

## *Exposure Draft*

# Revisions to Subsection 3260 of the Practice-Specific Standards for Pension Plans – Reporting: External User Report; Advice on the Funded Status or Funding of a Pension Plan

**Actuarial Standards Board**

**June 2017**

Document 217064

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## Memorandum

**To:** All Fellows, Affiliates, Associates, and Correspondents of the Canadian Institute of Actuaries and other interested parties

**From:** Ty Faulds, Chair  
Actuarial Standards Board  
Geoffrey Melbourne, Chair  
Designated Group

**Date:** June 20, 2017

**Subject:** **Exposure Draft – Revisions to Subsection 3260 of the Practice-Specific Standards for Pension Plans – Reporting: External User Report; Advice on the Funded Status or Funding of a Pension Plan**

**Comment Deadline: September 30, 2017**

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### Introduction

This exposure draft (ED), revising the practice-specific standards for pension plans with respect to the disclosures in an external user report on work pursuant to subsection 3260 – Reporting: External User Report, was approved for distribution by the Actuarial Standards Board (ASB) on June 6, 2017.

### Background

The ASB has created a designated group (DG) which will be responsible for developing these revisions to the Standards of Practice to enhance the disclosures of future pension plan funding risks. The designated group includes Edward Gibson, Alexandra Leslie, Geoffrey Melbourne (Chair), Phil Rivard, and Tony Williams.

A [notice of intent](#) on these revisions was issued on July 6, 2016. A summary of the comments received and the DG's responses appears in the appendix.

The main changes the DG made in its deliberations following the feedback are:

- Moving from a prescriptive to a principles-based approach for the new disclosures—in this regard, the approach adopted for dynamic capital adequacy testing (DCAT) under the practice-specific standards for insurance was used to guide the development of the revisions in this ED.

- Not requiring the additional risk assessments to be conducted where this is precluded by the terms of the engagement under which the work is being performed, provided there is no conflict with the law—as there are already exceptions for designated plans and pension plans not registered under a pension benefits standards act of a province or the federal government of Canada, and the revisions contemplate the referencing of related work such as asset-liability modeling work, where applicable, the DG envisages the main other circumstance where the risk assessments would not be carried out is where the potential contribution requirements of the pension plan are deemed to be immaterial relative to the financial capability of the plan sponsor(s).

## **Timeline**

It is the responsibility of the ASB to make final decisions regarding the revised standards of practice. It is anticipated that the ASB would adopt final standards with an effective date on or after February 1, 2018. Early implementation would likely be permitted.

## **Your Feedback**

The ASB is soliciting feedback on this ED from members of the CIA and other stakeholders. Comments on the proposed revisions are invited **by September 30, 2017**. Please send them, preferably in an electronic format, to Geoffrey Melbourne at [geoffrey.melbourne@willistowerswatson.com](mailto:geoffrey.melbourne@willistowerswatson.com), with a copy to Chris Fievoli at [chris.fievoli@cia-ica.ca](mailto:chris.fievoli@cia-ica.ca). No other forums for the receipt of comments are currently contemplated.

## **Due Process**

The ASB's Policy on Due Process for the Adoption of Standards of Practice was followed in the development of this ED.

TF, GM

## **Appendix: Exposure Draft – Revisions to Subsection 3260 of the Practice-Specific Standards for Pension Plans – Reporting: External User Report; Advice on the Funded Status or Funding of a Pension Plan**

**Summary of the comments received on the notice of intent (NOI), the DG’s responses, and other changes**

### **Comments Received**

The DG received 18 responses to the NOI, from three pension plan boards or organizations, four individual members, nine pension consulting firms, one regulatory organization, and the Committee on Pension Plan Financial Reporting (PPFRC).

### **General Comments**

There was broad recognition of the importance of recognizing the risks in pension plan funding, tempered by concerns about the cost, complexity, and proposed mandatory nature of the proposed changes.

Some comments questioned the necessity for change or were otherwise more generally opposed.

