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Chairperson's Corner

by Carolyn E. Zimmerman

This "Chairperson's Corner" is a collection of thoughts rather than a single theme.

As I mentioned in our last issue of *Pension Section News*, this year the Pension Section Council's focus is on improving the value of the Section to its members. We have started some new initiatives based on what we believe will benefit the membership, but we would like to know what you think. (In other words, using actual information is better than making an actuarial assumption!) So, using a time-honored approach, we are enclosing a survey with this newsletter. I know that pension actuaries are notoriously busy, but please try to take some time to complete the survey and return it to Lois Chinnock at the Society office at the address indicated on the form. We are in the process of deciding which projects to support, and want to focus our efforts on issues of most importance to you.

On another front, I am very excited about the prospect of developing a training course for entry-level actuaries. We

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A New Pension Accounting Standard for Multinational Companies

by Dennis M. Polisner

In the world of employee-benefit plans, employers and their advisors are faced with requirements to comply with governmental requirements, tax regulations, and accounting standards which continue to increase in their detail and complexity. In the U.S., the focus has been on local requirements, but increasingly, multi-national companies are faced with compliance issues that vary widely from country to country.

Public companies that have operations around the world may be accounting for their pension and other long-term benefit plans both in accordance with local country accounting standards and with the standards of the parent company's country for consolidated reporting purposes. This can be a time-consuming and costly process. Many of these companies might be better served if there was a single international accounting standard which could be used to report pension costs and liabilities for all countries on a single, consistent basis. One of the principal reasons this has not occurred in the past is that each country has its own security regulation mechanism such as the SEC in the U.S. Each country's regulators have tended to require local accounting standards for companies issuing equity or debt securities.

It is first necessary to understand the structure of international regulation and standard setting in order to address the establishment of uniform standards around the world. This article briefly describes that structure, the process that is taking place to establish uniform standards, and some of the significant provisions of the new international accounting standard for pension and other postemployment benefits.

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International Regulatory Environment

There is a structure established on the international level that addresses the regulation of securities, the establishment of accounting standards, and the public opinions of the global actuarial profession on relevant issues issues.

In most industrialized countries around the world, there exists a security regulation body, an accounting standards body, and an actuarial organization. In the U.S., these bodies are the Security and Exchange Commission (SEC), the Financial Accounting Standards Board (FASB), and the American Academy of Actuaries (AAA). At an international level, a structure has been established to address security registration, accounting, and actuarial issues. This has been accomplished through the following three international organizations:

- International Organization of Security Commissions (IOSCO)
- International Accounting Standards Committee (IASC)
- International Forum of Actuarial Associations (IFAA).

Each of these three bodies comprises members from the corresponding local country organizations, and each has a similar mission—to provide a more uniform process of doing business on a global basis. It is helpful to understand a little about the specific goals of each organization.

IOSCO

The IOSCO is made up of more than 130 member agencies and has the following objectives:

- To promote high standards of regulation in order to maintain just, efficient and sound markets
- To exchange information on their respective experiences in order to promote the development of domestic markets
- To unite their efforts to establish standards and an effective surveillance of the international securities transactions
- To provide mutual assistance to promote the integrity of the markets by a rigorous application of the standards and by effective enforcement against offenses.

As a step in the furtherance of its mandate, in 1993, the IOSCO agreed on a set of core accounting standards that would comprise a comprehensive body of accounting principles for enterprises undertaking cross-border offerings and listings. In 1995, the IOSCO announced that the IASC had developed an agreeable work plan that, once successfully completed, would enable IOSCO to recommend endorsement of International Accounting Standards for cross-border capital raising and listing purposes in all global markets, particularly the U.S., Canada, and Japan. In the U.S., the SEC has said it intends to consider allowing the use of IASC standards by foreign issuers once the core standards have been completed.

IASC

The IASC, as the international counterpart to the FASB in the U.S., is the body responsible for issuing the core standards required by the IOSCO. To date, the IASC has completed many of the required core standards. The most recent was the finalization of the employee benefits standard, which was approved by the IASC in January 1998. This standard will replace the existing employee benefit standard, IAS–19.

