PSAB
Public Sector
Accounting Board

Invitation to Comment

Employment Benefits: Non-Traditional Pension Plans

October 2018

COMMENTS TO THE PSAB MUST BE RECEIVED BY
February 1, 2019

A PDF response form has been posted with this document to assist you in submitting your comments to PSAB. Alternatively, you may send comments via email (in Word format), to:
info@psabcanada.ca

Please address your comments to:

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

This Invitation to Comment is issued by the Public Sector Accounting Board (PSAB).

Individuals, governments and organizations are invited to send written comments on all aspects of the Invitation to Comment. Comments are requested from those who agree with the Invitation to Comment as well as from those who do not.

Comments are most helpful if they are related to a specific paragraph or group of paragraphs. All comments received by PSAB will be available on the website shortly after the comment deadline, unless confidentiality is requested. The request for confidentiality must be stated explicitly within the response.

Highlights

This Invitation to Comment sets out the issues and considerations related to an update of the accounting guidance for all types of pension plans in RETIREMENT BENEFITS, Section PS 3250, issued by the Public Sector Accounting Board (PSAB).

The objectives of this Invitation to Comment are to:

- explain why PSAB is considering an update of the accounting guidance in Section PS 3250;
- explore how to reflect the entity's share of the risk and ultimate cost related to non-traditional pension plans in the reported accrued benefit obligation; and
- seek stakeholder input prior to the Board establishing its preliminary views on this issue.

This project's ultimate objective is to issue a new employment benefits Section in the CPA Canada Public Sector Accounting Handbook, replacing RETIREMENT BENEFITS, Section PS 3250, and POST-EMPLOYMENT BENEFITS, COMPENSATED ABSENCES AND TERMINATION BENEFITS, Section PS 3255.

Main features

The main features of this Invitation to Comment are as follows:

- There is a need to review and update Section PS 3250 because:
  - there is no specific guidance on accounting for the target benefit and risk-sharing provisions in public sector pension plans in Canada;
  - the classification and related definitions of the five types of pension plans in Section PS 3250 are inadequate to address plans with characteristics of more than one of the five types of plans; and
  - the accounting requirement for the participating employer of multiemployer defined benefit plans in Section PS 3250 may not reflect its share of the risk and ultimate cost related to the plan.
- This Invitation to Comment focuses on exploring accounting principles and guidance that:
  - can be applied to all types of pension plans, from traditional defined contribution plans to traditional defined benefit plans, and plans in between that involve employers sharing different degrees of risk related to pension benefits with other parties (i.e., non-traditional plans); and
  - would result in reflecting the proportionate share of the risk and ultimate cost of all types of pension plans in the accrued benefit obligations reported by the (participating) employer, the sponsoring entity and the government reporting entity in its consolidated financial statements.
- This Invitation to Comment considers that:
  - an expanded classification approach is not a viable option to address the accounting for the wide range of public sector pension plans in Canada;
  - a potential general principle would require the entity (which may include the employer, the participating employer, the sponsoring entity or the government reporting entity) to recognize its share of the accrued benefit obligation of the pension plan in its financial statements, reflecting the substance of the terms in the plan and taking into consideration relevant factors, facts, events and circumstances;

- the actuarial assumptions used to determine the accrued benefit obligation of the plan would reflect the effects of risk-sharing provisions in pension plans;
- the substance of plan surplus/deficit-sharing provisions in pension plans with other parties (e.g., employees, the sponsoring entity, other employers and their employees) would be reflected in determining the entity's proportionate share of the accrued benefit obligation of the plan; and
- the non-employer sponsoring entity of a pension plan is an entity that has assumed some or all of the employer's obligations to pay required contributions toward current service and additional contributions in the event of insufficient plan assets to pay benefits related to current and prior period services.

The accounting principles and guidance explored in this Invitation to Comment may have significant effects on the accrued benefit obligations reported by public sector entities.

Background of the project

This is the third Invitation to Comment issued for this project. Two Invitations to Comment were issued in November 2016 and November 2017 respectively:

- "Employment Benefits: Deferral Provisions in Sections PS 3250 and PS 3255"; and
- "Employment Benefits: Discount Rate Guidance in Section PS 3250."

Given the complexity of the issues involved and the potential implications of any changes that may result from a review of Sections PS 3250 and PS 3255, PSAB decided to issue an Invitation to Comment on each key issue to seek input from stakeholders prior to establishing its positions.

PSAB plans to deliberate stakeholder feedback on the three Invitations to Comment and develop its positions on the issues in 2019. The Board expects to issue a Statement of Principles with its preliminary views in 2020.

Other issues that will also be addressed in this project, in the Exposure Draft and/or in the Statement of Principles, include:

- the accounting for sick leave benefits and other non-pension benefits;
- other improvements to existing guidance; and
- issues that may arise or be identified by stakeholders throughout the development of the project.

PSAB encourages stakeholders to check the status and background information about this project online or to subscribe to email updates.

Comments requested

PSAB welcomes comments from individuals, governments and organizations on all aspects of the Invitation to Comment.

When comments have been prepared as a result of a consultative process within an organization, it is helpful to identify generically the source of the comment in the response. This will promote understanding of how the issues affect various aspects of an organization.

Comments are most helpful if they relate to a specific paragraph or group of paragraphs. Supporting reasons for your comments are most valuable when they demonstrate how they would:

- produce more relevant information for accountability and decision making by external users;

- improve the representation of the substance of the underlying transaction or event;
- contribute to improved measures and understanding of financial position and annual results;
- facilitate enhanced comparability; and
- provide sufficient information for external users to understand the financial statements.

Please respond to the following questions, considering how public interest would be best served:

Need for update of accounting guidance

1. Do you agree that there is a need to review and update Section PS 3250 to address plans that involve employers sharing different degrees of risk related to pension benefits with other parties (paragraphs .065-.081)?