Feedback included the following:

- *We agree that the typical actuarial funding report is deficient with respect to risk.*
- *We commend all efforts to improve the readability, clarity, and helpfulness of these reports, particularly in the area of disclosure of risks.*
- *We agree that providing enhanced disclosures that inform stakeholders of the inherent funding risks of the pension plan, including risks associated with the asset liability mismatch, may be beneficial provided that the enhanced disclosures can be done in a simple way.*
- *The goal of disclosing additional funding risks is a laudable one, if tailored to the specific circumstances of the pension plan.*
- *We would support even greater risk disclosures in actuarial funding reports, but such disclosure should be restricted to the identification of these risks and not include quantification of those risks.*
- *We agree in principle to enhancing disclosures in valuation reports, but we are not convinced that all the proposed changes will be helpful to the plan sponsor.*
- *We agree that risk management is extremely important for pension plan stakeholders; however, we do not believe that it should be a requirement of funding reports.*
- *We question the need for these revisions, and it remains unclear to us what the driver of change is, what problem is being solved by these revisions, or which users are asking for these enhancements.*
- *We believe additional information is needed regarding what current problem(s) the changes are intended to address and how the proposed changes to the Standards of Practice will help resolve it.*
- *We believe that there is merit in having a greater understanding of a given plan’s sensitivity to various factors. That being said, the expectation is that the calculations required by the*

*NOI will be complex and thus result in a significant increase in valuation costs, which is of concern.*

- *We appreciate and agree with the importance of increasing stakeholders’ awareness of the various risks associated with pension plans. With that said, we do not believe that funding reports are an appropriate venue for this type of analysis.*
- *We think that funding risk analysis and its subsequent disclosure should only be done when a plan sponsor requests it—with the analysis tailored to the circumstances of the plan and plan sponsor.*
- *The suggested additional disclosure is arbitrary and does not enhance the disclosures of funding risks in any meaningful way.*
- *We do not agree with additional disclosures for statutorily required reports on the basis of usefulness and costs.*
- *We support the objectives sought, but even so, disagree with the proposed new disclosures.*
- *I am greatly concerned by the NOI due to the effect it will have on the work required, thus the cost, to perform an actuarial valuation for funding purposes.*

**DG Responses**

Issue	DG Response
Drivers of change	<ul style="list-style-type: none"> <li>▪ The genesis can be traced as far back as this 2008 <u>NOI</u>, key outcomes of which were the current 1 percent discount rate sensitivities and the solvency incremental cost, which may then be thought of as interim steps on the path to more holistic disclosures.</li> <li>▪ Consideration of changes in these areas is not restricted to Canada, and we took note of the <u>U.S. approach</u> as well as the <u>first EU stress test for occupational pensions</u>.</li> </ul>
Usefulness and ease of application	<ul style="list-style-type: none"> <li>▪ The DG deliberated the merits of a prescriptive approach as per the NOI or a more principles-based approach which would be more practical but, some feel, increase the professional risk for actuaries. Ultimately, the DG decided to retain the current 1 percent discount rate sensitivities, but to adopt a more principles-based approach for the new disclosures, while focusing on the same risks. For this purpose, the approach adopted for dynamic capital adequacy testing (DCAT) under the practice-specific standards for insurance was leveraged.</li> <li>▪ It is recognized that the principles-based approach may increase the need for educational guidance, and it remains the expectation that the revisions would be supplemented by related guidance.</li> </ul>
Mandatory versus optional and costs	<ul style="list-style-type: none"> <li>▪ The DG expects that the additional risk assessments would be performed in many cases. Nonetheless, it is proposed that the assessments not be done when precluded by the</li> </ul>

	<p>terms of the engagement. Deemed immateriality represents one circumstance envisaged where the work not necessarily be done, and there may be other appropriate cases such as in respect of plans in the process of being merged (where assessments for the successor plan may suffice) or wound up.</p> <ul style="list-style-type: none"> <li>▪ This may help to address the cost issue, but the DG does not believe that cost in isolation ought to be the primary determinant of whether the assessments are performed.</li> </ul>
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The DG took note of the specific comments on the various additional risk assessments. The DG reaffirmed its belief that the risks under focus (interest rate risk; deterioration of asset values; longevity risk; “contribution base” risk for fixed contribution plans) are appropriate. Furthermore, given the change from a prescriptive to a more principles-based approach, the context for some specific comments has changed and it would therefore be appropriate to await any further comments following release of the exposure draft (ED) before responding in more detail.

