Milliman Research Report

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Survey of UAE employee benefit obligations

An analysis of employee benefit obligations as at 31 December 2013 among FTSE NASDAQ Dubai UAE 20 companies

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INTRODUCTION

Milliman conducts continual and extensive research on issues connected to the employee benefits offered by companies in the Gulf Cooperation Council (GCC) member states.

We present here our first annual study of the employee benefit obligations among United Arab Emirates (UAE) companies, with the intention to report the major trends with regard to these obligations. The main aim of the study is to create awareness and understanding about the cost of the employer-sponsored long-term employee benefits programs.

We focus on post-employment benefits provided directly by companies to their employees. This primarily relates to the cost of providing the severance benefit mandated under the country's labour laws. (To clarify, this does not include any contributions made to state-managed pension plans: the companies' obligations to GCC nationals in this regard are settled annually via the income statement, with no residual long-term benefit obligation).

Our analysis is based on the companies featured in the FTSE UAE NASDAQ Dubai UAE 20 index as of 30 September 2013, all of whom report under International Financial Reporting Standards (IFRS). For three of the companies the required data for our analysis was not readily available or discernible at the time of the study. Consequently we have restricted our analysis to the 17 companies outlined in Figure 1. We have extracted data from their published annual reports for the year ended 31 December 2013.

FIGURE 1: STUDIED SUBSET OF THE FTSE NASDAQ DUBAI UAE 20 AS OF 31 DECEMBER 2013

Company name	Industry
Abu Dhabi Commercial Bank PJSC	Financials
Agthia Group PJSC	Consumer Goods
Air Arabia PJSC	Consumer Services
Aldar Properties PJSC	Financials
Arabtec Holding PJSC	Industrials
Aramex PJSC	Industrials
Dana Gas PJSC	Utilities
DP World PJSC	Industrials
Drake & Scull International PJSC	Industrials
Dubai Financial Market PJSC	Financials
Dubai Islamic Bank PJSC	Financials
Emaar Properties PJSC	Financials
Emirates NBD PJSC	Financials
First Gulf Bank PJSC	Financials
National Bank Of Abu Dhabi PJSC	Financials
Union National Bank PJSC	Financials
Waha Capital PJSC	Industrials

Throughout the remainder of this report we shall refer to the companies as A to Q. (The labels A to Q have been assigned according to the size of the benefit obligations and, as such, they do not directly correspond to the ordering of the firms in Figure 1.)

Our analysis is based on the consolidated obligations for each company. In some cases the underlying figures may partially relate to non-UAE subsidiaries. This is not thought to significantly distort the underlying trends prevalent specifically in the UAE.

Finally, please note that in some instances the figures required for our analysis were not explicitly specified in the 17 annual reports studied. In these cases we have made inferences about the benefit costs from other statements in the accounts.

ACCOUNTING STANDARDS FOR EMPLOYEE BENEFIT COSTS

WHAT IS THE DEFINED BENEFIT OBLIGATION?

Under IFRS, the relevant framework for accounting for the cost of employee benefit plans is outlined in International Accounting Standard No. 19, amended 2011 (IAS 19).

The defined benefit obligation (DBO) is the present value of expected future payments required to settle an employee benefit obligation resulting from the employee's service with the employer. IAS 19 outlines a specific actuarial method for estimating the DBO. This involves a projection of the benefits to be paid based on expected salary growth, resignation rates and retirement rates. They are discounted using market interest rates to give a present value of the projected benefits.

DIVERGENCE IN APPROACHES

Of the companies surveyed, only four explicitly mentioned the use of an actuarial method for determination of the DBO.

Four others explicitly mentioned the use of an alternate, more simplistic method under which the DBO is taken to be the aggregate benefit payment if all employees were to cease employment immediately. This approach is not consistent with the IAS 19 framework and can lead to a materially different DBO from the approach specified under IAS 19.

The situation is ambiguous for the remaining companies in the study.