IFAA

The IFAA was founded in 1995 and currently has 36 associations as full members from 34 countries on six continents around the world. Recognizing the important and increasing role of actuaries throughout the world, the IFAA has as its principal objective the promotion, across international boundaries, of high standards of professionalism and education within the world's actuarial associations. Among the objectives of the IFAA are the following:

- To provide a forum for discussion among actuarial associations of matters relating to the initial and continuing education of actuaries, professional conduct and discipline, the role of actuaries in relation to matters of government regulation and public policy, and the setting of standards of practice in relation to particular national and international jurisdictions
- To accredit those actuarial associations which meet agreed upon requirements in relation to the education and professionalism of its members
- To suggest, where appropriate, international standards of practice
- To represent member associations in discussions with international bodies.

Development of Employee Benefits Standard

The development of the international accounting standard on employee benefits began, after some research and study by the IASC staff, with the issuance of an exposure draft called E-54 in October 1996. In order to comply with the timetable that the IASC had established, there was very little time allowed for comments. A comment deadline of January 31, 1997 was established. The IFAA formed a subcommittee to study E-54 and to provide comments to the IASC from the international actuarial profession.

The exposure draft followed the general framework of U.S. Generally Accepted Accounting Principles (GAAP) and looked on the surface to be very much like *FAS 87*, *FAS 88*, *FAS 106*, and *FAS 112* combined into a single standard. However, there were some very significant differences in the exposure draft from U.S. GAAP. There were also some important issues that needed to be addressed in the context of a single standard applying to benefit plans in countries with diverse benefit arrangements and economic conditions. The IFAA subcommittee addressed these issues and provided a formal response to the IASC on behalf of its member associations.

Some of the significant differences between *FAS 87* and the E-54 exposure draft were as follows:

- Actuarial gains and losses were subject to a 10% corridor just as in *FAS 87*, except that amounts in excess of the corridor were to be recognized immediately instead of amortized
- The immediate recognition of gains and losses was to be those amounts which occurred in the current year.

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FAS 87 recognized gains or losses in the year following the one in which they occurred. The effect of this would have been a full recognition of amounts outside the 10% corridor, and those amounts would not be known until measured after the close of a fiscal year. This would create volatility in earnings with no possibility to plan or prepare for those fluctuations in earnings.

- Plan assets are measured at fair value under E-54 without the possibility of using a smoothed market-related value as allowed under *FAS 87*.
- There would be no required minimum liability under E-54 as is required under *FAS 87*.
- If a balance sheet asset occurs under E-54, the amount of that asset would be limited to the amount of economic value anticipated from future refunds from the plan to the employer or from future reductions in contributions. *FAS 87* has no such limitation on an asset.
- E-54 attributed costs to fiscal years on a straight-line basis as contrasted with *FAS 87*, which attributes cost to fiscal years based on the pattern of benefit accrual.
- E-54 left open the recognition of past service costs and requested comments. It presented two options. One was to recognize all past service costs immediately, and the other was to immediately recognize the past service cost for inactive participants and amortize the past service cost for active participants. Under *FAS 87*, all past service costs are amortized.
- *FAS 87* provided for amortization of any transition adjustment. E-54 did not provide any guidance in transition issues.

The IFAA subcommittee did not agree with some of the above differences with *FAS 87* and had a significant disagreement on the basis for selecting the discount rate. The discount rate was to be selected based substantially on the same criteria used for *FAS 87*. That was the rate of return on corporate bonds. The IFAA disagreed with this basis on two accounts.

First, unlike the U.S., private pensions in many countries are more a function of long-term prices and wages, and as a result, the duration of liabilities tends to be longer. The IFAA's opinion was that corporate bonds, or any other fixed-income basis, do not adequately reflect the nature of the liabilities and that a basis which included price and wage indexation would produce more appropriate measurements.

Second, from a more practical perspective, most countries outside the U.S. do not have a deep market for long-term corporate bonds.

The principal comments to the IASC by the IFAA and the final outcome are outlined below. A more complete outline of the provisions of IAS 19 and a comparison of its provisions to *FAS 87* is shown in the Appendix on pages 6–8.

Discount Rate

The IFAA argued strongly for a discount rate that would be more suitable from an actuarial perspective. This was included in the formal response and was discussed at several of the subsequent meetings of the IASC staff. The final decision of the IASC was to leave the discount rate as originally communicated in E-54 because it was not convinced that the IFAA arguments had sufficient merit. In the absence of more data, the IASC believed the discount rate as stated would provide greater comparability. The IASC, however, is now working on an insurance standard and will be developing a general standard on discounting. It has left this door open to further discussion related to those two projects and, pending the outcome, may be willing revisit the discount rate issue in IAS 19.

