KPMG

Belgian Pensions Accounting Survey 2017

Giving you an overview of the big trends regarding IAS19 assumptions

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Content

Introduction

In an effort to get to the bottom of IAS19 general trends in Belgium, KPMG Advisory civil CVBA introduces the first edition of the KPMG Pensions Accounting Survey in Belgium. In this benchmarking report, we will take a closer look at the assumptions used by companies to value their pension liabilities for year-end 2016.

The presented figures are based on our analysis of the assumptions used by 50 companies on the Belgian market as well as general observations for the year-end 2016 situation. The results focus on the assumptions used by the companies that participated in the survey and are supplemented with publicly available information on the assumptions used by listed companies (focused on the BEL20, the top twenty companies on the Belgian Stock Exchange by market capital). For confidentiality reasons, none of the aggregated results allow identification of the individual data of any given company.

Managing your pension plans from a financial accounting perspective is a real challenge for Finance and Human Resources functions. In Belgium, you operate in a landscape with ever changing legislation and a market environment that requires adaptability. In addition, international accounting standards also require that companies determine the value of their pension liability. Both IFRS and ASC 715 standards prescribe additional assumptions and recommendations that are added to the measurement requirements.

The role of actuarial consultants and advisors is to give actuarial advice; in some cases they may interpret the assumptions' guidelines in which case there are many perspectives possible. The result is a wide variety of assumptions. This leaves you, as a Finance or Human Resources team, facing a range of alternative actuarial assumptions to choose from.

The insights on how the IAS19 or ASC 715 guidelines are implemented on the Belgian market will give a good chance to see the trends in accounting assumptions.

General context

In the context of IAS19 (IFRS), actuarial assumptions assist in determining the ultimate cost of providing benefits. They represent the entity's best estimates of the future variables that will determine this cost and should be unbiased and mutually compatible. The financial assumptions are based on current market expectations of future events.

As in IFRS, the actuarial assumptions in ASC715 represent the entity's best estimates of the future variables that will determine the ultimate cost of settling the defined benefit obligation. The financial assumptions are based on current market expectations and presume that the plan will continue.

Based on the standards, the key economic assumption in determining the pension liability remains the discount rate. Any salary increase (which is generally linked to the inflation in Belgium) can also play a crucial role. Withdrawal rates, mortality tables, the inflation rate and the retirement age complete the list of most commonly used parameters in the calculation process. This report focuses on these assumptions.

Changes and trends in pension legislation

We observed two major hot topics on the Belgian pension market: legal changes and Defined Contribution plans. We believe the legal changes and the evolutions regarding the Defines Contribution plans are representative of the main discussions currently underway.

Zoom on the legal changes

Belgium is a very "creative" country with regard to pension legislation. There are constantly changes to the legislative context and it appears this will continue to be the case in the future.

Here is a brief summary of the trends and changes we have observed:

- Strengthening the conditions for unemployment with additional indemnity from the employer SWT/RCC, previously called "bridge pension" (Law published on 30 December 2014);
- Upcoming changes in the legal retirement age (66 years as from 2025 and 67 years as from 2030) and stricter conditions for early legal retirement (Law published on 21 August 2015);
- Impact on the accounting treatment of Defined Contribution plans beyond the minimum guaranteed interest return of 1.75% (current rate) as from 1 January 2016 and this for both employer and employee contributions (Law published on 18 December 2015);
- Mandatory minimum death benefits coverage for deferred plan members as of 1 January 2016 (Law published on 24 December 2015);
- Existing favorable anticipation rules no longer valid (transition rules are applicable) and no new anticipation rules as from 1 January 2016 (Law published on 24 December 2015).

And we anticipate the following:

- A full occupational pension pillar will be introduced for self-employed natural persons comparable to the occupational pensions for employees;
- Employees are entitled to convert a part of their salary into a contribution for an occupational pension regime even if this occupational pension regime is not yet installed within the employing company;
- Finally, as of 1 January 2019, it will be possible to participate in a partial pension plan for employees and self-employed individuals (the specific entitlement conditions still need to be further implemented). This would allow them to combine their pension with additional activities. The result is we will see further increase of the pension entitlements in the future.

Zoom on Defined Contribution plans

No pensions hot topics list 2017 would be complete without the Defined Contribution plans. Without divulgating inside information, it is clear that this topic will be part of our next edition in 2018.

First let's start with the context.

