Communication of Financial Information for Social Security Systems

Eurostat/ILO/IMF/OECD Workshop on Pensions

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POTENTIAL COMMUNICATION ISSUES

- Should present appropriate stats
- Should not encourage one financing approach
- Closed Group Valuation of "Liabilities" can be 150% to 350% of GDP for many "Pay-as-you-go" or "Partially-Funded" Plans

POTENTIAL COMMUNICATIONS ISSUES

- Low Liabilities do not imply sustainability
- High Liabilities do not imply lack of sustainability

POTENTIAL COMMUNICATION ISSUES

- Need to Explain fully what numbers mean
- Could be Misused or Misinterpreted
- Could result in Erroneous Response
- A Single Figure may be Inappropriate

POTENTIAL COMMUNICATION ISSUES

- Need a Robust Framework for Effective Communication and Interpretation
- Enables Informed Decisions to be Made
- Educate Users
- Do Not Confuse or Mislead Them
- A Multiple Disclosure Approach may be best

CONTEXT: ISSA-ILO Guidelines on Actuarial Work (38)

- If Methodology for Determining Liabilities is Not Consistent with the Financing Approach:
  - Should Disclose in an Supplementary Note Alternative Calculations Consistent with the Financing Approach
  - Plus Explanations on the Different purposes of Different Sets of Results
  - And a Discussion on Long-term Sustainability

CONTEXT: IAA ISAP 2

- Actuarial Report Should:
  - Include enough information to enable sound decisions to be made
  - Indicate the nature and timing of future cash flows being quantified
  - State the nature and significance of material risks faced by the SSP
  - Indicate any material uncertainty
  - Include sensitivity tests on key variables

CONTEXT: IAA ISAP 2

- Several measures that can present the results:
  - Projected cash flows and ending position
  - Discounted cash flows
  - Required contribution rates for sustainability

CONTEXT: IAA ISAP 2

- STATE THAT:
  - The data are sufficient and reliable
  - The assumptions used are reasonable and appropriate both in the aggregate and individually; and
  - The methodology employed is appropriate and consistent with accepted actuarial practice

CONTEXT: IAA ISAP 2

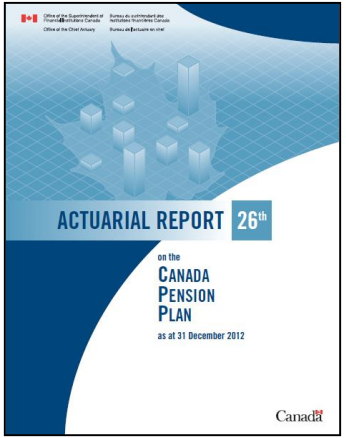
- Statement as to the extent to which the SSP is financially sustainable over the projection period
- That is, “in” cash flow will cover “out” cash flow given the assumptions

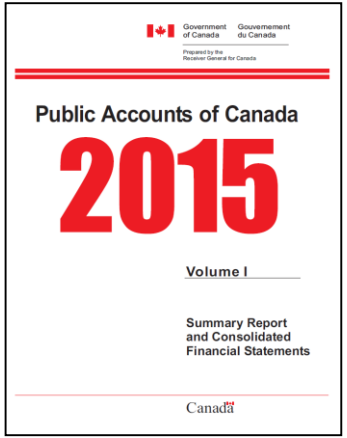
Example: Canada Pension Plan

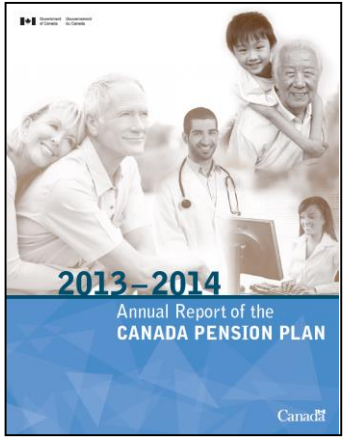
- Canada Pension Plan (CPP) is the 2nd pillar of the Canadian Retirement Income System (DB, earnings-related)
- Financed through employer/employee contributions and investment earnings
- Partial funding approach with contributions being the main source of financing
- The key legislatively prescribed measure for evaluating the CPP is the steady-state contribution rate
  - It is expected to remain below the legislated contribution rate of 9.9% of covered earnings.

Government doesn't and won't provide any subsidies to the CPP

Main sources of financial status reporting for the CPP







Long-term sustainability reporting

Consolidated Financial statements

http://www.osfi-bsif.gc.ca/Eng/oca-bac/ar-ra/cpp-rpc/Pages/cpp26.aspx
http://www.tpsgc-pwgsc.gc.ca/recgen/cpc-pac/2015/index-eng.html
http://www.esdc.gc.ca/en/reports/pension/cpp_reports/2014/cpp_report.page
http://www.esdc.gc.ca/en/reports/pension/cpp_2015.page

All three reports are tabled in Parliament

- The goals are
  - to provide stakeholders with the information on the financial status of the CPP to allow making informed decisions
  - To enable comparison of government finances
  - To educate, and not to confuse the users

Reporting should be internally consistent.

