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Subject: Employee Benefits, Proposed Section PS 3251

The Canadian Institute of Actuaries (CIA) is pleased to submit the following response to the "Exposure Draft – Employee Benefits, Proposed Section 3251." We have responded to the questions posed at the start of the draft, although for some questions we have not formulated a response.

As a preface to our responses, the CIA would like to reiterate our position on the discount rate. We acknowledge that PSAB addressed this issue in its 2018 discount rate invitation to comment, however, we feel strongly on this critical issue and would like to share again our views from our comments dated March 9, 2018:

> 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.
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> … 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.
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> 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.

The views expressed above relate to pure defined benefit plans. Further effort is necessary to determine an appropriate accounting treatment for plans with significant risk-sharing and cost-

sharing elements. We understand that PSAB intends to consider this issue in future phases of the project.

1. Do you find the scope of this standard (paragraphs PS 3251.004-.008) to be clear? If not, please describe the situations for which the scope is unclear.

The scope of the standard is clear; however, we note that self-insured workers' compensation plans, which we believe would be covered under this standard, are not specifically referenced in the document.

2. Do the definitions contained in the Glossary help you interpret and apply the standard as it relates to the proposals outlined within this Exposure Draft? If not, what further clarifications or additional definitions are necessary?

Under the definition of a joint defined benefit plan, subparagraph (d) we suggest the words "on an equitable basis" could be removed, as not all risks may be shared equitably.

Although it's not included in the glossary, more clarification is needed around the definition of the partially funded plan. The definition outlined in paragraph PS 3251.115 is not consistent with the partially funded plan criteria outlined in the funding assessment described in PS 3251.107. We note that paragraph PS 3251.105 already defines a partially funded plan, resulting in paragraph PS 3251.115 being unnecessary.

3. Would applying the guidance for recognizing a public sector entity's net defined benefit cost related to defined benefit plans that share risks between public sector entities under common control (paragraphs PS 3251.039-.042) change the accounting treatment for your involvement in a post-employment benefit plan? Please explain.

No response.

4. Is the guidance on category-wide plans (paragraphs PS 3251.043-.046) relevant for the Canadian public sector? If not, why?

No response.

5. Paragraph PS 3250.109 states that "sufficient information to follow the standards for defined benefit plans is not normally available for each participating employer other than the sponsoring government. For this reason, a multi-employer plan is accounted for by each participating government following the standards for defined contribution plans." Proposed paragraph PS 3251.033 of this Exposure Draft also states that when sufficient information is not available to use defined benefit accounting, a public sector entity should account for the plan as if it were a defined contribution plan. Would applying the guidance provided in proposed paragraphs PS 3251.033 and PS 3251.035 of this Exposure Draft change the accounting treatment for your involvement in a multi-employer plan? Please explain.

The appropriate accounting treatment for the participating employer should be based on the nature of the risks to which they are exposed. If their risks are the same as they would be if they participated in a pure defined benefit plan, they should account for their participation on a

defined benefit basis. Similarly, if their risk exposure is similar to a defined contribution plan, they should account on a defined contribution basis.

Most Canadian multi-employer public sector pension plans are neither pure defined benefit plans nor pure defined contribution plans. Most involve forms of risk-sharing and/or cost-sharing. Consequently, the participating employers in such plans are not exposed to the same risks as they would be if they participated in a pure defined benefit plan – and hence a pure defined benefit accounting treatment may not be appropriate. We believe that further effort is necessary to determine an appropriate accounting treatment for these types of plans and understand that PSAB intends to consider this issue in future phases of the project.

Deciding whether to account for participation in a multi-employer defined benefit plan on a defined benefit basis or a defined contribution basis is a critically important decision. The choice could have a material impact on the financial statements of the employer. As noted above, we believe that the appropriate accounting treatment should be based on the nature of the risks to which the participating employer is exposed.

The current draft standards allow wide latitude for participating employers to choose the approach that they prefer. As has been the case historically, the vast majority of employers are likely to follow the standards for defined contribution plans if they are given the choice (since defined contribution accounting is simpler to apply, avoids the need to disclose pension liabilities, and produces less volatile results). In order to narrow the range of practice and improve comparability of financial statements, there should be specific guidance as to what constitutes "sufficient information" to follow the standards for defined benefit accounting.

Employers participating in large multi-employer defined benefit pension plans are unlikely to ever have complete data necessary to develop precise estimates of their pension liabilities. This is particularly true if there is a large number of participating employers and there is significant movement between those employers. Tracking the movement of members as they terminate from one employer and/or potentially merge their membership from previous employment is likely to become very complicated very quickly. Most participating employers are unlikely to have the data or in-house expertise to perform these calculations. Consequently, it is likely that the pension plans themselves or their external advisors would need to do the calculations. We expect that this would result in significant effort and resources to perform this tracking.

Notwithstanding these complications and the resulting administrative costs and efforts, it should be possible for multi-employer defined benefit plans to develop reasonable estimates of the pension liabilities for the participating employers.