Belgian "Defined Contribution" plans are subject to the Law of 28 April 2003 on occupational pensions (hereafter "the WAP/LPC"). According to article 24 of this Law, the employer has to guarantee an average minimum return of 3.25% on employer contributions and of 3.75% on employee contributions.

The law about occupational pension plans, published on 18th of December 2015, introduces changes that have an impact on the accounting for Defined Contribution plans. As from 1 January 2016 the law replaces the 3.25% (employer) and 3.75% (employee) by 65% of 10-year OLO ("Obligation Linéaire/Lineaire Obligatie", the Belgian government bonds) yield averaged on 1 June over the last 24 months. It is possible this will be increased to 75% (as from 1 January 2018) and 85% (as from 2019) if the National Bank of Belgium approves the principle, leading to a minimum of 1.75% and a maximum of 3.75%. This means that in the long run the rates could change.

For insured plans the current 3.25% and 3.75% remain applicable for pre-2016 contributions. For other plans the new rates also apply to the accumulated pre-2016 contributions as from 1 January 2016 onwards.

Belgian Defined Contribution (DC) schemes with minimum return guarantee borne by the employer are currently Defined Benefit (DB) plans under IAS 19. The paragraph IAS9.67 states that an entity should use the Projected Unit Credit method (PUC) to determine the present value of its Defined Benefit Obligations (DBO). A consensus on the Belgian market has been found on the nature and the method used. However, endless discussions have started on the practical implementation of IAS19 concepts to the Defined Contributions in Belgium.

For the completeness of this benchmark analysis please note that the PUC method is defined by the following steps (IAS19.57):

- Provide a reliable estimate of the ultimate cost of the benefit(s) that employees have earned in return for their service for the current and prior periods for the entity. This requires the use of estimations (actuarial assumptions) about demographic and financial variables that will affect the cost of the benefit;
- Discount that benefit in order to determine the present value of the Defined Benefit Obligation.

The assets valuation is also under discussions since the Fair Value concept defined in IFRS13 is broad and subject to various interpretations.

A look at the most important assumptions in Belgium

Discount Rate

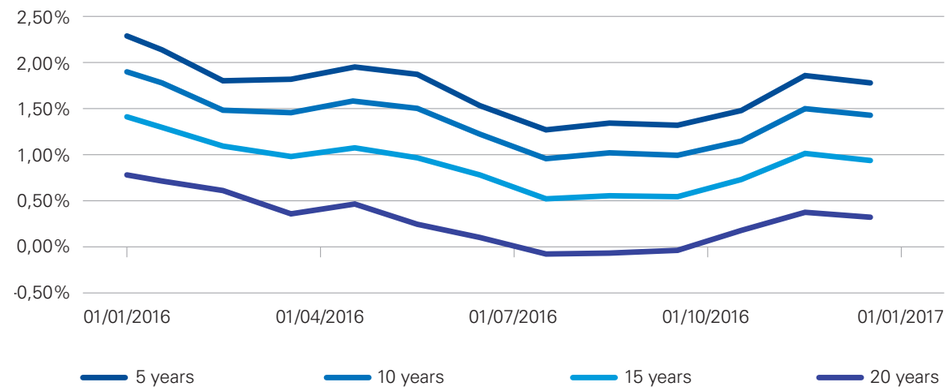
The Defined Benefit Obligation (DBO) related to estimated future payments is measured on a discounted basis.

For IAS19 purposes, the discount rate is based on the duration of the pension plan, which reflects the timing and size of the benefits (IAS19.83-85). The obligation is discounted using a high-quality corporate bond rate. Referring to high-quality corporate bonds is generally interpreted as at least a "AA" bond. In addition, the currency and maturity of the bonds needs to be consistent with the currency and maturity of the liabilities.
If the corporate bond market is not sufficiently deep or qualitative, the discount rates are based on the government bonds, possibly with an adjustment (i.e. taking into account some level of risk premium to approximate the corporate bond rate).

Under ASC 715, the currency and maturity of the bonds should also match the currency and maturity of the pension obligation. Like IFRS, the obligation is discounted using a high-quality corporate bond rate; however, US GAAP has additional guidance on the determination of the high-quality bond rate, and therefore differences from IFRS may arise in practice. Furthermore, unlike IFRS, there is no guidance for situations in which the corporate bond market is not deep, although it would be acceptable to use government bonds in those circumstances.

