

In Brief

A plain and simple overview of research findings on hybrid pension plans

“From a Canadian perspective, when the AcSB looked at the period from 1990 to 2016, the AcSB found that the number of hybrid plans, combination plans, and other plans grew from over 220 to over 870 — a huge calibration of almost 300%.”

– Linda Mezon, Chair,
AcSB

Project objectives:

Canada participated with other national standard setters from Germany, Japan, the United Kingdom and the United States¹ in conducting research to understand the experiences to date with hybrid pension plans.² The research findings would demonstrate whether there is a need for accounting guidance addressing these plans.

This overview will give you an understanding of:

- why we undertook this research;
- what the research is about;
- key research findings and observations; and
- what we recommended to the International Accounting Standards Board (IASB).

The project stage:

We summarized the results of our research, and found that it demonstrates the need for action to address challenges in applying current accounting standards to hybrid plans by public companies. We provided the results of our research to the IASB, in addition to offering our assistance with its [targeted standards-level review of disclosures](#) in IAS 19 *Employee Benefits*. As the IASB’s current project — [Pension Benefits that Depend on Asset Returns](#) — is narrowly scoped, they thanked us for our broader research on hybrid plans as well as our offer of assistance.

Next steps:

The IASB plans to consider the results of our research on hybrid plans when assessing priorities in its next Agenda Consultation.

¹ “We” is used throughout the In Brief to refer to these five-national standard setters who undertook this research on a collaborative basis.

² Hybrid pension plans are new types of pension plans that are neither traditional defined contribution plans nor traditional defined benefit plans. They have elements of both traditional defined contribution plans and traditional defined benefit plans and have evolved in order to reduce the risks to which plan sponsors are exposed from defined benefit plans.

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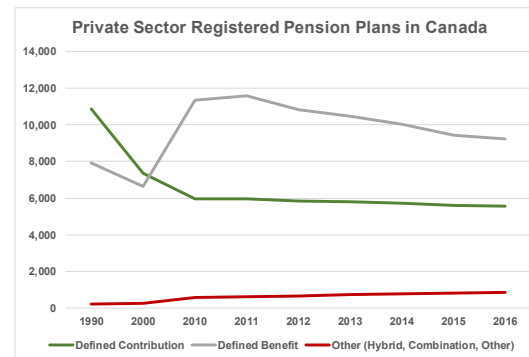
Why did the AcSB participate with other national standard setters in this research?



The AcSB is committed to conducting research to support evidence-based decision making on topics relevant to Canadians.

Along with other national standard setters, the AcSB did research to produce evidence on whether there is a need for accounting guidance for hybrid plans.

Hybrid plans are becoming more prevalent in multiple jurisdictions, including Canada. More hybrid plans exist today than in the past and new innovative types of hybrid plans exist that, in some cases, arise in conjunction with the closure of defined benefit plans.



Note: Other plans, as described by Statistics Canada, consist of hybrid plans, combination or composite plans, and other plans as follows:

- Hybrid — Plan in which the pension benefit is the better of that provided by DB or DC provisions;
- Combination or composite — Plan that has both DB and DC characteristics; and
- Other — Includes plans that may be for different classes of employees or one benefit type may be for current employees and other for new employees.

Source: Information compiled using data from the [Statistics Canada website](#) (table 280-0016).

Given the trends in our jurisdictions, a joint staff working group wanted to:

- understand the experiences of jurisdictions around the world with hybrid plans and whether common issues arise; and
- determine whether existing standards adequately deal with such plans and identify possible improvements, if needed.

It is important that financial information reported about hybrid pension plan obligations provides users with measurements and explanations that reflect their economic characteristics. We wanted to determine whether there was a need to improve this information.

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What is the research about?

Where did we gather our data
and what did we consider?



In 2016, our research began with an environmental scan of pension obligations by companies applying IFRS® Standards and local GAAPs, with input from audit firms and benefit consulting firms, in each of our jurisdictions. We examined the characteristics of pension obligations, including hybrid plans, in terms of:

- their nature and prevalence;
- risks faced by the plan sponsor;
- market trends;
- legislative/regulatory environment; and
- any accounting difficulties encountered.

As a result of discovering hybrid plans becoming more prevalent in multiple jurisdictions, including Canada, Germany, Japan, and the U.S.,³ we focused on identifying the accounting issues associated with these plans. We explored how to better account for their economic characteristics compared to current practices.



We selected four example hybrid plans to best illustrate the accounting challenges posed by hybrid plans in our jurisdictions. Distinguishing features of the example plans include:

- **two shared-risk plans** — targeted benefits based on different formulas with no guarantee by the plan sponsor; contributions shared equally between the plan sponsor and plan members pursuant to a funding policy;

³ In the U.S. the number of hybrid plans in 2017 exceeds the number that existed in 1998. The number of hybrid plans in the U.S. peaked in 2005 and has declined steadily since that time.

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What is the research about? (*cont'd*)

- a **cash balance plan** — benefits in the form of a current account balance that is a function of salary-based principal credits and future interest credits with no guarantee by the plan sponsor; and
- a **security-linked plan** — plan sponsor makes contributions to plan members' accounts with contributions invested in a specified securities portfolio generating returns and plan sponsor guarantees a minimum return.

The shared-risk plans and the security-linked plan all contain a risk-sharing element from the perspective of the plan sponsor.