If the risks to which the participating employer is exposed are similar to those to which they would be exposed in a pure defined benefit plan, the default approach should be defined benefit accounting. Participating employers who wish to use defined contribution accounting should need to demonstrate why the results of defined benefit accounting would be inferior to defined contribution accounting in their particular situation. As noted in the C.D. Howe commentary, "Gaps, Quirks and Fixes: Accounting for Broader Public-Sector Pension Plans in Canada," "It is better to be roughly right than precisely wrong in financial reporting. Employers

who are incurring and/or already bear material risk and show nothing on their statements of operations and financial position are being precise – zero is a precise number – and wrong."

6. **Is the guidance on assessing the funding status of a plan (paragraphs PS 3251.105-.110) clear and sufficient to determine funding status for identifying the appropriate rate to use to discount post-employment benefit obligations? If not, why?**

As noted at the outset of this letter, the CIA's view is that users of financial statements would be better served if a discount rate based on high-quality or risk-free bond yields were used to measure liabilities and costs for pure defined benefit plans. The appropriate measure of defined benefit liabilities for financial reporting purposes should not be dependent on how the benefits are funded. Consequently, we believe that determination of the appropriate discount rate should be independent of whether the plan is fully funded, partially funded, or unfunded. Our preference is that the proposed approach be discarded in favour of a bond yield approach for all plans. This is consistent with the approach used for both international private sector and public sector standards.

With that being said, we offer the following additional comments if PSAB decides to maintain the proposed approach.

The guidance is not straightforward and has some technical issues.

Specifically, including cash flows (benefit payments and contributions) for service accruing after the balance sheet date would be inappropriate. Accounting obligations for employee benefits are based on benefits attributed for service rendered to the balance sheet date, and this should apply to partially funded plans, as well. It could be appropriate to include contributions that are associated with past service, e.g., deficit funding.

Further, from a practical standpoint, we suggest that the order in which the funding status of a plan is determined be revised – the concepts of paragraph PS 3251.110 should be placed between paragraphs PS 3251.106 and PS 3251.107. This would avoid needless complicated calculations from being required if a plan is deemed to be a fully funded plan.

An example of a technical issue is that the "normal cost" used in the future contributions is based on the existing demographics. In a future projection, the "normal cost" would have to be projected and adjusted to reflect the expected future population. In addition, future contributions would not be clear and obvious at the balance sheet date. For plans with existing or potential future special payment contributions due to deficiency, it's also not clear if the existing or potential future special payments should be reflected in the funding assessment.

Also see comments in response to question 8. Even after some of these technical issues are resolved, we expect this type of projection would only be accessible to the larger and more sophisticated organizations.

We would encourage a much simpler and appropriate approach of comparing accrued assets to accrued benefits for the existing employee group – and while there are technical issues for this calculation, we believe it is much simpler than the one proposed. In this calculation, it could be appropriate to include contributions that are associated with past service, e.g., deficit funding.

PS 3251.110 will allow significant “professional judgment.” It’s not clear who would be in a position to opine on this “professional judgment.” If a qualified actuary is required to opine, the CIA would likely need to create some additional professional standards.

7. **Do you agree with the proposed discount rate approaches for fully funded (paragraphs PS 3251.111-.114), partially funded (paragraphs PS 3251.115-.117) and unfunded plans (paragraphs PS 3251.118-.120)? If not, please specify which approach you disagree with and why.**

As noted at the outset of this letter, the CIA’s view is that users of financial statements would be better served if a discount rate based on high-quality or risk-free bond yields were used to measure liabilities and costs for pure defined benefit plans. The appropriate discount rate used to measure defined benefit liabilities for financial reporting purposes should not be dependent on how the benefits are funded. Consequently, we believe that determination of the appropriate discount rate should be independent of whether the plan is fully funded, partially funded, or unfunded. Our preference is that the proposed approach be discarded in favour of a bond yield approach for all plans. This is consistent with the approach used for both international private sector and public sector standards.

With that being said, we offer the following additional comments if PSAB decides to maintain the proposed approach.

For fully funded plans, ultimately, it will be the entity’s responsibility to determine the discount rate assumption. Nevertheless, when actuaries are asked for input on this assumption, or to assist with the preparation of the financial statement calculations, the CIA *Standards of Practice* requires 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.

For unfunded plans, we support using an external benchmark such as provincial borrowing rates. This is particularly relevant for entities that do not have debt or are unable to borrow.

8. **Do you foresee any challenges that may result from the proposed approach (paragraphs PS 3251.105-.110) to assessing the funding status of a post-employment benefit plan in order to determine the appropriate rate for discounting the post-employment benefit obligation? If so, please explain the source of those challenges and any modifications to the proposed guidance that would assist in reducing or eliminating those challenges.**

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 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 for pure defined benefit plans 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). 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.

Please also see our response to question 6, as it identifies some of the challenges and flaws in the proposed approach.