Looking more deeply into the assumptions, the discount rates per year-end 2016 show a decrease for all the maturities compared to those per year-end 2015. The differences between the discount rates curves as used by KPMG at year-end 2015 and year-end 2016 is shown in Figure 1 below. The evolution of the curves between year-end 2015 and year-end 2016 shows fewer differences on shorter maturities than on the longer maturities, given a decrease of 52 basis points for yields with a five years maturity and a 64 basis points decrease for yields with a maturity of twenty years.

Figure 1: KPMG central guidance discount rate during 2016

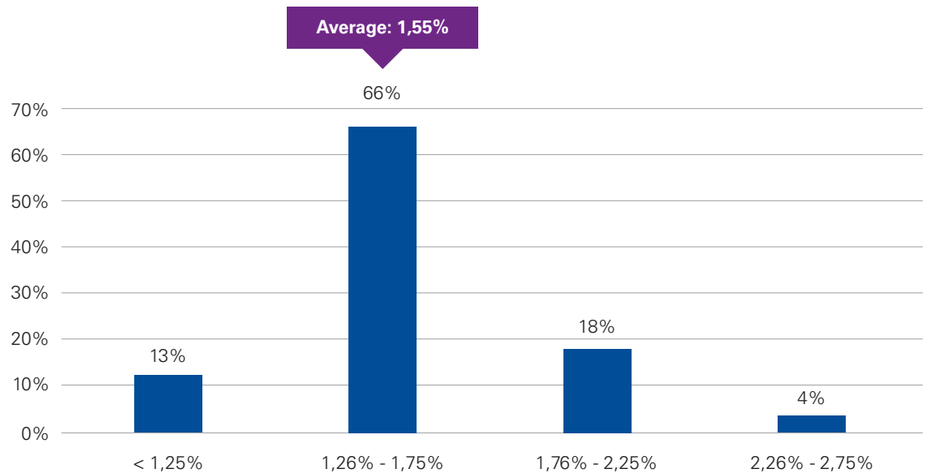


Source: KPMG analysis

In 2016, the discount rates dropped significantly, even resulting in negative yields for shorter maturities, as shown in the curve during the third quarter of the year. The overall decrease in 2016 results mainly from the monetary policy of the European Central bank.

In fact, a lower discount rate leads to a higher Defined Benefit Obligation. The discount rates per year-end 2016 are somewhat lower than the discount rate per year-end 2015. Therefore, most companies have undergone an increase of the pension liabilities recorded on their balance sheet at year-end 2016.

Figure 2: Discount rates



Source: 56 surveyed plans

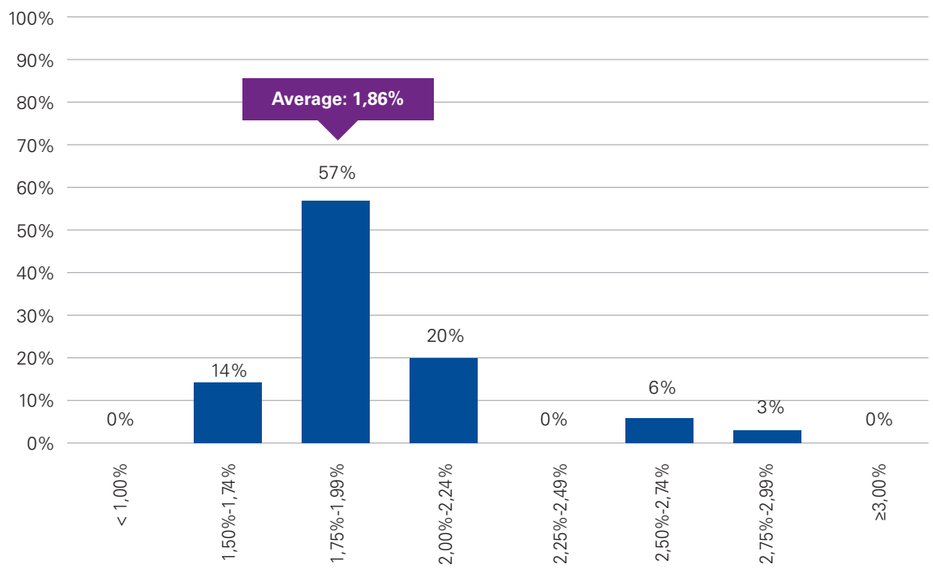
Figure 2 shows the discount rates applied by the surveyed companies at year-end 2016. The discount rates applied in the different pension plans of the surveyed companies are between 0.75% and 2.75%. **The average discount rate is 1.55%.** Approximately 66% of the surveyed companies use a discount rate within a range of 1.26% to 1.75%.