Accounting issues arising from developments in public sector pension plans

2. Are there any developments in the landscape of public sector pension plans that may require accounting guidance that have not been identified in this Invitation to Comment (paragraphs .009-.019)?
3. Are there any plan features that may have accounting implications that have not been identified in this Invitation to Comment (paragraphs .020-.050)?

Potential accounting guidance

4. Do you agree that an expanded classification approach is not a viable option to address the accounting for all types of public sector pension plans (paragraphs .072 and .090)? If you disagree, what classifications:

   (a) would capture all types of public sector pension plans; and

   (b) can be practically and conceptually differentiated from each other?
5. Do you support a simple two-classification approach (paragraphs .093-.096)?
6. Do you agree that PSAB should further develop the potential guidance discussed in this Invitation to Comment (paragraphs .097-.155)? If yes, are there any specific areas that the Board should further develop?
7. Do you agree with the general principle for the potential accounting guidance stated in paragraph .100?
8. Are there any specific areas that may be challenging in applying the general principle stated in paragraph .100?
9. Do you agree that the effects of risk-sharing provisions should be reflected in the actuarial assumptions used to determine the accrued benefit obligation of the plan (paragraphs .108-.131)?
10. Do you agree that the entity should report its share of the accrued benefit obligation of the plan that reflects the ultimate cost and risk it bears (paragraphs .132-.155)?
11. Do you agree that it is in the public interest that the accrued benefit obligation reported by the participating employer of a multiemployer defined benefit plan reflects the risk and cost related to the pension benefits they offered to their employees (paragraphs .141-.146)?
12. What challenges do you anticipate in determining the entity's share of the accrued benefit obligation of the plan that reflects the ultimate cost and risk it bears (paragraphs .132-.155)? How might the challenges be overcome?

Other

13. Are there any reasons that the potential accounting principles and guidance discussed in paragraphs .097-.155 would not be appropriate for estimating accrued non-pension benefit obligations?

14. Are there specific issues with, or related to, Sections PS 3250 and PS 3255 that have not been identified in the ‘Background of the project” section that PSAB should consider in this project?

Employment Benefits: Non-traditional Pension Plans

TABLE OF CONTENTS

PURPOSE AND SCOPE

Purpose

.001 The objectives of this Invitation to Comment are to:

(a) explain why PSAB is considering an update of the accounting guidance in Section PS 3250;

(b) explore how to reflect the entity's share of the risk and ultimate cost related to non-traditional pension plans in the reported accrued benefit obligation; and

(c) seek stakeholder input prior to the Board establishing its preliminary views on this issue.

Scope

.002 This Invitation to Comment focuses on exploring principles and guidance for determining the accrued benefit obligation of all types of pension plans, including:

(a) traditional defined contribution plans in which plan members bear all the risks;

(b) traditional defined benefit plans in which the employer bears all the risks; and

(c) plans in between, referred to as "non-traditional plans" in this Invitation to Comment, that involve employers sharing different degrees of risk related to pension benefits with other parties (i.e., employees including current and former employees and their beneficiaries,[1] the sponsoring entity as described in paragraph .150, other employers and their employees).

.003 Non-traditional plans include joint defined benefit plans, multiemployer defined benefit plans and multiple-employer defined benefit plans that are addressed in RETIREMENT BENEFITS, Section PS 3250. They also include target benefit plans, and plans with any of the risk-sharing provisions described in paragraphs .037-.050.

.004 One of the objectives of this Invitation to Comment is to explore accounting guidance for non-traditional plans. Traditional defined contribution plans and traditional defined benefit plans are in the scope of this Invitation to Comment to ensure that the potential accounting guidance can be applied to all types of pension plans.

.005 This Invitation to Comment focuses on pension plans only because:

(a) they are the most significant and complex type of benefit plans offered in the public sector;

(b) pension plans have evolved substantially since the issuance of Section PS 3250 and need updated guidance;

(c) fewer significant widespread accounting issues have been raised regarding non-pension benefit plans; and

(d) including non-pension benefit plans in the scope at this stage may add complexity to the discussion.

.006 While one of the objectives of this Invitation to Comment is to explore accounting guidance for determining the accrued benefit obligation of all types of pension plans, the focus is on the projected future cash flow component of the accrued benefit obligation. This Invitation to Comment does not address the discount rate component of the accrued benefit obligation because PSAB has not yet

[1] References to employees include current and former employees and their beneficiaries, where applicable.

deliberated the discount rate assumption to be used.[2]

.007 The potential accounting principles and guidance discussed in this Invitation to Comment are based on the measurement approach prescribed in Section PS 3250; that is, the projected benefit method prorated on services.

.008 This Invitation to Comment focuses on exploring guidance for determining the accrued benefit obligation of pension plans, rather than the net pension liability or asset,[3] because:

(a) PSAB has not yet deliberated how pension assets should be measured and how actuarial gains and losses should be recognized;[4] and

(b) determining the accrued benefit obligation is required for all types of pension plans, regardless of whether assets have been set aside to fund the obligation.

PENSION EVOLUTION IN THE CANADIAN PUBLIC SECTOR

.009 When Section PS 3250 was issued in 2001, defined contribution plans, defined benefit plans and multiemployer defined benefit plans were the dominant types of pension plans in the public sector. A few pioneers in the public sector had introduced non-traditional plans, such as:

(a) pension plans with basic pension benefits defined in a benefit formula (i.e., defined benefit component) and the indexation of pension benefits based on contributions and related earnings (i.e., defined contribution component); and

(b) joint defined benefit plans in which employees share the benefit of any plan surplus and the cost of any plan deficit with the employer (referred to as "plan surplus/deficit-sharing provisions" in this Invitation to Comment).

The accounting for these two types of non-traditional pension plans is addressed in Section PS 3250.

