

Working Document

Proposed Changes to the Practice-Specific Standards for Pension Plans

Committee on Pension Plan Financial Reporting

March 2007

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Memorandum

To: All Fellows, Affiliates, Associates and Correspondents of the Canadian Institute of Actuaries

From: Stephen Butterfield, Chairperson
Committee on Pension Plan Financial Reporting

Date: March 14, 2007

Subject: **Proposed Changes to the Practice-Specific Standards for Pension Plans**

Deadline for Comments: May 15, 2007

The Committee on Pension Plan Financial Reporting (PPFRC) issued a statement of principles in March 2005 proposing changes to the Practice-Specific Standards for Pension Plans with respect to reports on the funding of pension plans. Subsequently, PPFRC issued a report to CIA members in October 2005 regarding feedback received and the committee's comments on this feedback.

Since then, the PPFRC has had several meetings to further discuss the appropriate changes to our standards. Our ideas have been informally presented to the membership through a series of presentations at the Pension Seminar in April 2006, the Annual Meeting in June 2006, and the General Meeting in October 2006.

Over the past year, our internal discussions have been guided through a "working document." The purpose of this working document has been to summarize the ultimate substance of the pension-specific standards.

The working document has been reviewed by the Actuarial Standards Board (ASB), and it is in general agreement with its contents.

It is the intention of the PPFRC and the ASB to prepare an exposure draft based on the substance of the working document. However, in conjunction with the preparation of the exposure draft, the committee is inviting feedback on the working document, from both members of the Institute and other pension plan stakeholders.

The committee's intention is to develop some sections of the exposure draft in advance of the 2007 Pension Seminar to facilitate member feedback throughout the process. At this stage, the committee does not have a final completion date but this is expected to be announced following the Pension Seminar.

Please provide your feedback no later than May 15, 2007 to Stephen Butterfield at stephen.butterfield@towersperrin.com.

SB

NEW STANDARDS OF PRACTICE FOR FUNDING OF PENSION PLANS**A. GOAL OF FUNDING**

The goal of funding is the systematic accumulation over time of dedicated assets which, without recourse to the funder's assets, secure the plan's promised benefits.

B. FUNDING POLICY

The adoption of a funding policy by funders is to be encouraged. However, the standards will apply whether or not there is a relevant funding policy. If a funder has a funding policy, then the actuary would be guided by this funding policy. However, if no funding policy exists, then the actuary would still be able to undertake a funding valuation in accordance with the standards of practice.

C. REAL WIND-UP VALUATION

- a) The financial position on a true wind-up basis must be reported. However, consideration is being given to permit certain exclusions to this requirement. It is expected that these exclusions would be minimal and strong justification would be required for not conducting a hypothetical wind-up valuation.
- b) The fact that a plan may be expected to have a significant wind-up surplus or the fact that the plan is unlikely to wind up in the near future would not be sufficient justification for not reporting the wind-up position.
- c) The wind-up valuation must report assets on a market value basis.
- d) A wind-up incremental annual cost must be reported for each year from the valuation date to the date of the next required actuarial valuation of the plan. The actuary would exercise judgment where the inter-valuation period exceeds one year as to whether the first year wind-up incremental annual cost would remain appropriate for subsequent years, or whether supplemental calculations would be required to determine the costs for such subsequent years.
- e) A simplified wind-up gain/loss analysis would be required, including as a minimum:
 - Interest on wind-up surplus (deficit);
 - Amortization payments/use of surplus;
 - Past service contributions/use of surplus;
 - Effect of changes in assumptions;
 - Investment gain (loss);
 - Other gain (loss).

Other items may be included if deemed significant by the actuary.

D. WIND-UP VALUATION INCLUDING SOME FORM OF RISK ANALYSIS

- a) The financial position of the plan on a wind-up basis must also be determined/reported, based on specified adverse situations in order to provide the reader of the report with an indication of the risks inherent in the wind-up position.