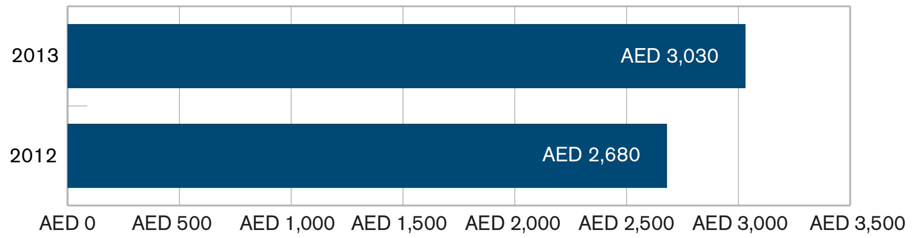
DEFINED BENEFIT OBLIGATIONS AS OF 31 DECEMBER 2013

HIGHER DBO LEVELS RECORDED IN 2013

The companies registered a rise in their DBOs from the prior year. From 2012 to 2013, their combined DBOs grew about 13.1%, from approximately AED 2,680 million to approximately AED 3,030 million.

This rise in cumulative DBO can be attributed to several factors. The primary cause is the accrual of extra service. Other important influences are changes in economic valuation assumptions, the aging of the covered populations, and other broader demographic trends.

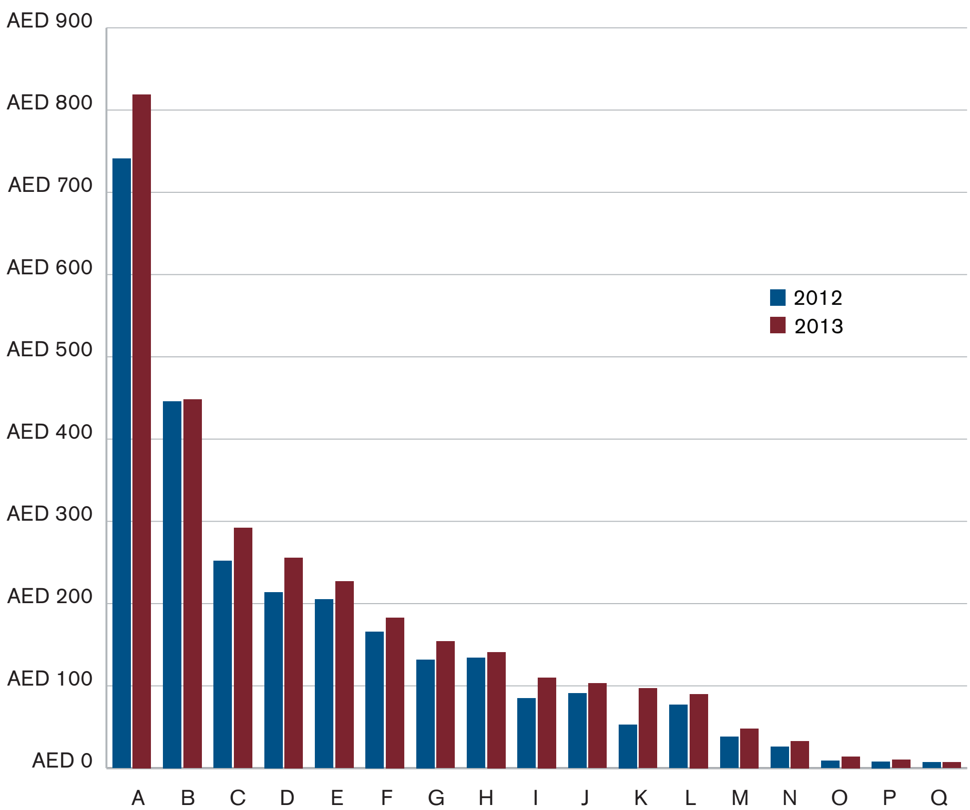
FIGURE 2: CHANGES IN DBO (IN MILLIONS)



COMPANY-SPECIFIC DBO

The DBO increased or remained constant across all companies. This is indicative of a consistent gradual aging of the covered workforces.