.010 At that time, many pension plans were contemplating using funding surplus for benefit improvements and contribution holidays. Since Section PS 3250 was issued, the cost of providing pension benefits has increased due to:

(a) improved life expectancy of plan members;

(b) maturity of plan membership;

(c) low interest rates over an extended period; and

(d) market volatility after the 2008 financial crisis.

.011 Some jurisdictions have undertaken pension reform to address the sustainability of pension plans. Canadian public sector pension plans are known as innovators in governance and plan design. As employers seek to share more risk with their employees and other employers (and their employees), the innovations have resulted in a heterogeneous set of public sector pension arrangements. Plans vary widely across the country in terms of design, governance and financial status.

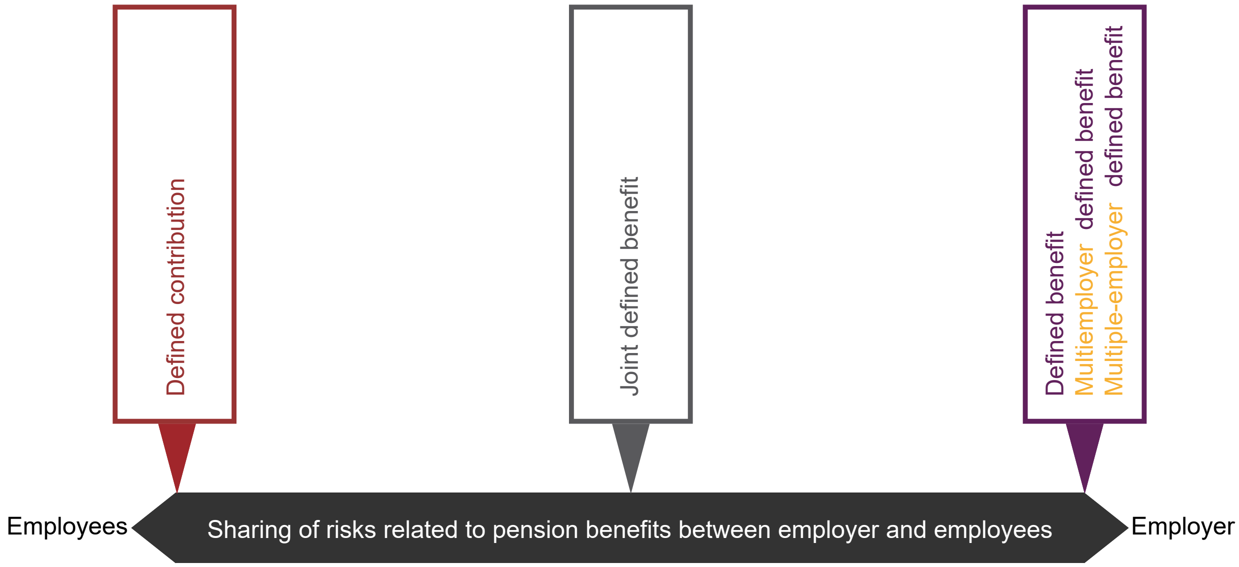
2 The discount rate component of the accrued benefit obligation is discussed in Invitation to Comment, "Employment Benefits: Discount Rate Guidance in Section PS 3250."

3 Defined as accrued benefit obligation less plan assets, and adjusted for unamortized actuarial gains and losses in Section PS 3250.

4 The valuation of pension assets and the recognition of actuarial gains and losses are discussed in Invitation to Comment, "Employment Benefits: Deferral Provisions in Sections PS 3250 and PS 3255."

Chart 1: Public sector pension plans and pension plans in Section PS 3250

PENSION PLANS IN SECTION PS 3250



PENSION PLANS IN THE PUBLIC SECTOR

Multiemployer defined contribution
Target benefit with fixed employer contribution
Target benefit with employer contribution limit
Joint target benefit
Joint defined benefit with risk-sharing provisions
Multiemployer joint defined benefit
Multiemployer target benefit with joint trustees
Defined benefit with employees sharing surplus/deficit
Defined benefit basic pension and defined contribution indexation
Defined benefit with conditional indexation
Multiemployer defined benefit with joint trustees
Defined benefit minimum and defined contribution maximum

Colours correspond to characteristics of:
defined contribution plans
joint defined benefit plans
multiemployer plans
defined benefit plans
target benefit plans
risk-sharing provisions

.012 As shown in Chart 1, many public sector pension plans:

(a) involve employers sharing different degrees of risk related to pension benefits with employees and other parties; and

(b) have characteristics of more than one of the five types of pension plans in Section PS 3250.

.013 Depending on the circumstances of the plans, evolution in public sector pension plans has ranged from changes in the salary component of the benefit formula and increases in regular employee contributions, to more substantial changes, including:

(a) introduction of, or conversion to, target benefit plans (see paragraphs .021-.036);

(b) introduction of risk-sharing provisions (see paragraphs .037-.050) and plan surplus/deficit-sharing provisions;

(c) conversion to joint defined benefit plans (see paragraphs .016-.017); and

(d) merging with other pension plans (see paragraphs .018-.019).

.014 Target benefit plans and plans with risk-sharing provisions often contain a benefit formula that describes how the basic pension would be determined. In target benefit plans and plans with risk-sharing provisions, plan members would be provided with a monthly pension throughout their retirement years, even though the pension payment may be lower than the benefit formula. Some consider these two types of plans (as well as joint defined benefit plans, multiemployer defined benefit plans and multiple-employer defined benefit plans) as different variations of defined benefit plans.

.015 The landscape of pension plans in the private sector has also evolved. Many defined benefit plans have been replaced with defined contribution plans and non-traditional plans such as those with benefits that are based on accumulated contributions and a promised return. Some consider these non-traditional plans in the private sector as variations of defined contribution plans.