- b) The Task Force on the Determination of Appropriate Provisions for Adverse Deviations in Hypothetical Wind-up and Solvency Valuations is researching and modeling possible approaches to the development of such risk analysis. The committee will wait to see the task force report before fleshing out this concept any further.
- c) The wind-up incremental annual cost (for the period to the next required valuation) would also need to be determined/reported based on the specified adverse situations.

E. GOING CONCERN VALUATION

- a) The going concern funded position of the plan must be determined/reported unless these conditions are both met:
 - i. the funding policy stipulates that no such valuation is required;
 - ii. there is no regulatory requirement to undertake a going concern valuation.
- b) Other than the selection of actuarial assumptions and methods, where the actuary may now be guided by a funding policy, requirements for a going concern valuation would be very similar to our current standards of practice.
- c) The remaining requirements of this section would only apply if a going concern valuation was undertaken.
- d) The actuarial balance sheet must show assets on a market value basis.
- e) The actuarial assumptions for the going concern valuation are ultimately the responsibility of the actuary.
- f) If there is a funding policy, the manner in which the actuary would develop the assumptions would be set out in the funding policy. The funding policy may provide detailed information to assist the actuary in developing the assumptions, or it may be very vague. In any event, it is the role of the actuary to develop the assumptions based on the applicable funding policy. However, the standards would state that each individual assumption could be no more aggressive than best estimate.
- g) If there is no funding policy, then our standards would be similar to our current standards meaning that, in most circumstances, the assumptions must include provision for adverse deviations.
- h) It is acknowledged that best estimate assumptions are not uniquely determinable, but that there is a range of possible best estimate assumptions. Accordingly, the determination of best estimate assumptions and any provisions for adverse deviations involves individual judgment. In general, it is believed that the current initiatives requiring that assumptions be “independently reasonable” and that pension valuations require “justification” of the assumptions, will prove sufficient to guide the actuary in selecting appropriate assumptions and to provide users of the report with appropriate information to appraise the assumptions. It is noted that accounting standards require the use of best estimate assumptions and, although the accounting standards require that these assumptions be determined by management, in many cases, the actuary develops these assumptions for management.
- i) Notwithstanding the above, the selection of an appropriate best estimate discount rate is still subject to much contention. Rather than specifying what a best estimate discount rate would

be (or how to determine a best estimate discount rate), our standards would require that the discount rate be set in a reasonable manner, taking into account the investments of the plan.

- j) Guidance would be prepared from time to time that would set out upper and lower limits for the discount rate. Extensive work will be required to flesh out all of the details of this guidance, but it may be premised on the recognition of maximum risk premiums by asset class (for the upper limit) and on a minimum risk portfolio (for the lower limit).
- k) A very simplified example for the upper limit is that the guidance may state that the maximum discount rate for a pension fund would be determined using the building block approach where expected fixed income returns must be limited to a Government of Canada bond yield plus “x” bps and equity returns must be limited to a Government of Canada bond yield plus “y” bps. Work will be required to determine what asset should form the base upon which the risk premiums are added and the size of the permissible premiums for the various asset classes.
- l) The going concern financial position would be reported based on the market value of assets and the going concern actuarial liability.
- m) The going concern normal actuarial cost would also be determined/reported for the duration of the period to the date of the next required valuation.
- n) Finally, terminology is being reviewed with the intention of replacing some common terms, such as “liability”, “surplus” and “deficit”, to more accurately describe these amounts.

F. FUNDING

- a) The above would represent the required disclosure of financial information.
- b) Contribution requirements would be determined in accordance with the funding policy and regulatory requirements.
- c) It would continue to be acceptable to use an asset smoothing method to determine the contribution requirements, subject to the funding policy and regulations.
- d) Any adjustment to the assets would be shown in the contribution section of the report (i.e., as amounts not subject to amortization or as additional amounts subject to amortization).