

Employee's participation (contributions) to the funding of pension benefits : how to best incorporate it in the actuarial valuation of pension obligations ?

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Context

- Pension actuarial fundamentals used for (employer's) accounting purposes are under comprehensive revision globally :
 - IASB employee benefit project (July 2006) :
 - long term : “a fundamental review of all aspects of post-employment benefit accounting”
 - FASB (November 2005) :
 - “the objective of this project is to comprehensively reconsider guidance in FASB 87-88-106-112”
 - ASB (UK standard setter) designated by other national standard setters and EFRAG to lead European research on pension accounting
 - part of the IASB – FABS convergence project

Context – Example of the FABS « menu »

- *Delayed Recognition*
 - *Expected long-term return on plan assets*
 - *Actuarial gain and losses amortized subject to 10 percent corridor*
 - *Calculated value of assets for expected ROA and 10 percent corridor*
 - *Prior service costs amortized over active service period*
- *Combining of service cost, asset returns, and financing costs*
- *Insufficient information about cash flows*
- *Measurement of the liability*
 - *PBO versus ABO versus termination liability*
 - *Cash balance plans and plans with lump-sum benefits*
 - *Discount rate(s) to use*
- *Assumptions provide too much latitude*
 - *Discount rate and expected rate of return on assets.*
- *Contributions-based accounting for an employer's participation in a multiemployer plan*
- *Insufficient and overly complex disclosures.*

Context – Example of the ASB « menu »

- *how is the relationship between an employer and a pension scheme best reflected in the employer's financial statements?*
- *how should the employer's liability in respect of pensions be quantified? In particular:*
 - *what is the most appropriate actuarial method?*
 - *should the employer's liability reflect future salary increases?*
 - *what discount rate should be used to translate future cash flows into a realistic present value?*
- *what is 'the expected return on assets', and how (if at all) should it be reflected in the employer's financial statements?*
- *what is the impact on financial reporting of pension fund regulation arrangements, such the introduction of the PPF levy?*
- *are the disclosures required by current standards appropriate? This will include consideration of whether liabilities that might arise in the event of a takeover of the employer are adequately disclosed under current requirements.*

Accounting for employee contributions – why a topic ?

- a particular aspect to the fundamental review of pension accounting / actuarial principles
- numerous pension schemes include minimal employees' contributions as a requisit
- internationally, employee participation vary from minimal (a couple of % of salary, subject to caps) to very significant (« share of costs » schemes under which employee pay 50% of plan costs)
- still, usually immaterial in North America

Accounting for employee contributions – why a topic ?

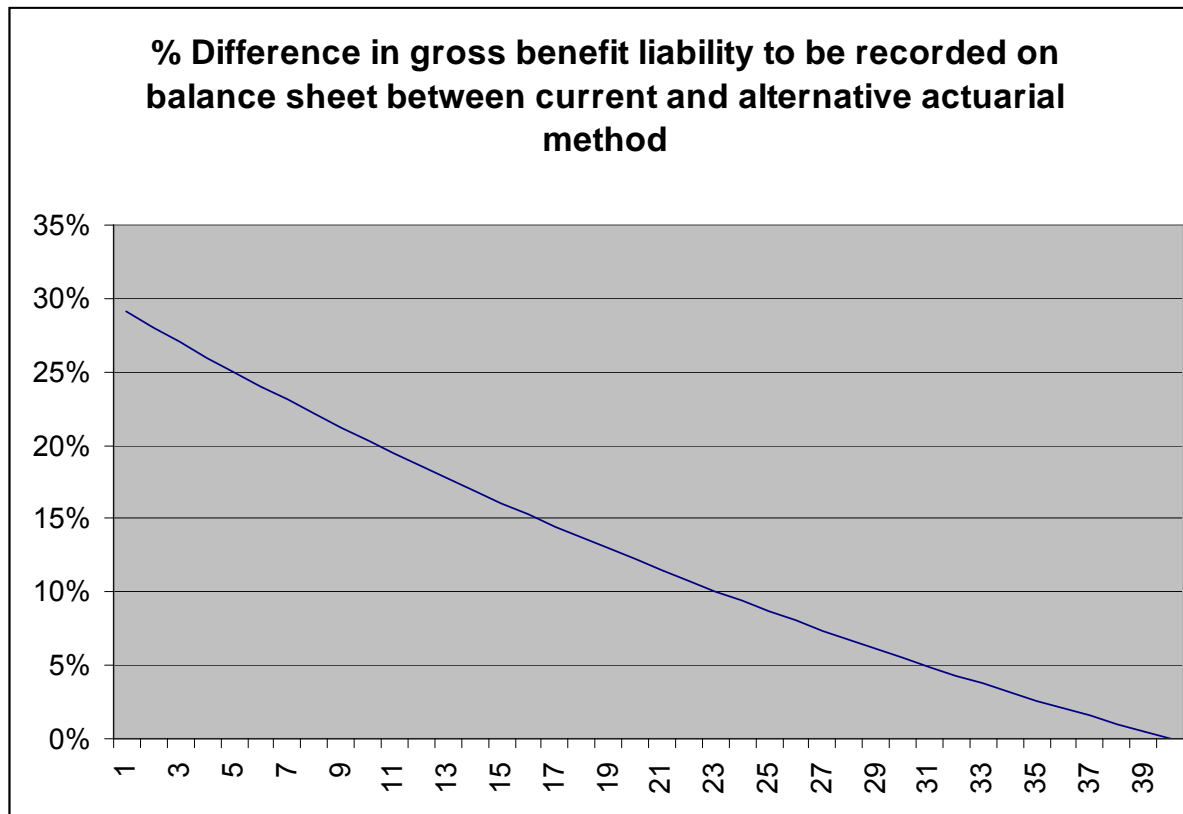
- Current « internationally recognized » accounting standards (IASB, FASB) :
 - do not future factor employee contributions
 - into the actuarial measurement of the employer's liability
- Employee contributions are taken into account when cashed out as an element of the fair of plan assets
- One major exception is FAS 106 (post retirement medical obligations) under which employer costs are valued as :
 - the probable present value of future health costs
 - less the probable present value of beneficiaries' future contributions (premiums)