FIGURE 3: COMPANY-SPECIFIC CHANGES IN DBO (IN MILLIONS)



ADVANCE FUNDING

The post-employment benefits are payable, by definition, at the time the employee ceases employment. To help with cash-flow management (and for other strategic reasons), a company may choose to set aside funds over the course of an employee's career in anticipation of this future payment.

None of the companies in the study reported funding in advance for the benefit obligations. This is not atypical for the market. Though, from our broader experience, we are aware that an increasing number of companies are beginning to consider this path.

DISBURSEMENT OF OBLIGATIONS

The benefit payments were not readily available or discernible for four of the 17 companies under consideration. For the remaining 13, the total payments made in 2013 were approximately AED 400 million, or approximately 19.5% of the aggregated DBO for these companies. This is a high proportion compared to similar accounting measures in other countries in the region–and could be indicative of underestimation of the long-term benefit costs, or shorter working periods relative to other markets.

EMPLOYER EXPENSE FOR 2013

WHAT IS THE EMPLOYER EXPENSE?

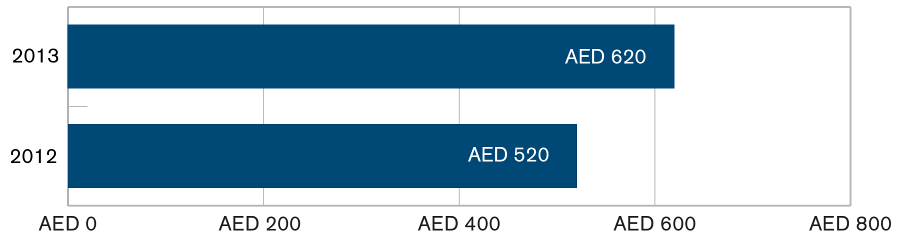
The annual employer expense is the amount recognized in an employer's comprehensive income account for the year due to the sponsorship of the benefit plans for employees. There are various components to this charge. The portion relating to the additional benefit entitlement earned during the year is known as the service cost. Another component is an adjustment for obligations becoming one year closer to payment by the end of the fiscal year, known as the interest cost. Additional components may be present too.

Only one of the 17 companies disclosed the breakdown of their employer expense into the service cost, interest cost, and remeasurements. The total employer expense allowance was not discernible or available for three of the companies.

HIGHER CHARGES RECORDED IN 2013

The annual charges were not readily available or discernible for four of the 17 companies under consideration. For the remaining 13 companies, the aggregate reported annual expense grew about 19.6% from approximately AED 520 million in 2012 to approximately AED 620 million in 2013.

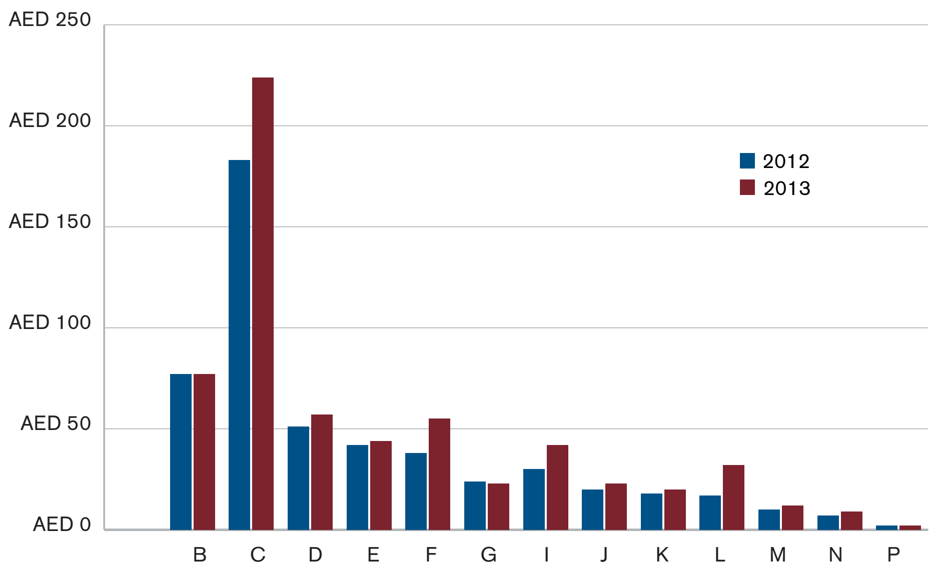
FIGURE 4: CHANGES IN EMPLOYER EXPENSE (IN MILLIONS)