For ease of reference, the DG would like to highlight the following additional changes from the NOI to the ED:

- Designated plans (maximum funding valuations thereof) and plans not registered under a pension benefits standards act of a province or the federal government of Canada would be exempt.
- The additional risk assessments would be performed on a going concern basis only.
- For fixed contribution plans, it has been clarified that the disclosure of stochastic funding model results would be required only where actuarial certification of the funding of the plan in accordance with the law or any regulatory policy or guideline is directly dependent on the results of a stochastic funding model regarding the adequacy of the contributions to the plan to sustain one or more target levels of benefits from the plan.
- For fixed contribution plans, the reference to a drop in the active membership has been replaced by a reference to a drop in the contribution base.
- A going concern gain and loss analysis would no longer be required where the going concern valuation is based on an extrapolation of results disclosed in a previous external user report.
- The ED anticipates an effective date on or after February 1, 2018.

### 3260 Reporting: External User Report

- .01 An external user report on work pursuant to section 3200 should:
- Include the calculation date, the report date, and the next calculation date;
  - Describe the sources of membership data, plan provisions, and the pension plan's assets, and the dates at which they were compiled;
  - Describe the membership data and any limitations thereof;
  - Describe the tests applied to determine the sufficiency and reliability of the membership data and plan asset data for purposes of the work;
  - Describe the assets, including their market value and a summary of the assets by major category;
  - Describe the pension plan's provisions, including the identification of any pending definitive or virtually definitive amendment;
  - Disclose subsequent events of which the actuary is aware, whether or not the events are taken into account in the work, or, if there are no subsequent events of which the actuary is aware, include a statement to that effect;
  - State the type of each valuation undertaken under the terms of the appropriate engagement; and
  - Describe any significant terms of the appropriate engagement that are material to the actuary's advice. [Effective December 30, 2012]

.02 For each going concern valuation undertaken by the actuary, the external user report should:

- Describe the rationale for any assumed additional returns, net of investment management expenses, from an active investment management strategy as compared to a passive investment management strategy, included in the discount rate assumption;
- Report the funded status at the calculation date and the service cost or the rule for calculating the service cost between the calculation date and the next calculation date;
- Disclose any pending but definitive or virtually definitive amendment of which the actuary is aware, and whether or not such amendment has been included in determining the funded status and the service cost;
- Describe any contingent benefits provided under the pension plan and the extent to which such contingent benefits are included or excluded in determining the funded status and the service cost;
- Describe any benefits that are not contingent benefits and that have been excluded in determining the funded status and the service cost; and
- If there is no provision for adverse deviations, include a statement to that effect. [Effective March 31, 2015]

.03 If an external user report includes one or more going concern valuations then the external user report should, for at least one such valuation included in the report, describe and quantify the gains and losses between the prior calculation date and the calculation date, unless the going concern valuation is based on an extrapolation of results disclosed in a previous external user report. [Effective Month XX, 201X]

~~.04 Repealed If an external user report includes one or more going concern valuations, other than a valuation for the purpose of determining the maximum funding permitted by law for a "designated plan", as that term is defined in the Income Tax Regulations (Canada), then the external user report should, for at least one such valuation included in the report, report the effect of using a discount rate 1.0% lower than that used for the valuation on:  
The actuarial present value, at the calculation date, of projected benefits allocated to periods up to the calculation date; and  
The service cost or the rule for calculating the service cost between the calculation date and the next calculation date. [Effective December 30, 2012]~~

.05 For each hypothetical wind-up valuation and solvency valuation undertaken by the actuary, the external user report should:

- Describe the basis for inclusion and the amount considered in respect of a letter of credit of which the pension plan is the beneficiary;
- Report the funded status at the calculation date;
- Include a description of the postulated scenario; and
- Include a description of the extent to which contingent benefits provided under the pension plan are included or excluded in determining the funded status. [Effective March 31, 2015]

~~.06 Repealed If an external user report includes one or more hypothetical wind-up valuations or solvency valuations then, for any one such hypothetical wind-up valuation or solvency valuation, the external user report should:~~

