Discussion of “The Impact of Accounting Standards on Pension Investment Decisions”

Stefano Cascino
London School of Economics

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Outline

• 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

• 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

• 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

• 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!