Gains and Losses

The IFAA proposed an alternative that provided for amortization of gains or losses and the deferral of recognition to the year subsequent to the occurrence of the gain or loss. The IASC ultimately adopted the *FAS 87* methodology which, while not what the IFAA had proposed, addressed its main concerns.

Attribution

The IFAA proposed that attribution follow a plan's benefit formula or use straight-line attribution if the formula was back-loaded. The IASC adopted this approach.

Past Service Cost

The IFAA recommended that past-service cost for active employees be amortized. The IASC adopted a position that all vested past-service cost would be recognized immediately and nonvested past-service cost amortized over a period until vested.

Unfunded Plans

Unfunded plans are more common in some countries than in others. For example, in Germany pension plans accrue book reserves and are not funded. The IFAA suggested that combining service cost, interest cost, and return-of-plan assets into a net pension cost amount would cloud comparability between funded and unfunded plans. It suggested that the interest cost and return-of-plan assets could be included as financial costs separate from the pension cost. In IAS 19, the IASC ultimately provided that these costs could be placed wherever the sponsor desires in the income statement with appropriate disclosure.

Transition

The IFAA suggested that the final statement provide guidance on transition and that a five-year transitional period be provided. The final IAS 19 standard did include transitional guidance and an optional five-year period over which to recognize transitional adjustments.

Conclusion

The international organizations have made a strong push towards allowing for uniform accounting standards across country lines and the acceptance of those standards for the purpose of listing securities. The actuarial profession has, through its international association, been able to have an impact on this process in its sphere of practice.

It remains to be seen how swiftly these international accounting standards

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will receive approval. The IOSCO will first have to approve all the core standards which have been issued by IASC. The IOSCO will then have to obtain approval from its members for local application. The outcome of this process is still uncertain, but clearly been an impressive effort has been made to date to establish a basis for global acceptance of uniform accounting for pensions and other postemployment benefits, as well as other core accounting standards.

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APPENDIX

Comparison of IAS 19 Provisions U.S. GAAP as per *FAS 87, 88, 106,* and *112* (Actuarial Valuation Method: Projected Unit Credit Method)

	International Standard IAS 19	**U.S. GAAP *FAS 87, 88, 106*, and *112***
Measurement Data	Balance sheet data	Balance sheet date or any other consistent date not more than three months prior
Attribution of Benefits to Period		
• Attribution Begins	• When employee first becomes entitled to earn benefits	• When employee first becomes entitled to earn benefits
• Attribution Ends	• When additional benefits are no longer conditional on future service other than for increases in salary	• For pensions, when additional benefits are no longer conditional on future service other than for increases in salary. For OPEBs, at full eligibility date.
• Attribution Method	• Follow benefit formula unless formula is back-loaded and then use straight-line	• Follow benefit formula unless formula is back-loaded and then use straight-line
Discount Rate	Yield on high-quality corporate bonds at balance sheet data unless, for a given country, there is no deep market for such bonds, in which case government bonds are used. Nominal rate to be used except where real terms may be more reliable such as in hyper-inflationary countries.	Effective settlement rate/return on high-quality fixed-income investments. Discount rate to be stated in nominal terms.
Other Assumptions	Reflect plan provisions or constructive obligations, be individually realistic reflecting historical data and future expectations.	Reflect plan provisions or constructive obligations, be individually realistic reflecting historical data and future expectations.
Measurement Assumes Future Benefit Increases	Only if such increases are part of the formal plan or if there is a constructive plan to provide those increases.	If part of the substantive commitment of the plan or if regular or automatic
Actuarial Gains and Losses	Gains or losses inside of 10% corridor may be ignored and amounts in excess must be spread over average future service of employees. No gains or losses are recognized until the year following the year in which they were incurred. More rapid amortization permitted.	Gains or losses inside of 10% corridor may be ignored, and amounts in excess must be spread over average future service of employees. No gains or losses are recognized until the year following the year in which they were incurred. More rapid amortization permitted.