- ~~• Report the incremental cost between the calculation date and the next calculation date, in respect of the defined benefit portion of the plan;~~
- ~~• If the external user report does not include a going concern valuation, report the incremental cost between the calculation date and the next calculation date in respect of the defined contribution portion of the plan;~~
- ~~• Report the effect on the hypothetical wind-up or solvency liabilities, at the calculation date, of using a discount rate 1.0% lower than that used for the valuation; and~~
- ~~• If the external user report does not include a going concern valuation, describe and quantify the gains and losses between the prior calculation date and the calculation date;~~

~~unless~~

- ~~• The pension plan is a “designated plan” which has, as members, only persons “connected” with the employer as those terms are defined in the Income Tax Regulations (Canada); or~~
- ~~• The hypothetical wind-up valuation or solvency valuation is based on an extrapolation of results disclosed in a previous external user report.~~

.06.1 For each valuation that is not a going concern valuation, a hypothetical wind-up valuation, or a solvency valuation, the external user report should:

- Include a description of the extent to which contingent benefits provided under the pension plan are included or excluded. [Effective March 31, 2015]

.06.2 If an external user report includes one or more going concern valuations then the external user report should, for at least one such valuation included in the report, report the effects of using a discount rate 1.0% lower than that used for the valuation on:

- The actuarial present value, at the calculation date, of projected benefits allocated to periods up to the calculation date; and
- The service cost or the rule for calculating the service cost between the calculation date and the next calculation date;

unless

- The purpose of the valuation is the determination of the maximum funding permitted by law for a “designated plan”, as that term is defined in the Income Tax Regulations (Canada); or
- The going concern valuation is for a pension plan which is not registered under a pension benefits standards act of a province or the federal government of Canada; or
- The going concern valuation is based on an extrapolation of results disclosed in a previous external user report.

.06.3 If an external user report includes one or more hypothetical wind-up valuations or solvency valuations then, for any one such hypothetical wind-up valuation or solvency valuation, the external user report should:

- Report the incremental cost between the calculation date and the next calculation date, in respect of the defined benefit portion of the plan;
- If the external user report does not include a going concern valuation, report the incremental cost between the calculation date and the next calculation date in respect of the defined contribution portion of the plan;
- Report the effect on the hypothetical wind-up or solvency liabilities, at the calculation date, of using a discount rate 1.0% lower than that used for the valuation; and
- If the external user report does not include a going concern valuation, describe and quantify the gains and losses between the prior calculation date and the calculation date;

unless

- The pension plan is a “designated plan” which has, as members, only persons “connected” with the employer as those terms are defined in the Income Tax Regulations (Canada); or
- The hypothetical wind-up valuation or solvency valuation is for a pension plan which is not registered under a pension benefits standards act of a province or the federal government of Canada; or
- The hypothetical wind-up valuation or solvency valuation is based on an extrapolation of results disclosed in a previous external user report.

.06.4 Where contributions are fixed or restricted by the terms of the pension plan or other governing documents, and the actuarial certification of the funding of the plan in accordance with the law or any regulatory policy or guideline is directly dependent on the results of a stochastic funding model regarding the adequacy of the contributions to the plan to sustain one or more target levels of benefits from the plan, the report should disclose the stochastic funding model results which are relevant to the provision of the actuarial certification. [Effective Month XX, 201X]

**Plausible adverse scenarios**

.06.5 A plausible adverse scenario would be a scenario of adverse but plausible assumptions, relative to the best estimate assumptions otherwise selected for the valuation, about matters to which the pension plan's financial condition is sensitive. Plausible adverse scenarios vary among pension plans and may vary over time for a particular pension plan.

.06.6 If an external user report includes one or more going concern valuations, then the actuary should consider threats to the pension plan's future financial condition under plausible adverse scenarios that include, where appropriate, the following risks:

- Interest rate risk, the potential that interest rates will be lower than expected;
- Deterioration of asset values;
- Longevity risk, the potential that pension plan members will live longer than expected;
- For pension plans where contributions are fixed or restricted by the terms of the plan or other governing documents, the potential that the contribution base will be lower than expected;

unless

- The pension plan is a "designated plan" which has, as members, only persons "connected" with the employer as those terms are defined in the Income Tax Regulations (Canada); or
- The valuation is for a pension plan which is not registered under a pension benefits standards act of a province or the federal government of Canada; or
- The valuation is based on an extrapolation of results disclosed in a previous external user report; or
- The terms of the appropriate engagement under which the work is being performed preclude the actuary from conducting these risk assessments while causing no conflict with the law. In such an event, the actuary should disclose the preclusion in the external user report. [Effective Month XX, 201X]

