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Discussion of "The Impact of Accounting Standards on Pension Investment Decisions"

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Outline

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- Summary of key findings
- Identification challenges
  - Quasi-experimental design
  - Channels: The OCI effect vs. the ERR effect
  - The role of incentives
- Evidence-based policymaking
- Conclusion

Summary of Key Findings

- BKS (2017) study the “real effects” of accounting standards by examining the impact of **IAS 19R** on **pension investment** decisions
- Setting: Listed firms in Germany
  - Variation in *exposure* to defined-benefit pension plans
  - Treatment group: Switchers from “corridor method” to “OCI method”
  - Control group: Non-switchers (unaffected by IAS 19R)
- Main findings:
  - Adoption of IAS 19R significantly shifts **pension asset allocation** from equities to bonds (i.e., 2.4% reduction in equity investments)
  - Documented effects are less pronounced for:
    - Firms with ***larger*** pension plans
    - Firms with ***better-funded*** pension plans
- Key takeaway: **Unintended** real effects of accounting standards
  - Concerns about pension-induced equity volatility shifts pension asset allocation

Identification Challenges

- Quasi-experimental design
  - Potential **self-selection** concern
    - Non-switchers self-select into the control group
    - Control firms voluntarily opt for the OCI method (untreated “by choice”)
    - In a sense, they are also “treated” as they have not a choice anymore
  - BKS (2017) solution
    - Bias-corrected **DiD Matching Estimator for ATE**
    - Use **PSM** to mitigate the endogenous self-selection concerns
  - However:
    - **Unobserved** time-varying factors that differ across groups
    - Hard to generalize estimates outside common support (small sample size)
  - Possible suggestions
    - Alternative control group of **private German firms** (if feasible)
    - Use firms from other countries to construct a **synthetic-control group**

Identification Challenges

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- The (unintended) effect of IAS 19R on pension asset allocation
  - Through the "**OCI**" channel (BKS, 2017)
    - Germany
  - Through the "**ERR**" channel (AC, 2017)
    - Canada
  - The **net effect** is likely to be *jointly* determined
    - Possibly do more to disentangle the two
  - **Institutional complementarities**
    - Channels can be contingent on the features of the specific institutional setting
    - Would be great to "reconcile" findings in BKS (2017) with those of AC (2017)
      - Are there differences (Canada vs. Germany) that could explain the relative importance of the two channels?

Identification Challenges

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- Dependent variable
  - *%EQ* = percentage of equity investments
  - *%BONDS* = percentage of bond investments
- ***%OTHER*** = percentage of other investments → **20%**
  - What is this capturing?
  - If limited transparency. Why?
  - Suggestion for standard setters
  - Re-run analysis with *%OTHER* as alternative dependent variable
    - Does this category changes subsequent IAS 19R?

The Role of Incentives

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- Main idea of the paper
  - IAS 19R eliminates the corridor method, essentially a "smoothing device"
  - Immediate recognition of actuarial gains and losses in OCI expected to increase equity volatility
  - Lower weight on equities counterbalances unintended effect of IAS 19R
- However, the expected cost likely varies with managerial incentives
  - Current draft rather silent about incentives
  - Possibly do more to exploit cross-sectional variation in incentives
  - Is there a trade-off: employer vs. employee incentives?
- Is there a home bias in pension asset allocation?
  - If so, the IAS 19R effect is "two sided": investor and investee

Evidence-Based Policymaking

- Until recently policy has been on a par with "medieval medicine"
  - Interventions based on hunches, sometimes misplaced beliefs
- Need to take "guesswork" out of policymaking
  - We need to know what works and why
  - Rather then relying on assumptions to be verified only *ex post*
- Like in modern medicine, evidence based on (quasi-)randomized control trials
  - Pilot programs for new accounting standards
  - Staggered adoption dates
- Recent example: SEC Regulation SHO
  - Should short sale constraints be removed?
  - Examine the efficacy of price restriction through a "pilot program"
  - Randomly-selected group of U.S. stocks

Conclusion

- Interesting paper, well written and carefully executed
- Raises important questions about (unintended) real effects of accounting regulation
- Sharpen identification of main effect
- Emphasize the role of incentives
- Reconcile findings with AC (2017)

I look forward to seeing the paper published!