nine out of thirteen) supported the Capped Asset Return Approach. This model was assessed to be the least complex and this approach is also closer to the current requirements in IAS 19 than the other approaches. Some of the respondents thought that the Fair Value Based Approach and the Fulfilment Value Approach would only be appropriate to consider if IAS 19 were to be completely rewritten.

10 In relation to the remeasurements under the Fair Value Based Approach and the Fulfilment Value Approach, eight of the thirteen respondents thought that these remeasurements should be presented in other comprehensive income (OCI).

11 Respondents were generally not in favour of a risk adjustment for non-financial risks when discounting the pension obligation under the Fulfilment Value Approach (only two supported it).

Questions for EFRAG TEG

12 Do EFRAG TEG members have comments on the findings or drafting of the feedback statement?

13 What future steps should the EFRAG Secretariat consider in regard to the project?

Agenda Papers

14 In addition to this cover note, agenda papers for this session are:

(a) Agenda Paper 08-02 – the feedback statement;

(b) Agenda Paper 08-03 – the update on the IASB Research project *Pension Benefits that Depend on Asset-returns*; and

(c) Agenda Paper 08-04 – The IASB Staff summary paper presented at the IASB meeting in January 2020.