.06.7 In considering the plausible adverse scenarios, the actuary may:

- Make reasonable determinations of the asset classes which are classified as fixed income investments;
- Restrict the impact of interest rate risk to the asset classes deemed to be fixed income investments and to the discount rate to the extent that the discount rate is affected by fixed income investments;
- Assess the impact of the risks in combination, but the actuary would not be required to do so;
- Reflect the impact of any compensating adjustments, such as a potential reduction in any margin implicit in the discount rate in response to a lower interest rate scenario;
- Reference any related work, such as asset-liability modelling work, with which the actuary has been involved or which has otherwise been made available to the actuary.

.06.8 If an external user report includes one or more going concern valuations, then the external user report should, for at least one such valuation included in the report, report the effects on:

- The funded status of the plan on a market value or smoothed value basis at the calculation date, separating the effects on assets and liabilities, where applicable; and
- The service cost or the rule for calculating the service cost between the calculation date and the next calculation date;

of the plausible adverse scenarios selected by the actuary for the risk assessments under paragraph 3260.06.6. [Effective Month XX, 201X]

- .07 An external user report that provides advice on funding should:
- Describe the determination of contributions or a range of contributions between the calculation date and the next calculation date;
  - If contributions are fixed by the terms of the plan or other governing documents, then either:
    - Report that the contributions are adequate to fund the pension plan in accordance with the law; or
    - Report that the contributions are not adequate to fund the pension plan in accordance with the law; and
      - Describe the contributions required to fund the pension plan adequately in accordance with the law;
      - Describe one or more possible ways in which benefits may be reduced such that the contributions would be adequate to fund the pension plan in accordance with the law; or
      - Describe a combination of increases in contributions and reductions in benefits that would result in the funding being adequate to conform to the law.
- .08 An external user report should provide the following four statements of opinion, all in the same section of the report and in the following order:
- A statement regarding membership data, which should usually be, “In my opinion, the membership data on which the valuation is based are sufficient and reliable for the purpose of the valuation.”;
  - A statement as to assumptions, which should usually be, “In my opinion, the assumptions are appropriate for the purpose(s) of the valuation(s).”;
  - A statement as to methods, which should usually be, “In my opinion, the methods employed in the valuation are appropriate for the purpose(s) of the valuation(s).”; and
  - A statement as to conformity, which should be, “This report has been prepared, and my opinions given, in accordance with accepted actuarial practice in Canada.”
- .09 An external user report should be sufficiently detailed to enable another actuary to assess the reasonableness of the valuation. [Effective December 30, 2012]

### Membership data

- .10 Any assumptions and methods used in respect of insufficient or unreliable membership data would be described.
- .11 The actuary may describe limitations on the tests conducted in the review of the data which has been determined to be sufficient and reliable for purposes of the valuation(s). For example, the actuary may describe that the data tests will not capture all possible deficiencies in the data and reliance is also placed on the certification of the plan administrator as to the quality of the data.

### Types of valuations

- .12 The external user report may provide information with respect to multiple valuations, but would, as a minimum:

- If the pension plan is a registered pension plan and is not a “designated plan”, as that term is defined in the Income Tax Regulations (Canada), provide information with respect to:
  - A going concern valuation, if mandated by law or specified by the terms of an appropriate engagement;
  - A hypothetical wind-up valuation under the scenario regarding the circumstances resulting in the wind-up that, subject to paragraph 3260.19, maximizes the wind-up liabilities, unless the pension plan and the law do not define the benefits payable upon wind-up; and
  - Any other hypothetical wind-up or solvency valuation mandated by law;
- If the pension plan is a “designated plan” as that term is defined in the Income Tax Regulations (Canada), provide information with respect to:
  - A going concern valuation, if mandated by law or specified by the terms of an appropriate engagement;
  - A hypothetical wind-up valuation under the scenario regarding the circumstances resulting in the wind-up that, subject to paragraph 3260.19, maximizes the wind-up liabilities, unless the pension plan and the law do not define the benefits payable upon wind-up or the plan has, as members, only persons “connected” with the employer as that term is defined in the Income Tax Regulations (Canada); and
  - Any other hypothetical wind-up or solvency valuation mandated by law;

and

- If the pension plan is not a registered pension plan, include information with respect to the types of valuations required by the circumstances of the work.