9. Do you foresee any challenges that may result from the proposed approach to apply a single discount rate to partially funded plans as outlined in paragraphs PS 3251.115-.117? If so, please explain the source of those challenges and any modifications that would assist in reducing or eliminating those challenges.

A single discount rate makes the financials more understandable and, as such, we would not be opposed as long as the single discount rate would not materially impact the answer versus separate discount rates.

10. Do you agree that revaluations on the net defined benefit liability (asset) should be recognized in net assets without subsequent recognition in surplus or deficit (paragraphs PS 3251.064(d) and PS 3251.144)? If not, please explain why and provide your opinion on how these amounts should be recognized.

We believe that immediate recognition of revaluations in net assets/debts without subsequent recognition in the statement of operations will improve understandability of the financial reporting. It will result in greater balance sheet volatility but a more stable income statement.

We believe that revaluations should be recognized through a mechanism like other comprehensive income under Canadian generally accepted accounting principles (GAAP) and international financial reporting standards (IFRS) standards and be excluded from net income of the income statement.

Under the current version of the exposure draft, revaluations appear to be part of the defined benefit cost (see PS 3251.143(c)) as the approval of PS 1202 is still pending. If the revaluations of the net defined benefit liability (asset) are to be recognized in the accumulated other comprehensive income component of net assets, modifications to the exposure draft will be required.

11. **PSAB acknowledges the potential increased volatility in net debt that may arise as a result of public sector entities recognizing the impact of actuarial gains and losses immediately in the net defined benefit liability (asset) as compared to the approach in Section PS 3250. Would alternative presentation or disclosure options assist in addressing concerns regarding net debt volatility? If yes, please provide an explanation of which presentation or disclosures options should be considered, and how such options would assist in addressing concerns regarding increased volatility.**

We agree with the proposed presentation. The proposed presentation provides more transparency to the reader, and it's very similar to the presentation adopted by the Canadian GAAP and IFRS standards. It also better reflects the nature of the underlying pension and benefit obligations.

12. **Do you agree with the proposed transitional provisions (paragraphs PS 3251.200-.202)? If not, what changes would you make to these provisions, and why?**

Considering the magnitude of the changes that could be faced by organizations, including impacts on measurement, timing, attribution, disclosure, and balance sheets, having a number of years to prepare for these changes is appropriate.

13. **Do the illustrative examples (Appendix) assist you with the interpretation and application of the proposed Section? If not, what additional examples would be necessary?**

The examples will assist in interpreting and applying the proposed section. However, we have concerns about the inclusion of cash flows associated with future service, which are contrary to the fundamental concept that balance sheets should reflect benefits attributed for service rendered to the balance sheet date and not beyond. We have expressed concerns about this and other technical issues in our response to question 6. An updated example to align with any revisions made to PS 3251.107 would be helpful.

A bit more nuanced of a concern is that we note in example 13 there are periods where the plan has partial assets – e.g., in years 26 onward, but all benefit payments are treated as unfunded starting at year 26. This illustration could cause confusion, as we anticipate most individuals would interpret the fractional portion of the benefits for which there are plan assets to be discounted by the expected return on assets (EROA) and the fractional portion of the unfunded benefits to be discounted by the provincial bond yield. The example should be clarified.

14. **Do you think that applying the proposals as outlined in this Exposure Draft would significantly change the understandability of financial reporting on employee benefits? If yes, please explain how understandability would be affected.**

The removal of deferred recognition of gains and losses, and the introduction of aspects of mark-to-market accounting should improve understandability. The discount rate determination for partially funded plans could be confusing, whereas, having a pan-Canadian provincial yield curve as the basis for the discount rate for unfunded plans should improve comparability and hopefully, understanding.

The use of an EROA, that only has investment expenses reflected, as the discount rate for fully funded plans could lead to confusion amongst employee groups and funders of the benefit plans. Many funding discount rates include provisions for administrative expenses along with margins for adverse deviation.

15. **Do you think that applying the proposals as outlined in this Exposure Draft would result in a change in decision making for employee benefits? If yes, please explain the cause of the change. For example, would decision making change as a result of policies already in place in your organization or would changes occur as a result of legislative requirements.**

No response.

Other comments

We believe that the exposure draft could be enhanced to clarify the treatment of administrative expenses. While IAS19, and IPSAS39 do not do explicitly address this either, the basis for conclusions for IAS19 makes it clear that administrative expenses are recognized in the income statement as they are incurred.

The CIA appreciates the opportunity to provide feedback on these issues, and we would welcome further discussion with you throughout this process.

If you have any questions, please contact Chris Fievoli, CIA Staff Actuary, Communications and Public Affairs, at 613-656-1927 or chris.fievoli@cia-ica.ca.

Sincerely,

[original signature on file]

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The Canadian Institute of Actuaries (CIA) is the qualifying and governing body of the actuarial profession in Canada. We develop and uphold rigorous standards, share our risk management expertise, and advance actuarial science for the financial well-being of society. Our more than 6,000 members apply their knowledge of math, statistics, data analytics, and business in providing services and advice of the highest quality to help ensure the financial security of all Canadians.