Inflation Rate

The inflation rate in the long-run is an assumption that influences other economic parameters such as the salary increase rate, the social security increase rate or the pension increase rate.

It is important to note that inflation is very sensitive for short maturities. However IAS19 requires a long term expectation, therefore this assumption should remain stable over time.

Figure 3: Inflation rates



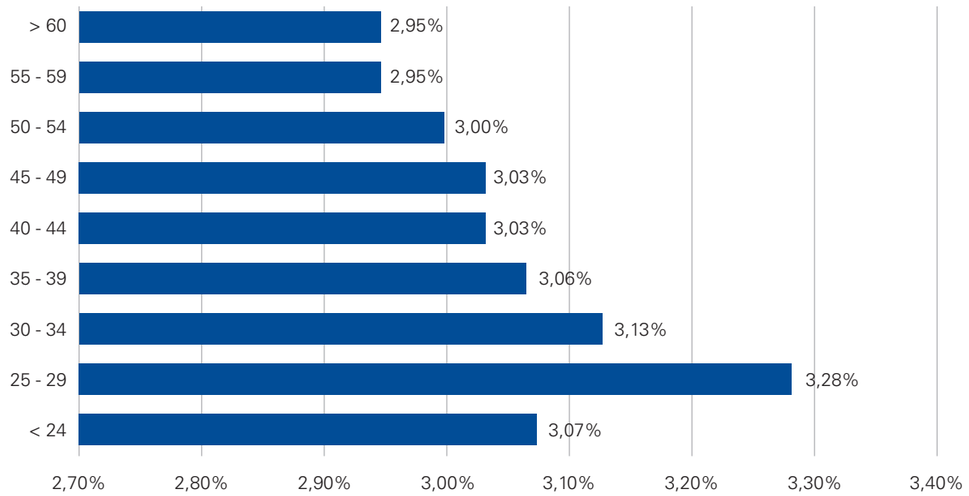
Source: 35 surveyed plans

Figure 3 shows the inflation rate applied by the surveyed companies at year-end 2016. The inflation rate applied in the different pension plans of the surveyed companies are between 1.50% and 2.80%. **The average inflation rate is 1.86%.** Approximately 91% of the surveyed companies use an inflation rate within a range of 1.50% to 2.25%. On average, the surveyed companies seem to follow the ECB long-term inflation rate expectation (between 1.80% and 2.00%).

Salary Increase

In the context of this benchmark, the salary increase is always referred to as the sum of the inflation and a merit increase. Indeed in Belgium, a systematic inflation mechanism is applied to a salary increase. A merit increase is then added.

Figure 4: Salary increase rates (including inflation)



Source: 33 surveyed plans

Figure 4 displays the rate of salary increase. This graph shows that the salary increase is approximately 3%. Therefore, it represents a merit increase rate of around 1.20% above the average inflation rate.

This trend could be partially explained by the use of a flat rate (not sensitive to the age) within the surveyed companies.

Withdrawal Rates

The majority of the surveyed companies applied turnover rate for their employees. This assumption is commonly age related. Moreover it is usually a company related assumption that will be consistent with that company's experience. Nevertheless, a limited number of surveyed companies didn't apply any turnover rate for the pension accounting. There is a direct link with the limited size of the company and the absence of turnover rates.

Please note that generally, using turnover rates reduces the liability of the company.

Figure 5: Withdrawal rates (per annum)