We looked for input on the challenges in accounting for the example plans within our jurisdictions, if any, by circling back to the audit firms and benefit consulting firms for their feedback. We also considered possible alternatives to account for these plans, including soliciting feedback at the International Forum of Accounting Standard Setters (IFASS) meeting in [September 2017](#).

We then expanded our research to understand the experiences with other stakeholder groups and multiple jurisdictions by consulting with:

- financial statement users and academics in our jurisdictions;
- members of IFASS; and
- members of [Consultative Forum of Standard Setters of European Financial Reporting Advisory Group](#) (EFRAG CFSS).

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Key research findings and observations

“The landscape in which we are dealing with has changed significantly.”

– Linda Mezon, Chair, AcSB at the Accounting Standards Advisory Forum (ASAF) meeting, July 2018

“Entities are looking to mitigate or reduce exposure to pension obligations.”

– Rebecca Villmann, Director, Reporting Initiatives and Research, FRAS Canada at the ASAF meeting, July 2018

What additional trends did we observe within, and outside, our jurisdictions?

- Defined contribution (DC) plans opening, in some cases, in place of defined benefit (DB) plans.

Where do the example plans exist within our jurisdictions?

- One type of shared-risk plan exists only in Canada, although rare in the private sector, it is an emerging type of shared-risk plan; stakeholders in Germany have a growing interest in establishing a similar type of plan.
- Canada and the U.S. have similar plans to the other type of shared-risk plan.
- The other type of shared-risk plan, the cash balance plan and the security-linked plan exist in more than one jurisdiction.
- Of the security-linked plan:
 - Common in Germany and on the rise.
 - Canada, the U.K. and the U.S. have similar plans to the security-linked plan.
- Cash balance plans are common in three jurisdictions; that is, Germany, Japan and the U.S., but not in Canada.

Do the example plans exist outside our jurisdictions?

- Yes, schemes similar to our example plans can be seen among IFASS and EFRAG CFSS member jurisdictions.

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Key research findings and observations (cont'd)

The accounting for hybrid plans does not fall out easily from applying the current binary accounting model.

Why?

It was designed for traditional DC and traditional DB plans.

What did we hear from our outreach in terms of the example plans? Are local GAAPs and IAS 19 fit for purpose?

Classification and **measurement** present the greatest accounting challenges.

In considering the guidance in IFRS Standards, we found diversity in the expected **classification** for a shared-risk plan and the security-linked plan, both across our jurisdictions and within specific jurisdictions. For example, the security-linked plan could be expected to be classified as:

- DC account with a DB guarantee;
- DB only; or
- DB depending on whether a specific concept proposed years ago by the IFRS® Interpretations Committee applies.

We found consistent classification for a shared-risk plan and the cash balance plan as DB across our jurisdictions.

We had similar findings under local GAAPs, except we found more than one jurisdiction that would classify the security-linked plan differently under local GAAP than they would under IFRS Standards.

We found **measurement** challenges often result in inappropriate reporting of the economics of the plan. These challenges related primarily to how to measure the obligation, in, for example:

- determining the portion of risks and costs retained by the plan sponsor for a shared-risk plan; and
- deciding on the appropriate discount rate for the security-linked plan.

We also learned of challenges with the quality of the **disclosures**. From our outreach, financial statement users expressed a need for more information about risk-sharing features by plan, key features/characteristics by plan, and the magnitude and associated risks of the obligation. These challenges with disclosures motivated us to offer to assist with the IASB's [targeted standards-level review of disclosures](#) in IAS 19.

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Key research findings and observations (cont'd)

Develop principles-based guidance with flexibility to better reflect the economics of hybrid plans

Based on input received from IFASS participants, we identified some ideas for consideration as possible alternatives to account for hybrid plans, including combining the first two ideas for further consideration.

- **Unbundling guarantees/risk elements from contribution-based promises** – Separate the DC element and DB element (guarantee) and account for each of the elements accordingly.
- **Focus on guarantees** – Analyze and explore how to define and measure a guarantee such as expanding the guidance in IAS 19 on categorization of risks. Start by examining the different types of risk shared between plan sponsors and plan members to better understand the risks and potential commonalities.
- **Specific measurement methodology** – Focus on the unique aspects of hybrid plans and develop a measurement methodology to address them.

Regardless of the methodology chosen, principles-based guidance should be developed with flexibility to better reflect the economics of hybrid plans.

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Next steps



The IASB plans to consider the results of our research on hybrid plans when assessing priorities in its next Agenda Consultation.

The IASB's current research project "[Pension Benefits that Depend on Asset Returns](#)" is narrowly scoped so we understand that the concerns raised by our work need to be considered separately. We await the IASB's consideration of our research on hybrid plans as part of its next Agenda Consultation.

In the meantime, we:

- stand ready to be of assistance with the IASB's [targeted standards-level review of disclosures](#) in IAS 19;
- will monitor related international activities such as the IASB's projects noted above and EFRAG's active [research project on pension plans](#); and
- will continue to think about how to raise awareness on the need for action to address challenges in applying current accounting standards on hybrid plan obligations by public companies.

Find out more!

Research results

To find out more about our preliminary research results, including findings and observations, refer to the [ASAF July 2018 paper on pension plans](#) as well as the [report, slides and audio recording](#) from this meeting.

Stay informed

Stay up-to-date on this research via the FRAS Canada website.

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