Accounting for employee contributions – research for alternative actuarial treatments

- Assumptions :
 - no change to current “projected unit credit method” (PUCM) required by current IAS 19 and FAS 87
 - no change to current practice references for main actuarial assumptions
 - illustration on one typical pension plan through
 - incorporation of future employee contributions as a reduction of future pension costs before discounting and prorating impacts of PUCM

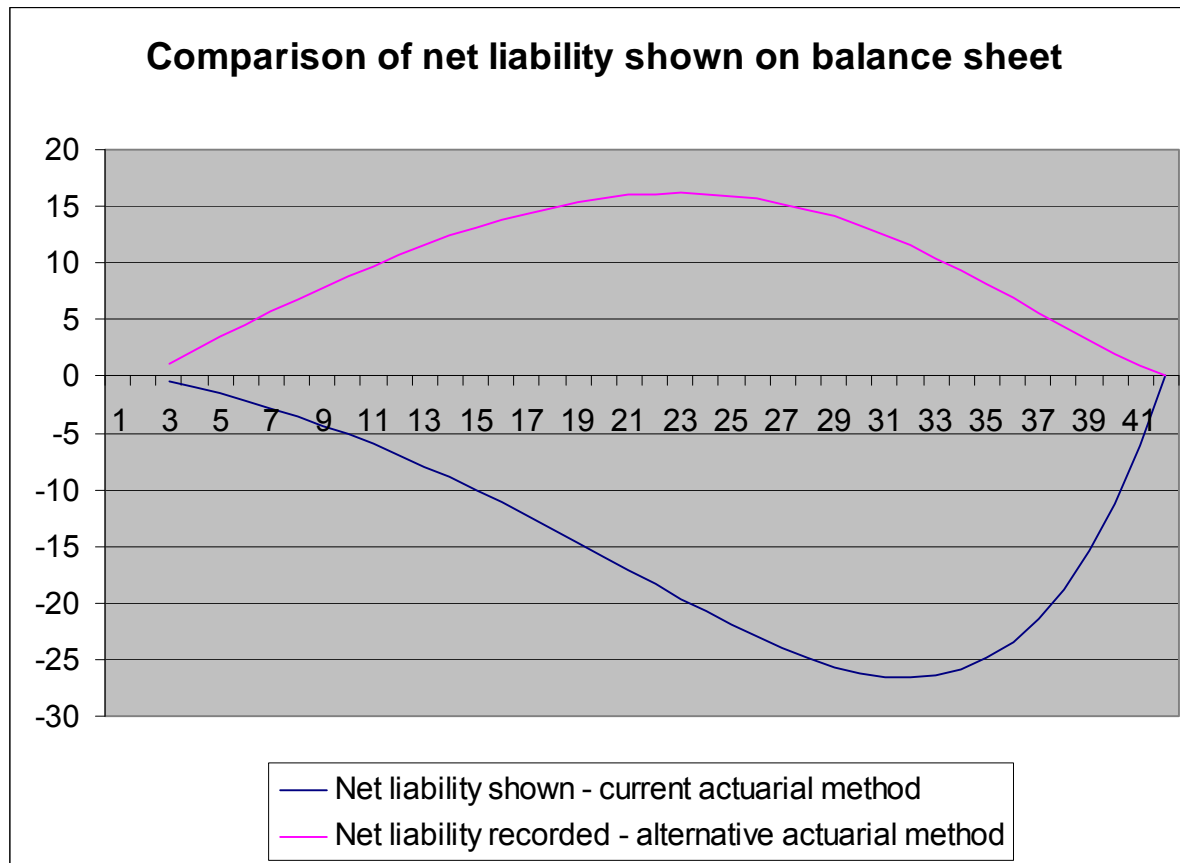
Preliminary results of research

- Impact on gross liability shown on balance sheet :



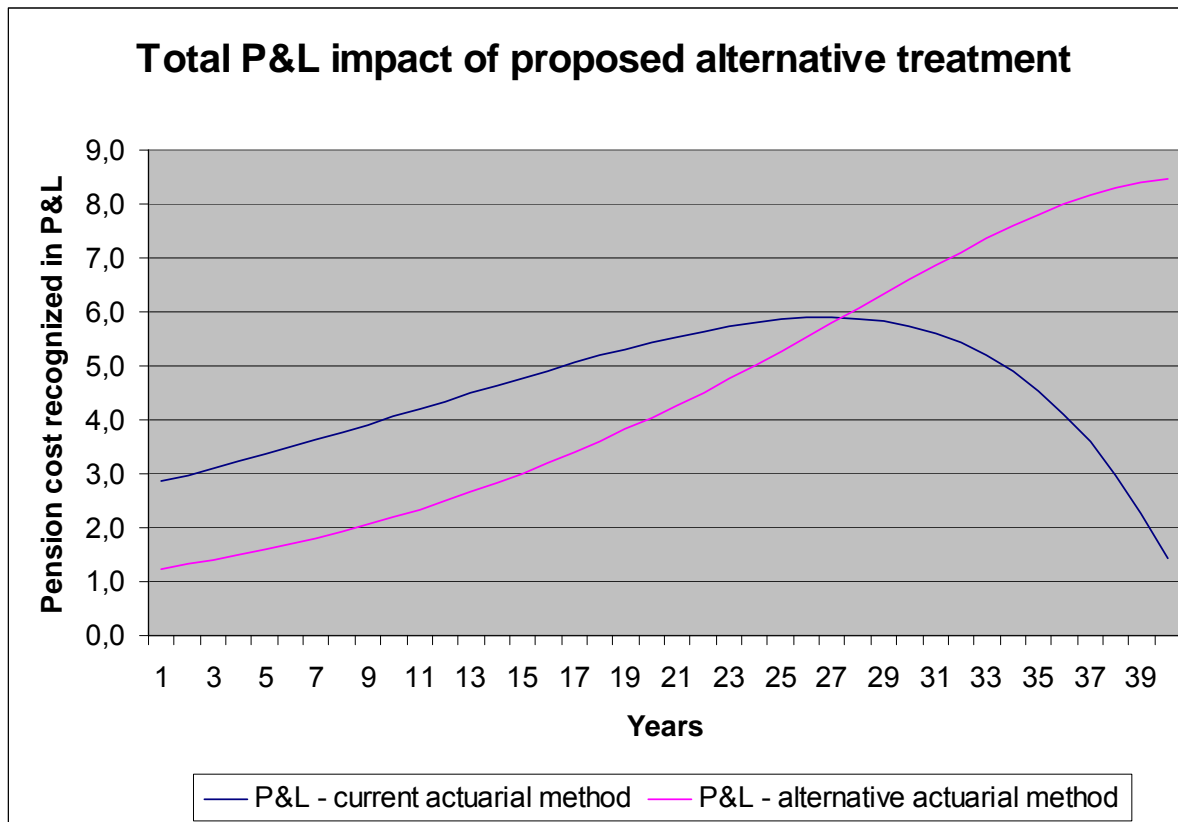
Preliminary results of research

- Impact on net liability shown on balance sheet :



Preliminary results of research

- Impact on profit and loss expense :



Conclusion

- For some schemes, employee funding (past and future) is a significant contributor to the total funding of plan costs
- Incorporation by current international accounting standards is “cash basis” and not prospective, which is not entirely consistent and thus satisfactory
- The fundamental revision of these standards is a good opportunity to revisit this topic
- Our preliminary research shows the potential significance of trying to better incorporate employee funding
- Complementary actuarial research will be needed to identify the best method



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