Canadian Institute of Actuaries | Institut canadien des actuaires

March 9, 2018

Michael Puskaric
Director, Public Sector Accounting Board
Public Sector Accounting Board
277 Wellington Street West
Toronto, ON M5V 3H2

Dear Mr. Puskaric,

The Canadian Institute of Actuaries (CIA) is the national, bilingual organization and voice of the actuarial profession in Canada. Its members are dedicated to providing actuarial services and advice of the highest quality. The Institute holds the duty of the profession to the public above the needs of the profession and its members.

The CIA is pleased to comment on the consultation paper entitled "Employment Benefits: Discount Rate Guidance in Section PS 3250". We have responded to the 14 questions posed in the document.

Question 1: Do you agree that PSAB needs to consider whether the discount rate guidance in RETIREMENT BENEFITS, Section PS 3250, is appropriate and sufficient?

Yes, we agree that PSAB needs to review and clarify the discount rate guidance in Retirement Benefits, Section PS3250. We observe a wide range of approaches being used by entities reporting under PS3250, which leads to significant variability in the discount rates used to calculate accrued benefit obligations. We would also encourage the development of more guidance that would allow for the determination of discount rates to be done more consistently.

Question 2: What challenges do you have, if any, in applying the discount rate guidance in Section PS 3250?

We believe that the current version of section PS 3250 could provide more guidance on the determination of a discount rate for unfunded plans when an entity's cost of borrowing is used as a reference. This is particularly relevant for entities that do not have debt or are unable to borrow. Furthermore, added guidance around the type of debt or characteristics of the debt to be used in setting the discount rate would be beneficial as well.

Question 3: What discount rate bases do you use in estimating accrued benefit obligation? If different discount rate bases are used for fully funded, partially funded and unfunded benefit plans, please identify them separately.

Typically, the expected return on plan assets is used to establish a discount rate for funded plans. For partially funded and unfunded plans, the most common approach is to set the discount rate in reference to the entity's cost of borrowing.

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Question 4: If you use the expected return on plan assets as the discount rate basis in estimating accrued benefit obligation, please answer the following:

(a) How do you determine the discount rate?

Ultimately, it is the entity's responsibility to determine the discount rate assumption. Nevertheless, when actuaries are asked for input on this assumption, or assist with the preparation of the financial statement calculations, the CIA Standards of Practice require that actuaries consider relevant Standards of Practice and published CIA educational notes.

Typically, the actuary's discount rate recommendation would be determined as the estimated returns for each major asset class set out in the statement of investment policies and procedures, reflecting market conditions on the measurement date and the expected time horizon over which benefits are expected to be paid. Adjustments for additional returns expected due to active management of plan assets, and fees expected to be payable from the plan assets may or may not be implicitly reflected in such a rate.

(b) Do you find the discount rate guidance in Section PS 3250 sufficient?

Paragraph 0.044 references short-term forecast of rates of return on assets held in the fund on the measurement date. We believe the wording should instead reference the expected time horizon over which benefits are expected to be paid.

(c) What additional discount rate guidance would be helpful?

We are aware of differing practice regarding the reflection of future changes in the target asset allocation in the determination of the discount rate. If the decision is made to continue with the expected return on plan assets approach to determine the discount rate, then section PS 3250 should provide additional commentary regarding the use of the current asset allocation at the reporting date versus contemplated changes to the asset allocation. This would clarify the PSAB's expectation.

Question 5: If you use the entity's cost of borrowing as the discount rate basis in estimating accrued benefit obligation, please answer the following:

a) How do you determine the discount rate?

In our experience, we typically see this information provided by the reporting entity.

(b) Do you find the discount rate guidance in Section PS 3250 sufficient?

Entities use many different approaches to establish their cost of borrowing rate, from using average rates, to estimates of the costs. If the decision is made to keep the cost of borrowing as the basis for determining the discount rate, then section PS 3250 should be amended to prescribe a single approach for establishing such a rate. The approach should be unbiased and not susceptible to manipulation.