The legislation mandates regular CPP long-term sustainability reporting

- The CPP has a strong governance mechanism that is based on the triennial review of the Plan by Federal, Provincial and Territorial (FPT) Ministers of Finance
- A vital part of this review is the triennial actuarial review with its results tabled in Parliament
- Supplementary actuarial reports are prepared when the CPP is amended.

The results contained in the latest CPP Actuarial report confirm that the legislated contribution rate of 9.9% is sufficient to financially sustain the Plan over the long term.

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Automatic Balancing Mechanism of the CPP

- Self-sustaining provisions of the CPP provide additional safeguards for sustainability
- The mechanism is activated only if Finance ministers can’t agree of ways to restore CPP sustainability
- It defines the cost-sharing mechanism between contributors and beneficiaries if the Plan is deemed to be unsustainable
  - Increase in contributions and freezing of benefits indexation.

Accounting for Liabilities of SS Plans

- Any SSP with a Balancing Mechanism
  Should not Create Debt
- To Avoid Political Influence, use an Automatic
  Balancing Mechanism (also no Debt)

CPP Actuarial Reports present balance sheet information

- The main content of the CPP Actuarial Report focuses on the long-term cash flow projections to determine the steady-state contribution rate
- However, Appendix A of the report presents the CPP balance sheet
  - The main emphasis is made on the open group balance sheet

Pension system's balance sheet should reflect its financing approach

  - The information on the closed group balance sheet is presented in a footnote

Open group used to account for intergenerational risk sharing and social contract

- CPP, as a partially funded plan, represents a social contract
  - Each year current contributors allow the use of part or all of their contributions to pay current beneficiaries' benefits
  - Claims for current and past contributors to contributions of future contributors is created
  - A balance sheet should take these claims into account

These claims are not government debt.

- At any valuation date, these claims
  - could be expressed as present value of future contributions of current and future contributors
  - represent a part of system's assets
- The corresponding future benefits should also be taken into account.

Some thoughts on the closed group approach

- Closed group approach is supposed to be backward- looking. But is it really?
  - It makes assumptions about future mortality, expected rate of return, inflation, etc.
- Closed Group Valuations ignore legislated reforms not yet taking effect

Looking forward is critical for social security systems assessments

- Social security systems are fundamentally different from traditional pension plans
  - They are long-term systems affected by a country's past and future economic, demographic and policy environments
  - They are supposed to be enduring in nature and cover multiple generations
- To provide a comprehensive and objective picture, future developments should be taken into account in compiling a balance sheet for social security systems.

CPP Consolidated Financial Statements provide multiple disclosures

- **Note 13: Financing of the Canada Pension Plan**
  - Summary of the financing principles of the CPP
  - Main findings of the latest actuarial report
- **Note 14: Actuarial obligation in respect of benefits**
  - CPP balance sheet is presented under two approaches
    - open group, and
    - closed group without future accruals
- Same information is included in the Public Accounts of Canada.

Note 14 discusses the interpretation of information presented in the balance sheets

- The choice of the methodology used to produce a social security system's balance sheet is mainly determined by the system's financing approach
- The CPP was never intended to be a fully-funded plan and the financial sustainability of the CPP is not assessed based on its actuarial obligation in respect of benefits
- The CPP is intended to be long-term and enduring in nature, a fact that is reinforced by the federal, provincial, and territorial governments' joint stewardship through the established strong governance and accountability framework of the CPP.

Public Accounts of Canada favour the open group approach

"if the CPP's financial sustainability is to be measured based on its asset excess or shortfall, it should be done on an open group basis that reflects the partially funded nature of the CPP, that is, its reliance on both future contributions and invested assets as a means of financing its future expenditures." (CPP Act)

	Excluding Future Benefit Accruals	Including Future Benefit Accruals	
ent Value as at 31 Dec. 2012 billion)	Closed Group	Closed Group	Open Group
ets			
rrent Assets	175	175	175
ture Contributions	-	804	2,071
tal Assets (a)	**175**	**979**	**2,246**
ilities*			
rrent Benefits	370	370	370
ture Benefits	635	1,175	1,885
tal Liabilities (b)	**1,005**	**1,545**	**2,255**
t Excess (Shortfall) (a) – (b)	***(830)***	***(566)***	***(9)***
l Assets as a Percentage of Total ilities (%) (a)/(b)	17.4%	63.4%	99.6%

The key to good disclosure is the cooperation between professions

- The Canadian disclosure model is a result of
  - many hours of discussions,
  - efforts to understand each other's position, and
  - several compromises
    - between professionals involved in the reporting process:

Actuaries

Accountants

Auditors

The triple "A" Team!

To conclude…

- The reporting of financial information for social security systems should be internally consistent
  - The information provided should educate and not confuse
- Multiple disclosures similar to those used for the Canada Pension Plan could be the answer
- International organizations, Governments and the actuarial community should work together to develop the reporting requirements that will provide meaningful and complete information to users.

To conclude…

- Social Security Systems are secured by Intergenerational Societal Commitments
- They should not be considered as large private occupational pension schemes for reporting assets and liabilities in national accounts
- The key focus should be on Sustainability

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Thank you