.016 Joint defined benefit plans are not new in the public sector. A few existed when Section PS 3250 was issued. However, it has become one of the dominant types of pension plans in the public sector as employers seek to share the risk and cost of providing pension benefits with employees. Many public sector pension plans have converted from traditional defined benefit plans to joint defined benefit plans.

.017 The joint governance structure typical to joint defined benefit plans has also been introduced in target benefit plans and can be found in multiemployer defined benefit plans. Many pension plans in the municipal and the SUCH (school, university, college and hospital) sectors are jointly governed multiemployer defined benefit plans.

.018 Mergers of pension plans have been one of the latest developments in the landscape of public sector pension plans in Canada. A few jurisdictions have introduced regulations in recent years that allow mergers of certain types of pension plans. There have been mergers of single-employer pension plans in the public sector, broader public sector and not-for-profit sector with jointly sponsored pension plans in the public sector. Mergers of pension plans are not limited to defined benefit plans. Defined contribution plans in the public sector have also merged in recent years.

.019 More mergers of pension plans may follow because mergers allow employers (and employees where applicable) to share the risk and cost related to pension benefits with other employers (and their employees). The participating employers of multiemployer plans share demographic risk, investment risk and other actuarial risk collectively. Mergers allow mature plans to lower their retiree-to-active-member ratio if they merge with plans with younger membership. Mergers give the participating entities, particularly smaller ones, access to more investment opportunities. Also, smaller entities benefit from economies of scale in plan administration, and better plan member services that they may not be able to afford on their own.

TARGET BENEFIT PLANS AND RISK-SHARING PROVISIONS

.020 Understanding the nature of target benefit plans and risk-sharing provisions would help assess whether:

(a) the guidance in Section PS 3250; and

(b) any potential guidance (see paragraphs .082-.155)

would be sufficient for entities to reflect the risk and cost they bear in the accrued benefit obligation.

Target benefit plans

.021 As employers seek to share more risk with their employees, a key idea behind the features of target benefit plans is to limit the employer's exposure to the risk and cost of providing pension benefits by providing target, rather than guaranteed benefits (as would be in traditional defined benefit plans). This is typically achieved through:

(a) limiting the employer's obligation to the contribution level specified in the plan's terms, or limiting the employer's risk exposure to a narrow predefined range of possible changes around the contribution level specified in the plan; and

(b) adjusting the earned and future benefits when there are insufficient plan assets to pay the target benefit specified in the benefit formula.

.022 In practice, there can be a wide range of target benefit plan designs, with varying degrees of expected contribution and benefit volatility. A target benefit level is chosen based on what can be afforded by the specified contribution level or the specified range of contributions.

.023 From the plan members' perspective, target benefit plans/provisions may appear similar to traditional defined benefit plans because they receive a monthly pension upon their retirement that is based on a benefit formula. However, as their pensions may be adjusted based on the plan's funded status, plan members of target benefit plans bear a certain degree, if not all, of the investment and actuarial risks that would otherwise be solely borne by the employer of traditional defined benefit plans.

.024 From the employer's perspective, target benefit plans/provisions may appear similar to traditional defined contribution plans if its obligation is limited to the contribution level specified in the plan. Depending on the specific design of each target benefit plan, employer contributions may vary within a range, which may or may not be narrow. In any case, the employer of target benefit plans would bear less (or none of the) investment and actuarial risk that would otherwise be borne by the employer of traditional defined benefit plans.

.025 A key mechanism to limit the employer's risk exposure in target benefit plans is the possibility of a reduction in earned benefits. A reduction in earned benefits is not permitted in most pension legislation, except for certain types of plans. Target benefit plans or provisions have been introduced in pension legislation in various jurisdictions in Canada to allow the possibility of a reduction in earned benefits.

.026 Target benefit plans have been introduced as an additional category of pension plans in some pension legislation. Some treat a target benefit provision as another type of benefit provision that may be included in any type of pension plan such as single employer, multiemployer and jointly sponsored. Pension legislation in each jurisdiction may define target benefit plans/provisions differently.

.027 Depending on the jurisdiction, pension plans in the public sector are not necessarily subject to the same pension legislation that governs private sector pension plans. Some are governed by their own enabling legislation or other specific pension legislation.

.028 Most jurisdictions have introduced target benefit plans in their pension legislation, or are consulting stakeholders regarding the appropriate regulatory framework for target benefit plans. The regulatory framework that governs target benefit plans may vary in different jurisdictions. They may address some or all of the following:

(a) funding;

(b) investment policy;

(c) governance policy; and

(d) disclosure requirements.

An example that illustrates how the benefit and funding of a target benefit plan may interact is provided in the Appendix.

Funding

.029 The funding of target benefit plans may cover:

(a) contributions;

(b) benefit funding policy;

(c) regulatory funding requirements; and

(d) commuted value upon plan termination and membership termination.

Contributions

.030 Depending on the jurisdiction, target benefit plans may be defined in pension legislation as plans that have a fixed contribution set out in collective agreements. Contributions may be allowed to vary in other regulatory frameworks.

Benefit funding policy

.031 As benefits are not guaranteed in target benefit plans, a predetermined benefit funding policy may be required in some regulatory frameworks to ensure transparency and a common understanding of the implications of changes in the plan's funded status. A benefit funding policy would set out how a plan deficit will be eliminated and a plan surplus will be used, for example, including:

(a) the methods and assumptions to be used in the periodic assessment of affordability (usually on a funding basis);

(b) the conditions (usually defined on a funding basis) under which corrective actions would be required based on the affordability assessment;

(c) the types of corrective actions (usually the risk-sharing provisions described in paragraphs .037-.050) to undertake when specific conditions exist;

(d) the order or relative priority of activation among the corrective actions; and

(e) any limit on each type of corrective action.