(c) What additional discount rate guidance would be helpful?

N/A

Question 6: Which of the discount rate bases identified in paragraphs .052-.092 is most appropriate for estimating the fulfillment value of the accrued benefit obligation? Please identify any guidance that may need to be considered.

The invitation to comment provides a thorough understanding of the different arguments, both for and against, for each of the different discount rate bases and discount rate views. It is clear that the PSAB comprehends the various considerations that need to be understood in order to decide which discount rate basis and view is most appropriate for estimating the accrued benefit obligation.

Furthermore, we are pleased to see that the invitation to comment recognizes that the discount rate basis selected should be assessed based on the usefulness of the resulting financial information in meeting the needs of financial statement users (paragraph .130). In addition, the invitation to comment includes a helpful description of the qualitative characteristics that produce useful financial information (paragraphs .130-.139).

Ultimately, the CIA believes that the discount rate should be established in a manner that meets the needs of the users of the financial statements; we acknowledge that those needs may differ from the needs of the underlying entity itself (i.e., the government and/or plan sponsor). Also, the CIA acknowledges that the actuarial standards and guidance that exist to determine a best estimate discount rate assumption for a going concern funding valuation for a pension plan may not be directly applicable to the development of a discount rate for the calculation of the accrued benefit obligation for accounting purposes.

While the CIA is an advocate for the actuarial profession with governments and the public in the development of public policy, we recognize that we may not be best suited to confirm to the PSAB what the needs of the users of the financial statements are. Nevertheless, and for your consideration, we offer the following commentary on determining which discount rate basis and discount rate view is most appropriate for estimating the accrued benefit obligation.

It is our belief that users of the financial statements may be better served if the discount rate is determined using a market yield (high-quality debt or risk-free debt) basis, and using a current rate view approach (as opposed to an average rate view or projected rate view approach). Based on the various pros and cons of each of the discount rate bases and discount rate views discussed in the invitation to comment, it is our belief that using a market yield basis, along with a current rate view, will provide users with an estimate of the accrued benefit obligation that is more reliable (i.e., complete, neutral, and verifiable), comparable, and understandable.

Perceptibly, and consistent with the trend in many other accounting standards, we believe that users of the financial statements may be better served if the entity has less discretion in establishing the discount rate.

For greater clarity, we believe that any estimate of the projected growth in plan assets (which would reflect any potential equity risk premium) is best not reflected in the estimate of the accrued benefit obligation (and if warranted, can be reflected elsewhere in the financial statements, such as the expected return on plan asset component of the expense).

Also, while there could be some merit to retain the cost of borrowing basis to establish the discount rate, such as the consistency of the accrued benefit obligation to the entity's other debts or borrowings, we also acknowledge the key limitations in this basis. As noted in the invitation to comment, the cost of borrowing basis does not support comparability between different entities, or promote accountability (i.e., entities with lower credit ratings would be able to recognize lower benefit obligations).

Finally, we wish to observe that a change in the discount rate basis from the current approach to a market yield approach would, in most circumstances, have a significant impact on the results set out in the financial statements for plans that develop their discount rate in reference to its expected return on plan assets. We would recommend that the PSAB further investigate the potential consequences of such a change prior to making its final decision on this issue.

Question 7: Which of the discount rate views identified in paragraphs .093-.106 is most appropriate for estimating the fulfillment value of the accrued benefit obligation? Please identify any guidance that may need to be considered.

See answer to question 6.

Question 8: Are there any discount rate bases that may be used to estimate accrued benefit obligation that have not been identified in paragraphs .052-.092?

We believe that all the key bases have been identified.

Question 9: If you support a discount rate basis that includes adjustments for risks, which risks should be included in determining the discount rate (paragraphs .040-.046 and .080-.082)?