Comparison of IAS 19 Provisions
U.S. GAAP as per *FAS 87, 88, 106,* and *112*
(Actuarial Valuation Method: Projected Unit Credit Method)

	International Standard IAS 19	**U.S. GAAP *FAS 87, 88, 106*, and *112***
Past Service Costs • Immediate or Deferred Recognition	• Immediate recognition for inactive participants and for active participants who are vested in the past service benefits. Amortization for nonvested benefits or active employees.	• Deferred recognition
• Amortization Basis	• Nonvested past service cost is to be amortized on a straight-line basis over the period until vesting is achieved.	• For pensions, over average future service period of participants. For OPEBs, over average period to full eligibility date.
• Plan Amendments that Reduce Benefits	• Treat as negative past-service cost.	• Treat as negative past-service cost.
Additional Minimum Liability	There is no additional minimum liability to be recognized.	For pensions, there is a requirement to recognize an additional minimum liability if the unfunded accrued benefit obligation (ABO) is greater than the balance sheet accrued pension cost. For OPEBs, there is no additional minimum liability requirement.
Measurement of Plan Assets	Measured at fair value for all purposes within the standard	Measured at fair value for disclosure purposes. Measured at either fair value or market-related value for the purpose of determining pension expense and applying the gain/loss corridor provisions.
Limit on Recognition of Balance Sheet Asset	Yes. Limited to the lesser of the asset than results from the application of the statement or the net total of any unrecognized past-service cost, any unrecognized losses (either inside or outside the corridor), and the present value of expected reductions in future contributions and refunds from the plan.	There is no limit on recognition of a balance sheet asset.
Curtailments and Settlements • Timing of Recognition	• When the event occurs	• For settlements, when the settlement occurs. For curtailments, when probable and estimable if it is a loss. If it is a gain, when event occurs.
• Components Included in Measurements	• Both past-service costs and unrecognized gains or losses included	• Past-service cost included in measuring curtailment gains or losses and unrecognized gains or losses included in measuring settlement gains or losses
Termination Benefits	Recognized immediately when the employer is demonstrably committed to terminate employees or to enhance benefits for a voluntary program	Recognized immediately. If voluntary, it is recognized when employees accept the offer and amount is reasonably estimable. If involuntary, when amendment or decision is made.
Multiemployer Plans with Defined-Benefit Characteristics	Use defined-benefit accounting	Use defined-contribution accounting

Comparison of IAS 19 Provisions
U.S. GAAP as per *FAS 87, 88, 106,* and *112*
(Actuarial Valuation Method: Projected Unit Credit Method)

	International Standard IAS 19	**U.S. GAAP *FAS 87, 88, 106*, and *112***
Business Combinations	Recognize all unrecognized gains or losses, past service costs and transition adjustments at the date of combination	Recognize all unrecognized gains or losses, past-service costs and transition adjustments at the date of combination
Transition Provisions	The cumulative effect of adopting the new standard can be recognized immediately as an adjustment to retained earnings, or it can be spread over up to five years	The cumulative adjustment can be amortized over the average future service period of employees or, if longer, 15 years for pensions or 20 years for OPEBs
Short-Term Post Employment Benefits	Those benefits that accumulate with employee service should be recognized as the rights of those benefits accumulate. Benefits that do not accumulate with employee service should be recognized when an event occurs.	Those benefits that accumulate with employee service should be recognized as the rights to those benefits accumulate. Benefits that do not accumulate with employee service should be recognized when an event occurs.
Effective Date	Fiscal years beginning on or after January 1, 1999. Early adoption permitted.	Effective dates were: • *FAS 87:* Fiscal years after December 15, 1986 • *FAS 106:* Fiscal years after December 15, 1992 • *FAS 112:* Fiscal years after December 15, 1993

Study Note Corner

Valuation of Pension Benefits for Disabled Participants (Course P–461U Study Note)

by Edward Sypher

The mortality rates for a pension plan's disabled participants are substantially greater than the mortality rates for the healthy participants. Experience data from some large plans show that the disabled participants can be subject to mortality rates that are two or three times as great as those for the nondisabled. Because of this, many pension actuaries choose to use separate mortality tables for their disabled populations.

In this paper, we discuss some of the considerations involved in choosing such a table. We start with a brief review of fundamental concepts and terminology used in actuarial discussions of disability. Following this, there is a discussion of common disability tables, as well as other sources of disability data (including the disability experience of the Social Security program). Finally, we address several questions that a pension actuary should consider when valuing disability benefits.

The paper addresses only the valuation of benefits to persons who are currently disabled. It does not address the prediction of future rates of incidence. Nor does it address questions of how a plan's funding method might reflect the value of disability benefits.

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