.032 Whether the corrective actions would be executed automatically when certain conditions exist may depend on the plan's terms and/or the applicable regulatory framework. For example, certain pension legislation may require the plan administrator be given unrestricted authority to reduce benefits when certain conditions set out in the plan exist. Also, whether the specific corrective actions to undertake when certain conditions exist would be set out in the benefit funding policy may depend on the plan's terms and/or the applicable regulatory framework.

Regulatory funding requirements

.033 Target benefit plans are generally exempted from solvency funding requirements. However, they would be required to meet going concern funding requirements and, in some jurisdictions, additional minimum funding requirements.

.034 The regulatory framework in some jurisdictions may require separate minimum funding tests that could result in additional funding requirements even when corrective actions are not required based on the plan's own affordability assessment. The regulatory minimum funding requirements are often referred to as a "provision for adverse deviation". They may be satisfied through additional contributions or eliminated through benefit reductions.

Commuted value upon plan termination and membership termination

.035 One of the key characteristics of target benefit plans is that the commuted value calculated at plan termination would be adjusted based on the plan's funded status. Depending on the regulatory framework, the commuted value calculated when individual plan members leave the plan may also be adjusted for the plan's funded status.

Investment policy, governance policy and disclosure requirements

.036 A regulatory framework may also require:

(a) the filing of the investment policy of target benefit plans with the regulators;

(b) a governance structure to ensure that plan members' rights are fairly represented, given that they bear a certain degree, if not all, of the risks related to the pension benefits in target benefit plans; and

(c) minimum plan member communications and disclosure requirements such as the plan's benefit, funding, investment and governance policies.

Risk-sharing provisions

.037 Risk-sharing provisions are provisions in the plan that result in employees sharing a certain degree of risk related to pension benefits with the employer; that is, the investment and actuarial risks. Investment risk is the risk that the actual return on plan assets differs from expected. Actuarial risk is the risk that the plan's actual experience differs from the expected experience that would affect the ultimate benefit payments (e.g., plan members may live longer than expected).

.038 The risk and ultimate cost to the employer of providing pension benefits may be reduced through changes in contribution requirements and/or benefit provisions. Changes in contributions may increase or decrease the likelihood of future changes in benefits, and vice versa.

.039 Risk-sharing provisions can be classified as those that affect employer and/or employee contributions and those that affect future and/or earned benefits. Risk-sharing contribution provisions include contingent (or variable) contributions and contribution limits. Risk-sharing benefit provisions include contingent (or variable) benefits such as conditional indexation. Risk-sharing provisions may be included in all types of plans, regardless of whether the employer and employees have also agreed to share the benefit of a plan surplus and the cost of a plan deficit on a pro rata basis.

.040 Changes in benefits and employee contributions are the mechanisms used to limit the employer's benefit obligation in target benefit plans, given that the employer contribution is fixed or varies within a predefined range. When the employer's contribution varies within a predefined range, the plan essentially contains contingent contribution and contribution limit provisions. The specific benefits that would be subject to adjustments would likely be described in target benefit plan documents. Plan administrators of target benefit plans may have the authority to execute the specified benefit adjustments when certain pre-set conditions exist.

.041 Changes in contributions, on the other hand, are often the primary mechanism used in joint defined benefit plans to achieve surplus/deficit sharing with employees. A combination of changes in contributions and benefits (e.g., suspension of indexation to fund the employees' share of plan deficit and employer contribution increase to fund the employer's share of plan deficit) is also used in some joint defined benefit plans as a secondary mechanism. Joint decisions of the sponsors (employer and employees) are usually required to determine the specific changes to be made in contributions and benefits when a plan deficit/surplus arises in joint defined benefit plans.

.042 Conditional indexation is a common mechanism used in all types of plans to reduce the risk and cost the employers bear. Depending on the terms in a plan, indexation may be granted or adjusted automatically when certain pre-set conditions exist, or a decision may be required from the employer, employees, trustees or plan administrator to determine the specific adjustments to make.

Contingent contributions

.043 In a plan that has contingent contribution provisions, employer and/or employee contributions can go up and down depending on the plan's funded status or the existence of certain conditions set out in the plan's terms. Contingent contributions and conditional indexation are usually the first corrective actions to address the plan's funding surplus/deficit. Employers and employees may be subject to the same or different levels of contribution changes. Contingent contributions may apply to employers, employees or both.

.044 Depending on the plan's terms, contribution increases and decreases may:

(a) be executed by a plan administrator when the pre-set condition exists; or

(b) require decisions of the employer, employees, trustees or plan administrator to determine the specific changes to make.

Contribution limit

.045 A contribution limit may refer to a ceiling, floor or both. In a plan that has contingent contribution provisions, contributions may go up and down within a range or a corridor between a predefined ceiling and a floor. A contribution limit may apply to employers, employees or both. Employers may be subject to a different contribution limit than employees.

Contingent benefits

.046 In a plan that has contingent benefit provisions, benefits can increase or decrease depending on the plan's funded status or the existence of certain conditions set out in the plan's terms. Changes in benefits (improvements and reductions) may affect benefits related to past services (i.e., earned or accrued benefits) and/or future services. Depending on the applicable legislative/regulatory requirements, changes in earned benefits may only be allowed for certain types of plans (e.g., target benefit plans and certain multiemployer defined benefit plans). Reduction in earned benefits is often the last corrective action to take.

.047 Benefits provided in a pension plan may be classified as basic pension and ancillary benefits. Basic pension is often described in the benefit formula, which is usually based on the plan members' salary and years of service. Ancillary benefits may include inflation protection through indexation of pension benefits and unreduced early retirement pension benefits. Ancillary benefits are often among the first benefits to be reduced. Basic pension is usually the last to be reduced.

.048 Depending on the plan's terms, benefit increases and decreases may:

(a) be executed by the plan administrator when the pre-set condition exists; or

(b) require decisions of the employer, employees, trustees or plan administrator to determine the specific changes to make.

