

## Would the adoption of the Ind AS 19 from 2016-17 advance changes to investment policy of Post Employment Defined Benefit Plans?

Mayur Ankolekar charts the likelihood and offers pointers from behavioural finance.

A moment comes, which comes but rarely in history, when we step out from the old to the new, when an age ends, and when the ... Rings a bell? The epiphany, however, is in the provisions of the new IFRS adaptation guided Ind AS 19 on employee benefits. The transition from the present AS 15 on employee benefits to Ind AS 19 is planned phase-wise from financial year 2016-17.

The Ind AS 19 would usher in many recognition- and disclosure-related changes in respect of Post Employment Defined Benefit Plans (DB plans). Prominent among these is the treatment of actuarial liability- and asset-side gains and losses, and for this specific discussion, the asset-side actuarial gains and losses.

Both gains and losses would now not be charged to the Profit and Loss Account (P&L). In other words, under the Ind AS 19 gains and losses beyond the normal expected rate of return would not be a P&L charge, but can be parked in the Balance Sheet under the Statement of Other Comprehensive Income. The Other Comprehensive Income is an ongoing Balance Sheet item clubbed under "Reserves and Surplus." It aims to stabilise the P&L, among others, from the whirls of asset-side fair value change.

This article aims to answer four questions:

- ✦ What does stepping out from the old AS 15 to the new Ind AS 19 mean for companies with funded pension and gratuity obligations?
- ✦ Would company management and fund trustees become more adept at investing in more volatile, higher expected return-delivering assets?
- ✦ Does the new Ind AS 19 encourage funds to realize capital gains or losses?

- ✦ How would the investment guidelines for retirement funds support a more appropriate asset liability matching strategy?

### Stepping out to the new

Company management and trustees have, deservedly so, argued for steady asset returns on employee benefit plans. Even while the liability side dishes results disharmonious with expectation, trustees have taken solace in the predictability of asset movement. Traditional plans with smoothed bonus became popular. A small variation in year-on-year asset returns has been customary. Duration matching from investing in market linked bond plans gained mindshare, often a result of education.

managements overly worry about the annual P&L charge of DB plans, asset-side volatility was shunned. And the year's P&L charge was a greater propeller to investment strategy than the meritorious matching of assets with the nature, term and currency of liabilities.

### Overcoming past bias

DB plan liabilities, being linked to final salary, are significantly driven by earnings inflation, which in turn depends on economic inflation. As the nature of liabilities is real and its term long, an appropriate asset-matching can manifest from investment in long-term, real assets. The past bias of P&L charge precluded employers and their trustees from exposing the portfolio to long-



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And trustees evolved into appreciating the net gains/losses (i.e. the net result of liabilities and assets) from changes in interest rates.

In substance though, as company

term, real assets – which are synonymous with intra-year volatility. The knock-on effect of the new accounting treatment should, in merit, trigger an ideology of investing in long-term, real assets.

The recognition-related accounting policy in Ind AS 19 is likely to comfort the concerns on intra-year asset fair value change. Biases last longer than we imagine. Education and dialogue will be necessary to overcome these.

Emerging evidence on confirmation bias in the field of behavioural finance has many pointers to position the communication. Pension actuaries can render useful service in educating companies and trustees that in respect of long-term real assets, expected returns and realized returns have a greater chance of converging if assets are invested for the long-term. In behavioural finance speak, paths of nudging trustees about the 'not to worry' position of intra-year asset volatility would have to be travelled.

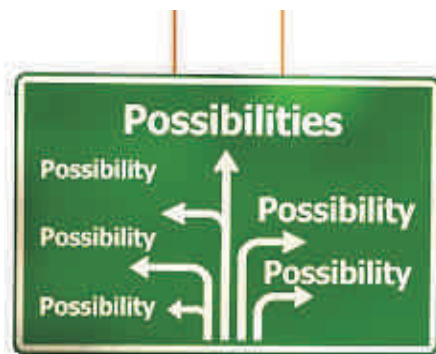
### No trade for gain

The new Ind AS 19 (like the AS 15) measures assets at their fair value. Recognising income, either in the Profit and Loss Account or in the Other Comprehensive Income, does not depend on whether the income is actually realised. So trustees would not be incentivised to trade in order to realise the accrued gains or losses. The approach is likely to reward a metronomic investment philosophy and reduce the overall cost of investment.

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### Tuning in the investment guidelines

DB funds in India, prominently the approved gratuity trusts, are allowed to invest as per the directions of Rule 101 of the Income Tax Rules, 1962. The investment can be in the form of contribution to group gratuity funds of an insurer or if managed in-house by the trust, the pattern should comply with



Rule 67 of the Income-tax Rules, 1962. Arguably trustees of approved gratuity funds (and in the same vein, approved superannuation funds) can invest in a range of assets including an exposure to insurer-managed equity-oriented funds.

The Insurance Regulatory and Development Authority's investment guidelines [Clause 6 of the Insurance Regulatory and Development Authority (Investment) Regulations, 2000] provide a cap of 60% exposure to domestic equity shares. Clause 7 of the exposure draft of these Regulations, if enacted, could permit investing an even higher proportion of a unit-linked fund in equities.

Equity investment, in view of its promise of real returns from a long-duration asset class, presents an option worthy of evaluation. Emerging international evidence on Liability Driven Investment (LDI) endorses investment in real assets, and a 'core and satellite' investment strategy.

### Swing the balance

Asset-Liability Management could dramatically change in Indian Defined

Benefit Plans, accommodate an LDI approach and more risky but real investment strategy in view of the new IFRS adapted Employee Benefit accounting from financial year 2016-17.

The ability to look beyond the horizon which is often reinforced in actuarial training would be valuable as the old AS 15 clears ground for the new Ind AS 19. I encourage my colleagues in the profession to see what opportunities arise in the challenges of communication with pension trustees and scheme advisors. Perhaps we can take cue from the famous midnight speech at the start of this discussion.



### About the Author



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