Arbeitsgruppe Internationale Rechnungslegung (AIR)

Discount Rate

UPDATE (March 2021): In order to further mitigate the fact that the discount rate quarterly publication is continuously and increasingly seen as a recommendation (most likely as the result of the publication of an actual *range*), the AIR has decided to publish instead, starting from 31.03.2021, only the minimum, maximum, average and median values resulting from the input of the nine participating actuarial firms.

The document below summarizes the results of the qualitative investigation that was performed in 2020 and which validated the respective methodologies of the participating firms. This is still highly relevant, especially since, starting from 31.03.2021, the quarterly publication will only be providing *market observations* as represented by these providers. Note that the description of the range as provided in this summary is of the one applicable until 31.12.2020 only, and which has now been replaced by the alternative methodology described above.

Background

For several years now the SKPE/CSEP has been providing quarterly input in the form of ranges at selected durations for discount rates according to IAS19 / ASC715. Over time, this discount rate quarterly input has been erroneously interpreted as a kind of best practice by the market (i.e. Reporting Companies, Audit Companies, etc.), while the initial objective was merely to provide a non-binding service to our members. As a result, the discount rate quarterly input is more and more frequently used as a justification for the discount rate applied by Reporting Companies. The AIR is of the opinion that such emerging practice is inappropriate, and that the discount rate quarterly input should remain a non-binding service from SKPE/CSEP, in accordance with its primary goal.

Collection process and quarterly input

Every quarter, nine actuarial firms provide to the SKPE/CSEP their illustrative discount rate for a duration of 10, 15 and 20 years. These values are then averaged for each duration and a range is computed:

- Lower bound: -10% of the average discount rate, but at least -5 basis points
- Upper bound: +10% of the average discount rate, but at least +5 basis points

The lower bound, the average and the upper bound are then published.

The AIR would like to emphasize that the discount rate quarterly input is an indicator and not a recommendation to IFRS preparers for a CHF discount rate under IAS 19. This is in accordance with the initial objective to provide a non-binding service to our members.

Nevertheless, given the market's increasing interest in the SKPE/CSEP quarterly input, the AIR has decided, for governance reasons, to perform a high-level, qualitative investigation into the different input provided by the nine actuarial companies that participate in the quarterly discount rate collection. The purpose of this qualitative review is not to assess whether the methodology used by a

given actuarial firm is adequate or sophisticated enough, but rather to make sure that there is a *sufficiently* reasonable methodology in place.

Results of the high-level quality review

- The nine actuarial firms use a yield curve to set discount rates;
- They all use a seemingly reasonable methodology to fit the bond data into a curve;
- They all use the Swiss Bond Index (SBI) basket of bonds as a starting point, with different filtering approaches thereafter (depending on the actuarial firm, the size of the bond universe ranges from 100 to 450);
- Depending on the actuarial firm, there are various criteria used for filtering (e.g. issue size, liquidity criteria, outliers, etc.);
- As a minimum, AA corporates bonds are always included in the considered basket of bonds, with some firms also including AAA-rated bonds;
- Some firms consider the size of bonds when establishing their yield curve (e.g. by weighting the data points by market capitalization when fitting the curve);
- There is a large variety of methodologies used to extrapolate beyond the available data points.

Analysis and outcome

Based on the above findings, and setting aside advanced considerations of theory, adequacy, or sophistication, the AIR concluded that the nine actuarial firms each have what appears to be a seemingly reasonable methodology for producing their discount rate quarterly input. Nevertheless, as part of this exercise, the AIR did discuss some minor theoretical points, and tentatively reached the following conclusions:

- Should the bonds of Cantonal Banks be included or not?
  The AIR is not necessarily against including Cantonal Banks in the bond universe. Note: excluding Cantonal Banks might result in a higher discount rate (10-15bps at the time of this review).
- Should the bonds of Supranational organizations be included or not?
  The AIR is of the opinion that bonds of such organizations cannot be considered 'corporate' in nature, as is required by the Standard, and as such should be excluded.
- Should the issue size (or market capitalization) of bonds be considered when establishing the yield curve?
  The AIR is of the opinion that given the non-material impact of such a 'weighted approach' (less than 5bps—at least currently), there is no strong preference.
- Should liquidity aspects be considered when filtering the bonds?
  According to the Standard, such aspects must be considered, but here again, given the non-material difference between considering and not considering those aspects, the AIR came to the conclusion that it is not worth formulating a strong recommendation on the matter. It is worth noting however that the SBI basket of bonds (i.e. the starting point for each firm's curve) already contains a certain amount of liquidity filtering.