Conditional indexation

.049 Conditional indexation is one type of contingent benefit. When a plan has a conditional indexation provision, the granting of indexation would be contingent on the plan's funded status. This has become a common feature in all types of plans, including defined benefit. Conditional indexation and contingent contributions are usually the first corrective actions to address the plan's funding surplus/deficit.

.050 Conditional indexation provisions may apply during the accumulation and/or retirement phase. Conditional indexation during the accumulation phase means that earned benefits may increase to keep pace with an index such as the consumer price index (CPI) or average industrial wage indices during the employment period, subject to the plan's funded status. Conditional indexation during the retirement phase means that pension payments may increase based on part or all of the change in CPI since the last increase.

PENSION PLANS IN SECTION PS 3250

.051 Similar to equivalent standards issued by other standard setters,[5] Section PS 3250 takes a classification approach in providing accounting guidance for pension plans. It defines,[6] describes and prescribes the accounting[7] for the following five types of pension plans:

(a) defined contribution;

(b) defined benefit;

(c) joint defined benefit;

(d) multiemployer defined benefit; and

(e) multiple-employer defined benefit.

.052 Pension plans are classified according to the definitions of the five types of pension plans in Section PS 3250. The classification of a pension plan would determine which method the employer should follow in accounting for its pension liability and expense, for example:

(a) "defined contribution accounting" for defined contribution and multiemployer defined benefit plans;

(b) "defined benefit accounting" for defined benefit and multiple-employer defined benefit plans; and

(c) "joint defined benefit accounting" for joint defined benefit plans.

Defined contribution plans

Definition

.053 A defined contribution plan is one in which the employer's contributions are fixed, usually as a percentage of compensation, and allocated to specific individuals. The retirement benefit for each employee is the amount that can be provided at retirement based on the accumulated contributions made on that individual's behalf and investment earnings on those contributions.

---

5 Including eight accounting standards issued by the International Accounting Standards Board (IASB), the International Public Sector Accounting Standards Board (IPSASB), the U.S. Financial Accounting Standards Board, the U.S. Governmental Accounting Standards Board (GASB), the U.S. Financial Accounting Standards Advisory Board, the UK Accounting Standards Board, the Canadian Accounting Standards Board, and the South Africa Accounting Standards Board.

6 The definitions in paragraphs .053, .055, .057-.058, .060 and .063 are from the Glossary in Section PS 3250.

7 The accounting description in paragraphs .054, .056, .059, .061-.062 and .064 is summarized at a high level.

Accounting

.054 Under “defined contribution accounting”:

(a) pension liability is the difference between the amount the employer was required to contribute and the amount that was contributed by the financial statement date; and

(b) pension expense is the amount the employer is required to contribute for employee services rendered in the period.

Defined benefit plans

Definition

.055 A defined benefit plan specifies either the benefits to be received by employees after retirement or the method for determining those benefits. The most commonly used defined benefit plans are:

(a) Final pay plan — Bases benefits on an employee’s length of service and compensation over a specified number of years (usually the years of an employee’s highest earnings).

(b) Flat benefit plan — Provides a specified benefit for each year of service rendered; the benefit earned in each period is usually fixed and determinable under the terms of the plan and the amount of benefits to be received varies only with the years of service rendered.

Accounting

.056 Under “defined benefit accounting”:

(a) pension liability and expense should be based on the value of the benefits attributed to employee service to the financial statement date, determined by the projected benefit method prorated on services with the entity’s best estimate actuarial assumptions; and

(b) actuarial gains and losses should be amortized to the liability and expense in a systematic and rational manner over the expected average remaining service life of the related employee group.

Joint defined benefit plans

Definition

.057 A joint defined benefit plan is a contractual arrangement between the government and another sponsor or sponsors representing plan participants that has all of the following characteristics:

(a) the sponsors co-operate toward achieving the significant clearly defined common goal of providing retirement benefits in exchange for services rendered by the employees;

(b) funding contributions are shared mutually between the government and the plan members, represented by the non-government sponsor;

(c) the sponsors share control of decisions related to the administration of the retirement benefit plan and to the level of benefits and contributions on an ongoing basis; and

(d) the significant risks associated with the retirement benefit plan are shared on an equitable basis between the government and the plan members, represented by the non-government sponsor.

.058 The contractual arrangement establishes that the sponsors have shared control over the retirement benefit plan, and ensures that neither party is in a position to control the plan unilaterally. Nevertheless, overall, there must be an equitable relationship between the funding by the government of the retirement benefit plan, the extent of control it is able to exercise over the plan and the risks and benefits that accrue to the government from the plan.

Accounting

.059 Under “joint defined benefit accounting,” the employer/sponsor accounts for its portion of pension liability and expense determined under defined benefit accounting (see paragraph .056).

Multiemployer defined benefit plans

Definition

.060 A multiemployer plan is a defined benefit plan to which two or more governments or government organizations contribute, usually pursuant to legislation or one or more collective bargaining agreements. The main distinguishing characteristic of a multiemployer plan is that the contributions by one participating entity are not segregated in a separate account or restricted to provide benefits only to employees of the entity and, thus may be used to provide benefits to employees of all participating entities.

Accounting

.061 The participating employer of a multiemployer defined benefit plan is required to follow defined contribution accounting (see paragraph .054).

.062 The sponsoring government of a multiemployer defined benefit plan (that has the responsibility to ensure that the defined benefits promised to employees are met) is required to follow defined benefit accounting (see paragraph .056) to account for its obligation for the plan.

Multiple-employer defined benefit plans

Definition

.063 A multiple-employer plan is a defined benefit plan maintained by more than one entity that is not a multiemployer plan. In contrast to multiemployer plans, a multiple-employer plan maintains separate accounts for each entity so that contributions provide benefits only for employees of the contributing entity. In addition, multiple-employer plans are intended to allow participating entities, commonly in the same industry, to pool their plan assets for investment purposes and to reduce the cost of plan administration. Multiple-employer plans may have features that allow participating entities to have different benefit formulae, with the entity’s contributions to the plan based on the benefit formula selected by the entity.

