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EFRAG Discussion Paper on Pension Plans with an Asset-Return Promise Cover Note

Objective

- 1 At its March 2019 meeting, EFRAG TEG approved to recommend to the EFRAG Board the publication of a discussion paper ('DP') on accounting for pensions plans with an asset-return promise.
- 2 The objective of this session is to discuss and approve this DP for public consultation.

Background

- 3 Based on a recommendation from EFRAG TEG, the EFRAG Board approved at its meeting in February 2016 to add a project to EFRAG's research agenda on pensions.
- 4 The aim of the project was to provide European input to the IASB's research project on certain pension plans.
- 5 The IASB eventually decided to only consider proposals to make a narrow-scope amendment to IAS 19 *Employee Benefits* for pension benefits that depend on asset returns. Plans including a variable return promise based on specified assets were the object of previous work by the IFRS Interpretations Committee.
- 6 The scope of the DP is accordingly to explore alternative accounting treatments for pension plans containing an asset-return promise. The DP thus considers accounting treatments for pension plans promising the higher of the return on an identified item or group of items and a minimum guaranteed return (referred to as an 'asset-return promise' in the DP).
- 7 An Advisory Panel was formed to assist EFRAG TEG with the project. Based on the recommendation of the Advisory Panel, the scope of the DP was further restricted to plans holding the identified item or group of items upon which benefits are dependent. The Advisory Panel noted that the risk profile of these plans was very different from the risk profile of plans promising a return based on items not held by the pension plan.

Content of the DP

- 8 The introduction in the DP provides some background to the discussion, a brief description of how pension accounting has evolved and the current developments of occupational pension plans in Europe.
- 9 Chapter 2 introduces the proposed scope and explains why it has been selected.
- 10 Chapter 3 describes the current requirements for defined benefit plans under IAS 19. The chapter uses a simplified case to illustrate the accounting outcome under the existing requirements. In particular, the simplified example considers changes in the

financial assumptions (e.g. expected returns on plan assets and discount rates) but not in other actuarial assumptions (e.g. period of service and salary increases). The chapter also describes the assumptions of the simplified example.

- 11 Chapter 4 illustrates three alternatives to the existing accounting requirements in IAS 19 for the pension plans within the scope of the DP:
 - (a) A Capped Asset Return approach, under which the rates used to project the final benefit entitlement are capped to the discount rate;
 - (b) A Fair Value Based approach, under which the measurement of the pension obligation is based on the fair value of plan assets and the minimum return guarantee; and
 - (c) A Fulfilment Value approach, under which the measurement of the pension obligation is based on the present value of the fulfilment cash flows and the value of the minimum return guarantee. The measurement of the fulfilment cash flows draws from elements of the measurement model in IFRS 17 *Insurance Contracts*.
- 12 The DP uses the simplified case used in chapter 3 to compare the outcomes of the three approaches to the outcome of the existing requirements and provides an explanation for some of the differences in outcomes. In order not to make the DP lengthy and less readable, the detailed calculations for each approach are not included in the DP. The details will, however, be included in a separate EFRAG Secretariat background paper which will be available on EFRAG's website.
- 13 Each of the alternative accounting treatments has advantages and disadvantages. Chapter 5 of the DP provides an initial assessment of the alternative accounting treatments. For the assessment, reference is made to the qualitative characteristics in the *Conceptual Framework for Financial Reporting*.
- 14 Chapter 7 briefly describes other alternative approaches that were discussed during the development of the DP. The DP does not apply the illustrative example and qualitative assessment to the approaches described in Chapter 7.
- 15 The DP acknowledges that other concerns have been raised in relation to the accounting for post-retirement employee benefits. Chapter 8 provides a short discussion of these other concerns.

Questions for the EFRAG Board

- 16 Does the EFRAG Board have any comments on the DP?
- 17 Does the EFRAG Board approve publication of the DP?

Agenda Papers

- 18 In addition to this cover note, Agenda Paper 08-02 – *Discussion Paper: Accounting for Pension Plans with an Asset-Return Promise* – has been provided for the session.