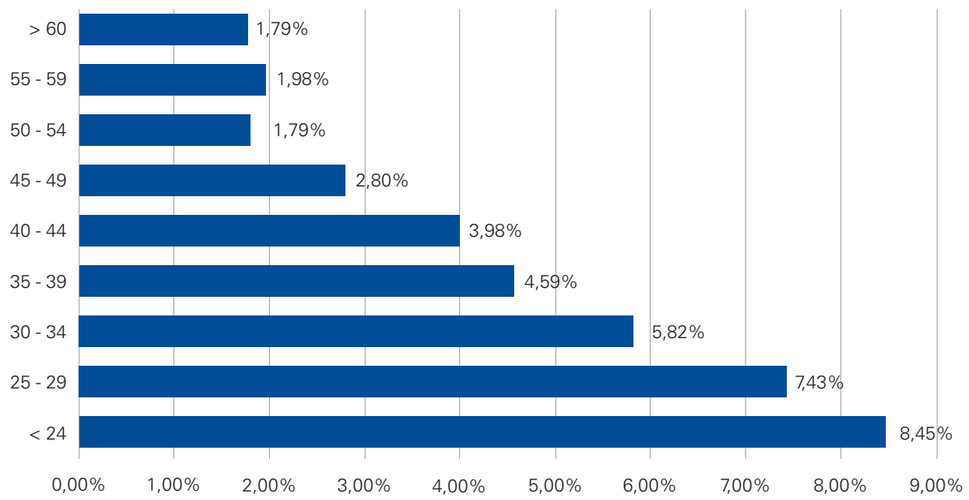


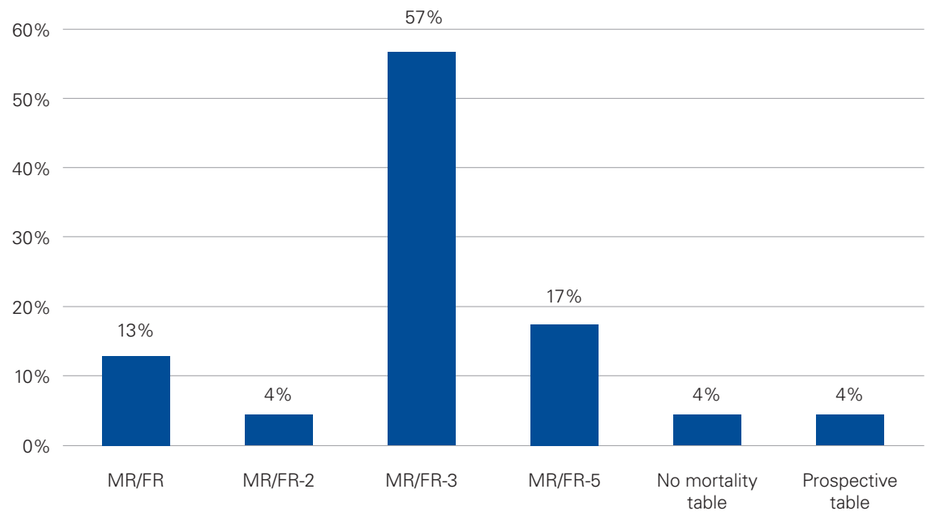
Figure 5 displays the withdrawal rates per range of 5 years. The graph shows that those rates tend to decrease with the age of the participants. It is in line with the general perception that younger employees are more likely to leave their employer than older ones.

However, it is more surprising to notice that senior people above age 50 still have turnover rates around 2.00% per year. This could be interpreted as a result of the governmental measures taken in recent years.

Almost all surveyed companies used the mortality tables MR for the males and FR for the females. These mortality tables are commonly used for actuarial valuations in Belgium. However, as they are no longer up to date they don't reflect the actual mortality observed nor expectations, most of participants applied an additional age correction. For the last few years the market practice has taken into account the life expectancy improvement and introduced age correction mechanism to be conform to the IAS19 revised in 2011 requirements.

Source: 23 surveyed plans

Overall, the age correction is limited to between -2 and -5 years. The majority of the respondents used a -3 years correction. At this stage, the market



didn't show an appetite for the prospective tables.

In regards to retirement age, we see two main trends. On the one hand, recent legal changes in Belgium imply that the normal retirement age (NRA) will be delayed to age 66 as from 2025 and to age 67 as from 2030. On the other hand, the minimum early retirement age has been delayed to age 62.5 as from 2017. This will be increased to age 63 as from the year 2018 (together with specific career conditions).