Accounting

.064 The entity that provides employee benefits through a multiple-employer defined benefit plan is required to follow defined benefit accounting (see paragraph .056).

NEED FOR REVIEW AND UPDATE OF SECTION PS 3250

.065 Pension evolution in the Canadian public sector (see paragraphs .009-.019) has given rise to the need for an update of Section PS 3250 because:

(a) there is no specific guidance on accounting for the target benefit and risk-sharing provisions in pension plans; and

(b) the classification and related definitions of the five types of pension plans in Section PS 3250 are inadequate to address plans with characteristics of more than one of the five types of plans.

.066 Also, a review of the accounting requirement for the participating employer of multiemployer defined benefit plans in Section PS 3250 is needed because:

(a) the current requirement may not result in the participating employer reflecting its share of the risk and ultimate cost related to the plan;

(b) some standard setters have changed their accounting requirement to require the participating employer to report its proportionate share of accrued benefit obligation of the plan; and

(c) recent and emerging mergers of pension plans have resulted in multiemployer defined benefit plans with participating employers from the public sector, broader public sector, not-for-profit sector and (potentially) the private sector.

Lack of specific guidance for target benefit and risk-sharing provisions

Target benefit

.067 There is no specific guidance in Section PS 3250 on how to account for target benefit. General guidance in LIABILITIES, Section PS 3200, and Section PS 3250 addresses situations when the actual benefit payments to plan members go beyond what is promised in the plan's benefit provisions. It is unclear whether and how the constructive obligation concept underlying this general guidance would apply when the actual benefit payments to plan members may be lower than the benefit formula in the plan.

Contribution limit

.068 There is no specific guidance in Section PS 3250 on how to account for a contribution limit (floor or ceiling). A contribution limit may restrict the extent contributions can be changed and indirectly affect the likelihood of changes in benefits. Section PS 3250 has guidance on determining the limit on the carrying amount of an accrued benefit asset (often referred to as "asset ceiling") on an accounting basis. It is questionable whether and how the concepts underlying the guidance on establishing the limit may be relevant in determining the accounting for a funding basis contribution limit that is usually predefined as a percentage of salary rather than an absolute dollar amount.

.069 It is unclear how the asset-ceiling concept can practically be applied when both contributions and benefits can vary under the contingent benefit and contingent contribution provisions, and changes in contributions can affect changes in future benefits and vice versa. It would be uncertain whether a similar concept can be established for a liability ceiling to ensure that the net pension liability/asset would reflect the economic substance of the existence of a contribution limit when there are contingent benefit and contingent contribution provisions.

Contingent contributions and contingent benefits

.070 A temporary deviation from the provisions of a benefit plan that increases or decreases the entity's share of the benefit costs incurred in the current period or past periods is addressed in Section PS 3250.[8] The guidance states that the entity would look to the substance of the temporary deviation to determine the most appropriate accounting. It is unclear whether and how this guidance may practically apply in the accounting for contingent contribution and contingent benefit provisions when they are part of (not a deviation from) the plan's benefit provisions.

Conditional indexation

.071 Conditional indexation is not specifically addressed in Section PS 3250. Section PS 3250 has guidance that addresses regular benefit increases for inflation protection even when such protection is not promised in the plan. The guidance essentially applies the constructive obligation concept to

---

8 Paragraph PS 3250.073.

determine the substance of the employer's accrued benefit obligation. It is unclear whether and how the constructive obligation concept may apply in accounting for conditional indexation when it is part of the plan's benefit provisions.

Limitations of classifications and definitions

Classifications

.072 The classification of the five types of pension plans in Section PS 3250 is inadequate to address the wide range of public sector pension plans with different degrees of risk-sharing between employers and other parties. Entities may classify similar plans, which have characteristics of more than one of the five types of pension plans, differently depending on which feature of the plan they focus. This could result in entities applying inconsistent accounting in determining the accrued benefit obligation of similar plans.

.073 PSAB needs to consider whether a classification approach remains appropriate and, if so, how to distinguish the different classifications in an effective and practical way so that the resulting accounting for each type of plan would reflect the risk the employer bears.

Definitions

.074 Added to the constraint of a classification approach is the rather restricted definition of some of the five types of pension plans in Section PS 3250. Some of the definitions do not focus solely on the risk and ultimate cost of the plan the employer bears, but also include other elements in plan design. The description of other elements may be necessary for a full understanding of the particular type of plan for regulatory, funding and other purposes. Some believe that they may not be relevant or necessary for accounting purposes. The definitions of defined contribution plans and joint defined benefit plans are two of the examples.

.075 The definition of a defined contribution plan (see paragraph .053) refers to allocation of the employer's fixed contributions to specific individuals. This is a typical characteristic of traditional defined contribution plans. However, whether employer contributions are allocated to specific individuals may not be necessary for the employer to apply defined contribution accounting (see paragraph .054). The relevant characteristic for applying defined contribution accounting would be that the employer has no obligation to make additional contributions once the required contribution for services rendered by employees in each period has been made.

.076 The definition and description of joint defined benefit plans (see paragraphs .057-.058) include the following characteristics:

(a) the sponsors co-operate toward the common goal of providing retirement benefits for services rendered by employees; and

(b) the sponsors share control over benefit and contribution decisions.

Some argue that these characteristics should not be a necessary condition to apply joint defined benefit accounting (see paragraph .059). Rather, the most relevant characteristic for applying joint defined benefit accounting would be that the sponsors agreed to jointly share the risks and the costs/benefits of the plan.