COMPANY-SPECIFIC EMPLOYER EXPENSE

The employer expense increased or remained constant across all companies.

FIGURE 5: COMPANY-SPECIFIC CHANGES IN DBO (IN MILLIONS)



Note: Where the employer expense is not shown, the company has not stated an expense figure.

ACTUARIAL ASSUMPTIONS

PURPOSE OF ACTUARIAL ASSUMPTIONS

In estimating the employee benefit obligation using the actuarial method, the company must make certain assumptions about future experience. These assumptions should reflect an entity's best estimate of future experience. The most important assumptions in the estimation of the employee benefit obligation are:

- Discount rate
- Future salary increases
- Rates of employee turnover, disability and early retirement
- Mortality

Only three companies disclosed the assumptions used in calculating their employee benefit obligations. We will not infer trends from a sample of this size.

However, assumption selection is a very important topic. We outline some general considerations on assumption selection below.

SELECTION OF THE DISCOUNT RATE

In accordance with IAS 19, the rate at which projected disbursements are discounted to arrive at the DBO should be calculated by reference to market yields at the end of the reporting period on high-quality corporate bonds (or, in countries where there is no deep market in such bonds, government bonds) of a currency and term consistent with the post-employment obligations.

The UAE does not have a deep market in corporate or government bonds. So the required yields are synthesized (under a variety of approaches, from our experience).

All else being equal, a higher discount rate results in a lower disclosed benefit obligation.

EXPECTED SALARY INCREASES

In measuring the obligation, an assumption is made about the expected long-term rate of increase in the salaries of the covered population. This rate should take account of inflation, seniority, promotion, and other relevant factors, such as supply and demand in the employment market. Long-term salary increases tend to be heavily dependent on the geography and industry of a particular company.

All else being equal, a higher salary increase assumption results in a higher disclosed benefit obligation.

TURNOVER RATES

An assumption is needed for the expected turnover of employees. This assumption can be a significant driver of the DBO. As with the salary increase assumption, the underlying rates tend to be heavily dependent on the geography and industry of a particular company, as well as its strategic plans.

The impact of a high or low assumed turnover rate is not as simple as for the discount rate or salary increase assumptions. The impact depends on the interaction of the aforementioned assumptions, as well as the demographic profile of the covered population.

OTHER ASSUMPTIONS

Other assumptions are needed for the estimation of the DBO. These include the patterns of retirement, disability and death among the covered population.

ABOUT THIS STUDY

MILLIMAN SURVEY OF UAE BENEFIT OBLIGATIONS AS OF 2013

This study covers the 20 companies featured in the FTSE UAE NASDAQ Dubai UAE 20 index as of 30 September 2013.

The results of this study are based on the employee benefit obligation accounting information disclosed in the footnotes to the companies' annual reports for the 2012 and 2013 fiscal years. These figures represent the generally accepted accounting principles (GAAP) accounting information that public companies are required to report under IAS 19.

Milliman publishes similar studies for other international industry groupings.

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ABOUT MILLIMAN

Milliman is among the world's largest providers of actuarial and related products and services. The firm has consulting practices in life insurance and financial services, property & casualty insurance, healthcare, and employee benefits. Founded in 1947, Milliman is an independent firm with offices in major cities around the globe.

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