

STAFF PAPER

December 2018

IASB® meeting

Project	Pension Benefits that Depend on Asset Returns		
Paper topic	Project update		
CONTACT(S)	Clair Grindley	cgrindley@ifrs.org	+44 (0)20 7246 6480
	Anuj Deuba	adeuba@ifrs.org	+44 (0)20 7246 6413

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Purpose

1. Pension Benefits that Depend on Asset Returns is a narrow-scope research project designed to consider only those pension benefits that depend, wholly or partly, on asset returns.
2. The expected output of this research project is evidence to help the Board decide whether to undertake standard-setting to develop proposals for a targeted amendment to IAS 19 *Employee Benefits* without changing other aspects of IAS 19.
3. The purpose of this paper is to provide an update on the project status and inform the Board of the nature and extent of consultative activities for this research project. The paper is being prepared for information only. There are no questions for the Board, but the staff would welcome any comments the Board may have.

Background

4. As explained at the [November 2015 Board meeting](#), existing IAS 19 requirements do not always provide the most relevant information on benefits that depend on asset returns.
5. Applying existing IAS 19 requirements, estimates of the ultimate cost of the benefits to be paid reflect an estimate of the future asset returns on which the amount of the benefits depend. That estimate typically reflects a higher than risk-free expected

return on assets caused by variability in the asset returns. On the other hand, the discount rate used to determine the present value of the benefits is generally based on interest rates for high quality corporate bonds and thus does not reflect the high return that market participants would require from assets subject to high variability.

Consequently, a measurement inconsistency arises because the variability (risk) in the future asset returns—and hence in the estimate of the cost of the benefits to be paid—is reflected only in the cash flows and not in the discount rate applied to those cash flows.

6. For example, suppose a plan promised a benefit equal to contributions plus the rate of return on a specified pool of assets for which the currently expected rate of return was 5%, and the discount rate specified by IAS 19 was 3%. Under existing IAS 19 requirements, an entity would measure the defined benefit obligation by projecting forward the cash outflows at the expected rate of return on the assets of 5% and then discounting the cash flows back to their present value at 3%.
7. We are exploring an approach to assess whether it can provide a cost-beneficial solution that addresses the measurement inconsistency that arises when applying existing IAS 19 requirements. Under that approach, any estimate of pension benefits that depend on asset returns would be determined by assuming an asset return not exceeding the discount rate specified in IAS 19.
8. Returning to the example discussed in paragraph 6, the approach we are exploring would cap the rate of return used to estimate the cash outflows at the discount rate of 3%. That capped estimate of the benefits would then be discounted back at 3%.
9. There is a more complete explanation of the approach, and of the reasoning for it, in appendix C (especially paragraphs C5-C14) to agenda paper 15 for the [May 2016 Board meeting](#).
10. As we recommended to the Board in May 2016 during the 2015 Agenda Consultation, we plan to carry out further analysis and outreach to investigate whether this approach can be developed in a way that:
 - (a) would eliminate or reduce the measurement mismatch caused by the inconsistency between the estimated cash flows for these benefits and the discount rate;

- (b) would have sufficient effect to be worth the costs of developing, exposing, finalising and implementing any resulting changes to IAS 19;
 - (c) does not require a disproportionate amount of work for stakeholders, the Board and the staff; and
 - (d) does not have unintended consequences.
11. If the research establishes that the approach we are exploring would not be feasible, the staff expects to recommend no work on pensions.

Consultative activities

12. We have held and are planning discussions with a range of stakeholders. Through these discussions we are seeking to understand whether stakeholders think the approach being explored could be helpful in addressing the measurement inconsistency identified without having any unintended consequences.
13. Since this research project became active, staff have had initial discussions with:
- (a) members of the International Actuarial Association (IAA); and
 - (b) representatives from one of the accounting firms.
14. In November 2018, the International Actuarial Association (IAA) is holding its Pension and Benefits Subcommittee meeting in Mexico. One topic that will be discussed at this meeting is Pension Benefits that Depend on Asset Returns. The staff have been invited to attend the meeting by phone.
15. In December 2018, staff are presenting at the Accounting Standards Advisory Forum ([ASAF meeting](#)) to obtain advice from ASAF members on the approach we are exploring in this project.
16. Staff are planning additional consultative activities in 2019 with accounting firms actuaries, preparers of financial statements and investors.

Next steps for the Board

17. Staff plan to provide the findings on this research project to the Board during the second half of 2019. At that time, staff plan to present a summary of the evidence

gathered from the consultative activities and ask the Board to decide whether any further work is needed to inform the Board on whether the approach being explored could address the identified measurement inconsistency without unintended consequences.