As noted in our response to question 6, the commentary in the invitation to comment makes it clear that the PSAB comprehends the various considerations that need to be understood in order to decide which discount rate basis and view is most appropriate for estimating the accrued benefit obligation. Determining which adjustment factors are to be included in the discount rate is critical, since they will directly influence the calculation of the accrued benefit obligation.

Again, while recognizing that the CIA may not be best suited to confirm to the PSAB what the needs of the users of the financial statements are, we offer the following commentary for your consideration.

When considering the fact that the risk of non-payment of benefits in the Canadian public sector is perceived to be extremely low, and the fact that under the going concern assumption an entity would be expected to fulfil its obligations, we recognize that there is an argument for the use of a risk-free discount rate.

However, for some of the other arguments raised in the invitation to comment, we believe it could be prudent to include adjustments for credit risk and liquidity risk, but it would be our expectation that such adjustments would be relatively limited in nature (i.e., perhaps generating a discount rate that would be no higher than a discount rate determined using the market yield on high-quality debt instruments).

Question 10: ***Are there any practical issues related to determining discount rates for which further guidance may need to be considered that have not been identified in the Invitation to Comment (specifically in paragraphs .065, .070, .076, .101, .105 and .107-.110)?***

To reiterate our response to question 2, if the cost of borrowing approach is used as a basis for determining discount rates, guidance should be provided to entities that do not have debt or are unable to borrow. Added guidance around the type of debt or characteristics of the debt to be used would be beneficial as well.

Question 11: ***Do you support using different discount rate bases/views for fully funded, partially funded and unfunded benefit plans? If yes, should it be based on:***

(a) the entity's funding policy as described in paragraph .116; or

(b) the benefit plan's funding level as described in paragraph .121?

When considering the fact that an entity's funding policy or funding level does not affect the underlying promise to provide benefits payments to plan members when due[1], and the fact that the risk of non-payment of benefits in the Canadian public sector is perceived to be extremely low, it is our belief that using a single basis for discount rate setting would provide users with an estimate of the accrued benefit obligation that is more reliable (i.e., complete, neutral, and verifiable), comparable, and understandable.

Question 12: ***If you support using different discount rate bases/views for fully funded, partially funded and unfunded benefit plans, which of the discount rate basis/view (paragraphs .050-.106) is most appropriate for estimating the fulfillment value of the accrued benefit obligation of:***

(a) a fully funded benefit plan;

(b) a partially funded benefit plan; and

(c) an unfunded benefit plan.

See answer to question 11.

Question 13: ***Are there any reasons that a discount rate approach taken for estimating accrued pension benefit obligation would not be appropriate for estimating accrued non-pension benefit obligation?***

See answer to question 11.

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[1] As is the case for traditional defined benefit plans. We note that the accounting for plans with risk-sharing features different from traditional defined benefit plans could differ, and that the PSAB will explore the accounting treatment for these types of plan in a future project.

Question 14: As shown in Chart 2, market yields of high-quality debt instruments at the reporting date is a discount rate used in most other equivalent standards reviewed by PSAB. Are there any reasons that can justify that the public sector in Canada is different from the others?

We believe it is plausible that the users of public sector financial statements may have different needs and expectations compared to the users of private sector financial statements. Thus, it may be justifiable that the accounting standards for the public sector differ from other accounting standards. Also, and as the PSAB is undoubtedly aware, there are already many other differences in the accounting standards for employee benefits, other than the guidance provided on the discount rate assumption.

Conclusion

Thank you for taking the time to consider our comments. In summary, we support greater guidance to the extent that it results in a narrowing of the range of practice. The CIA has extensive experience with developing guidance for our members, and we would be willing to assist in this effort. If you have any questions, please feel free to contact Chris Fievoli, CIA staff actuary, communications and public affairs, by telephone at 613-656-1927, or by e-mail at chris.fievoli@cia-ica.ca.

Yours truly,

Sharon Giffen
President, Canadian Institute of Actuaries