



International Accounting – Assumption Update

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The assumptions used for international accounting disclosures can have a significant impact on the financial results of an organisation. Accordingly, the importance of periodically reviewing and optimising one's assumptions cannot be emphasised enough. Assumption setting is, however, a vast and intricate topic – it relies in great part on market prevalence data, such as Aon's annual assumption survey, but also on an organisation's unique experience and expectations. Balancing all these different elements can seem daunting, and ever-increasing overall scrutiny is unlikely to make it easier anytime soon.

Overview

Fortunately, an internal survey of Aon Switzerland's international accounting clients is performed each year in order to determine the market prevalence of the most important valuation assumptions used by Swiss plans at the 31st of December. This year, our review of these assumptions showed that for most companies there were no major changes between the 2019 and 2020 year-ends. That being said, we do expect significantly more changes in the accounting assumptions that will be used at year-end 2021, especially given the publication of the latest BVG/LPP demographic tables at the end of last year.

Indeed, the release of the latest BVG/LPP Tables is always a perfect opportunity to review and ensure that all accounting assumptions remain optimised, or that any assumption-setting methodologies used in the past continue to be appropriate. Innovative trends do emerge quickly, and acceptable methodologies can change over time, so periodic reviews are always recommended. Incidentally, we expect that for many organisations the change to the new BVG/LPP Tables will have a positive effect on their international accounting disclosures, which is simply a further incentive this year.

Looking ahead, adequate time will need to be set aside for the review and selection of assumptions for the next year-end. Assumption setting methodologies are continuously evolving, and the process for customising or even selecting demographic assumptions in particular is becoming increasingly sophisticated. Refer to the last section of the newsletter for further guidance on this recommended assumption review process.

Annual Survey of 2020 Accounting Assumptions

As already mentioned, an internal survey of Aon Switzerland's international accounting clients is performed each year in order to review and document the various valuation assumptions used for disclosure purposes under ASC 715, IAS 19 or IPSAS 39. The survey includes results as of the end of 2019 and 2020 for approximately 140 companies with a 31 December 2020 financial year-end.

The largest variation observed in the financial assumptions this year was in the discount rate, which decreased by about 10 basis points (from 0.15% at 31.12.2019 to 0.05% at 31.12.2020). Most other financial assumptions remained fairly stable compared to their year-end 2019 values, although a slight decrease in inflation and its correlated assumptions was observed. A brief overview of these year-on-year changes can be found in the table below.

Financial assumptions	Average 31.12.2019	Average 31.12.2020	Change
Discount Rate	0.15%	0.05%	-0.10%
Interest Crediting Rate	1.15%	1.17%	+0.02%
Expected Return on Plan Assets	2.22%	2.24%	+0.02%
Inflation Rate	1.02%	0.96%	-0.06%
Salary Increase Rate	1.50%	1.46%	-0.04%
Increase in Social Security Limits	1.15%	1.11%	-0.04%
Pension Increase Rate	0.01%	0.01%	+0.00%

In addition, the following demographic assumptions were surveyed: mortality, disability, turnover, early retirement, lump sum election on retirement, and proportion of members with an eligible spouse or partner. Once again, minimal changes in these demographic assumptions were observed this year. The next significant shift in the selection of demographic assumptions is expected at year-end 2021 with the widespread adoption of the BVG/LPP 2020 demographic tables (see next section).



Click on the icon below to access the full survey.



BVG/LPP 2020 Tables

On 15 December 2020, Aon and Libera published the latest version of BVG/LPP Actuarial Tables, which were developed in cooperation with fifteen large Swiss pension funds. The BVG/LPP 2020 Tables are derived from the actual experience of these pension funds from the end of 2015 to the end of 2019.

 For more details on the background and main results of these updated tables, please click on the icon below to access our full publication.



From an accounting perspective, we expect that the change to the latest BVG/LPP Tables will have a positive effect for the majority of organisations. More specifically, for organisations already using one or more of the BVG/LPP 2015 Tables (adjusted or not), a change to the corresponding BVG/LPP 2020 table should lead to a decrease in liability.

Expected impact on accounting liabilities of updating from BVG/LPP 2015 to 2020	Illustrative only	
	Actives	Inactives
Mortality		
Disability		Not Applicable
Turnover		Not Applicable
Spouse/Partner % and Age Difference		

Still, the actual impact of updating to the latest BVG/LPP Tables is hard to predict, and it can certainly vary significantly from one organisation to another. Such differences may be caused by the demographic profile of the organisation concerned or by the need to review and adapt any adjustments/scaling currently applied to the tables. We recommend that you look at the impact early enough in the year-end process to allow sufficient time to analyse the results, discuss any adjustments/scaling that may be required or adapted, or potentially carry out an experience study (see next section).

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Preparing for Your Next Year-End

It is often repeated that assumptions used for international accounting valuations need to represent one's best estimate, be mutually compatible, and reflect future expectations of each individual organisation (whenever possible). The adoption of the BVG/LPP 2020 demographic tables is an ideal opportunity to review your accounting assumptions to ensure that they remain optimised according to these principles, and that any assumption-setting methodology used in the past continues to be appropriate. Financial assumptions are effectively reviewed every year, but demographic assumptions may be reviewed less frequently. Best practice is to review demographic assumptions in full at least every three to five years. Therefore, reviewing all demographic assumptions on the same cycle as the update to the BVG/LPP Tables, which are produced every five years, is a sensible and efficient approach.

As part of the review and optimisation of these demographic assumptions, and with input from their actuary, an organisation needs to think about whether the standard tables can be scaled or otherwise adjusted. One of the tools that Aon consultants can use in order to assist you with this process is an experience study – this involves reviewing your organisation's past experience against the assumptions used, and assessing whether it is sufficiently credible to adjust the assumptions accordingly. Statistical credibility refers to the amount of "weight" that can be attributed to past experience relative to the standard or default assumption (often derived using market data). Of course, to be fully credible, the data set needs to be sufficiently large, but there may still be partial credibility for the data sets of smaller organisations.

In any case, an organisation always needs to be able to demonstrate – in theory, or more likely, to an auditor – that any adjustment represents a better estimate of future expectations than the standard table, which is why experience studies are so useful. Aon consultants are well placed to assist your organisation with the carrying out of an experience study in a cost-effective manner, and with the preparation of supporting documentation when necessary.

Ideally, your assumptions are always optimised and justifiable – please contact us if you would like to ensure that is the case, or simply to learn more about any of the topics addressed in this newsletter.

About Aon

Aon plc (NYSE:AON) is a leading global professional services firm providing a broad range of risk, retirement and health solutions. Our 50,000 colleagues in 120 countries empower results for clients by using proprietary data and analytics to deliver insights that reduce volatility and improve performance.

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