Source: 39 surveyed plans

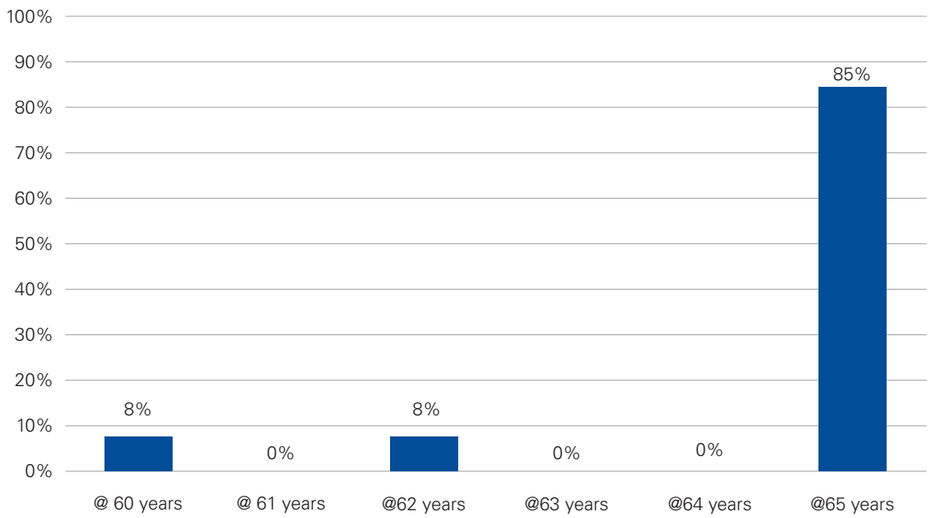


Figure 7 displays the retirement age applied by the surveyed companies. The retirement age used in the different pension plans of the surveyed companies are at age 60, 62 or 65. Approximately 85% of the surveyed companies use the NRA of 65 years. However, there are still some respondents opting for 60 years as the assumption for retirement age.

Furthermore, we note that none of the surveyed companies took into account an expected retirement age above 65.

Conclusion

This is the first Belgian edition of the KPMG Pensions Accounting Survey. At year-end 2016, the big trends regarding IAS19 assumptions in Belgium were:

- The average discount rates applied at year-end 2016 have decreased compared to year-end 2015 situation. The deterioration of the discount rates results in negative yields for shorter maturities (up to 5 years) during the third quarter of the year.
- Aligned with the guidance of the ECB for the long term, the observed inflation rates remained stable around 1,85%.
- On average, employees benefit from a merit increase around 1,20% in addition to the salary increase related to the inflation rate. In contradiction with the usual market perception, we didn't observe highly differentiated salary increases depending on the age or seniority of the employees.
- The turnover rates are age dependent. For more senior people the observed rates remain stable until the end of their career.
- The observed age correction on the mortality table MR/FR used in Belgium is three years on average. The appetite for prospective tables is currently rather limited.
- On average the retirement age is 65 in participating companies. In some rare cases, remnants of the past legislation could still be observed (i.e. retirement age of 60 or 62). The recent legal changes regarding the retirement age were not reflected in the surveyed companies.

More generally, we observed that Finance or Human Resources teams of the surveyed companies generally proposed assumptions that clearly demonstrated the trends of the market, guided by International Standards and other legislative requirements. This is commendable in light of the ever changing landscape in which they operate.

Furthermore we note that the framework in which each of the assumptions operate is very clear. It makes it fairly easy to spot an outlier or a unique situation. Of course, there remain additional options for these frameworks. With larger samples and further investigation, we assume that we can only increase our knowledge on and understanding of the general trends.

In a general accounting context and based on our experience, there is a clear impact of the legislative context on pension accounting. Each time a legislation is instated, the market follows suit. Since a lot of changes are expected in the coming months and years we are curious about what that will mean for the future development of the pension environment in Belgium. It is certain that the treatment of Defined Contribution plans will continue to be key. But the impacts could go further than that and we are curious to see where it will go.

We would like to hugely thank all participants. We expect to continue running this benchmark analysis again next year. We look forward to seeing how the assumptions will evolve in the near future.

About KPMG and the Employee Benefits Team

KPMG in Belgium offers services in the fields of audit, tax and advisory. We offer our services to a broad group of clients: major domestic and international companies, medium-sized enterprises, non-profit organizations and government institutions. The complicated problems faced by our clients require a multi-disciplinary approach. Our professionals stand out in their own specialist fields while, at the same time, working together to offer added value that enables our clients to excel in their own environment. In doing so, we draw from a rich source of knowledge and experience, gained worldwide in the widest range of different organizations and markets. We provide real answers so that our clients can make better decisions.

Financial Risk Management offers creative business strategies to clients in the rapidly changing insurance and pensions industry. We also bring insight and quantitative analytic skills to other clients assisting them with the challenges they are facing. We support numerous pension funds and companies with advice on pension plan design, pension valuations and risk analysis. Our team of (qualified) actuaries works together with other KPMG professionals to form multi-disciplinary teams and help guarantee the best service for our clients.

Please contact one of our Employee Benefit specialists who participated in this benchmarking for additional questions. They would be pleased to provide you with more details or to help you identify where you fall in the various assumptions studied.

Contact us:

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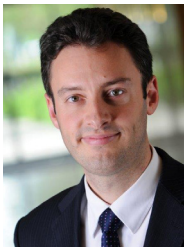

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