### **Significant terms of appropriate engagement**

- .13 Significant terms of the appropriate engagement may include matters like:
- The use of a specified actuarial cost method;
  - The use of a specified asset valuation method;
  - The exclusion of benefits for purposes of a valuation, as permitted by law;
  - The extent of margins for adverse deviations, if any, to be included in selecting assumptions;
  - A policy to fund only the minimum contributions required by law; and
  - Specified methodology for the determination of contribution requirements in excess of the requirements of law.

### **Service cost**

- .13.1 For a plan that is a hybrid of a defined contribution pension plan and a defined benefit pension plan, the service cost for a going concern valuation would include the service cost in respect of both the defined contribution portion of the plan and the defined benefit portion of the plan.

### **Reporting gains and losses**

- .14 The reported gains and losses for a going concern valuation would include the gain or loss due to a change in the actuarial cost method or a change in the method for valuing the assets and each significant change in assumptions and plan provisions determined at the calculation date. If an amendment to the pension plan prompts the actuary to change the assumptions, the actuary may report the combined effect of the amendment and the resultant change in assumptions.

### **Discount rate sensitivity**

- .15 When following the recommendations to illustrate the effect of a change in discount rate on a valuation, the actuary would maintain all other assumptions and methods as used in the underlying valuation.

### **Incremental cost**

- .15.1 The incremental cost for a hypothetical wind-up valuation or a solvency valuation represents the present value, at the calculation date, of the expected aggregate change in the hypothetical wind-up liability or solvency liability between the calculation date and the next calculation date, increased for expected benefit payments between the calculation date and the next calculation date.

### Methods

- .16 For each valuation included in the external user report for which there was a prior valuation, the description of the actuarial cost method would include a description of any change to the actuarial cost method used in the prior valuation and the rationale for such change.
- .17 For each valuation included in the external user report for which there was a prior valuation, the description of the method to value the assets would include a description of any differences in change to the asset valuation method used in the prior valuation and the rationale for such change.

### Assumptions

- .18 For each valuation included in the external user report for which there was a prior valuation, the description of assumptions would include a description of each change to the assumptions from the assumptions used in the prior valuation.
- .18.1 When describing the assumptions for methods of settlement for a hypothetical wind-up or solvency valuation, the actuary would describe any related limitations. For example:
- If the settlement method assumes that annuities would be purchased but it might not be possible to purchase annuities on actual wind-up of the plan due to capacity limitations; or
  - If the settlement method assumes the exercise of regulatory discretion, a change in law, or a plan amendment for which there is no specific authority.

### Scenario that maximizes wind-up liabilities

- .19 In reporting the funded status of the pension plan under the scenario regarding the circumstances resulting in the wind-up that maximizes the wind-up liabilities, the actuary would include benefits that are contingent upon the scenario regarding the circumstances resulting in the wind-up or mandated by law. However, the actuary may disregard:
- Benefits that are contingent upon a factor other than the scenario regarding the circumstances resulting in the wind-up or as mandated by law; and
  - Possible plan member earnings after the calculation date.

### Other types of valuations

- .19.1 Valuations that are not going concern valuations, hypothetical wind-up valuations, or solvency valuations are usually similar in nature to one of these three types of common valuations. In preparing the external user report for such a valuation, the actuary would consider the relevant reporting requirements for a type of valuation similar to the valuation undertaken and would include additional disclosures as appropriate.

**Statements of opinion**

- .20 Where different statements of opinion apply in respect of different purposes of the valuation, the above requirements may be modified but would be followed to the extent practicable.
- .21 While a separate statement regarding assumptions would generally be included in respect of each purpose of the valuation, the statements regarding assumptions may be combined where the statements do not differ among some or all of the valuation's purposes. The report would indicate clearly which statement regarding assumptions applies to each of the valuation's purposes.
- .22 While a separate statement regarding methods would generally be included in respect of each purpose of the valuation, the statements regarding methods may be combined where the statements do not differ among some or all of the valuation's purposes. The report would indicate clearly which statement regarding methods applies to each of the valuation's purposes.