Accounting for multiemployer defined benefit plans

.077 Section PS 3250 requires the participating employer of a multiemployer defined benefit plan to account for its pension liability and expense following defined contribution accounting (see paragraph .054). Unlike the employer of a defined contribution plan that has no obligation to make additional contributions if it has made the specified contributions, the participating employer of a multiemployer defined benefit plan typically has a legal obligation to make additional contributions in the event of insufficient plan assets to pay the employees of all the participating employers.

.078 The degree of risk borne by the participating employer of a multiemployer defined benefit plan is quite different from the degree of risk borne by the employer of a defined contribution plan. Defined contribution accounting may not reflect the substance of the risk and ultimate cost borne by the participating employer of a multiemployer defined benefit plan in the reported accrued benefit obligation.

.079 This accounting requirement allows the form of the multiemployer arrangement to determine the accounting for the participating employer. It could affect the comparability of the financial position and financial result reported by public sector entities that have a defined benefit plan and those that participate in a multiemployer defined benefit plan.

.080 As more defined benefit plans merge with or join other joint defined benefit plans and other multiemployer defined benefit plans, the extent of incomparable financial position and results between entities may broaden. Mergers would result in a change in the classification and the related accounting for the employer of the defined benefit plans, regardless of whether there is a substantial change in the employer's benefit obligation after the merger.

.081 Some equivalent standards issued by other standard setters[9] require the participating employer of plans equivalent to multiemployer defined benefit plans to recognize its proportionate share of the accrued benefit obligation of the plan, determined by following defined benefit accounting. PSAB needs to reassess the costs and benefits of this accounting requirement, taking into consideration relevant changes since this requirement was included in the standard.

POTENTIAL ACCOUNTING FOR NON-TRADITIONAL PLANS

Equivalent standards issued by other standard setters

Classification of plans

.082 As discussed in paragraphs .051-.052, Section PS 3250, similar to other equivalent standards, follows a classification approach. Pension plans in other equivalent standards may essentially be classified into two major categories:

(a) defined contribution plans including multiemployer defined contribution plans; and

(b) defined benefit plans including variations such as plans equivalent to the multiemployer defined benefit plans and multiple-employer defined benefit plans in Section PS 3250.

.083 Underlying the distinguishing criteria and related guidance in other equivalent standards for defined contribution and defined benefit plans is whether the employer has an obligation to make additional contributions if there are insufficient plan assets to pay for benefits. Defined contribution plans are often defined as those that the employer has no legal or constructive obligation to make additional contributions once the required contribution has been made.

.084 Defined benefit plans in other equivalent standards are defined as plans that are not defined contribution plans. Joint defined benefit plans, target benefit plans and plans that involve employers sharing different degrees of risk with employees would be considered defined benefit plans in other equivalent standards, unless the employer contribution is fixed.

.085 Over the past decade, the International Accounting Standards Board (IASB) and the IFRS® Interpretation Committee attempted multiple times to explore alternatives to address some of the non-traditional plans in the private sector (i.e., plans with benefits based on contributions and a promised return). They have not been able to identify an alternative approach that is non-complicated, conceptually sound and would not result in different accounting for economically similar plans.

---

[9] The IASB and the IPSASB, unless sufficient information is not available to use defined benefit accounting. The U.S. GASB requirement does not address sufficiency of information.

Guidance on non-traditional plans

.086 As the Canadian public sector is known for its innovations in pension plan governance and design, public sector pension plans in Canada that involve employers sharing different degrees of risk with employees are rather unique in the world (with the exception of the Netherlands). Most other equivalent standards other than International Accounting Standard (IAS) 19 *Employee Benefits* do not address non-traditional plans such as joint defined benefit plans, target benefit plans and plans with risk-sharing provisions.

.087 The Netherlands has collective defined contribution schemes that are similar to the target benefit plans in Canada. The employer contribution in collective defined contribution schemes is fixed and not subject to adjustment if there is insufficient funding. Shortfalls would be addressed through additional employee contributions and/or benefit reductions in, for example, indexation and future benefits.

.088 Because companies in the Netherlands follow IFRS® Standards, IAS 19 provides guidance on risk-sharing and conditional indexation features in pension plans. The Dutch Accounting Standards Board (DASB) also issued guidance for the application of IAS 19 in the Dutch pension environment. PSAB considered applicable guidance in IAS 19 and the DASB guidance when exploring potential accounting guidance that may apply to non-traditional public sector pension plans in Canada.

Classification approach

.089 As discussed in paragraph .072, the five types of pension plans in Section PS 3250 (i.e., status quo), would be insufficient to address the wide range of public sector pension plans in Canada that involve employers sharing different degrees of risk with other parties.

.090 Even an expanded classification approach that adds more types of pension plans (such as target benefit plans) in Section PS 3250 would not be a viable option to capture all types of public sector pension plans with different combinations of plan features. It is because any type of plan would have to be defined in a manner that distinguishes it from the other classifications. New types of plans may emerge in the future that cannot be anticipated at this time.

.091 Some consider target benefit plans in which the employer contribution can vary within a narrow range a close variation of traditional defined contribution plans. They reason that such plans can be accounted for as a defined contribution plan with adjustment for the possibility of changes in employer contributions. This approach would encounter the following challenges:

(a) It would be difficult to establish a clear boundary that is not rule-based because what is considered narrow may be subjective.

(b) Any rule-based cut-off may be considered arbitrary, not reflecting the economic substance, and may result in opportunities to structure benefit provisions to achieve certain accounting results. Economically similar benefits/plans may be accounted for differently because of the way benefit provisions are described.

(c) In a plan that has both a defined benefit component and a defined contribution component (see paragraph .009(a)), the employer has an obligation for the defined benefit component of the plan but no additional obligation to contribute for the defined contribution component. However, in a target benefit plan, the employer either has no additional obligation to contribute if the employer contribution is fixed, or has some obligation if the employer contribution can vary. Artificially splitting the target benefit into a defined contribution component and another component to account for the same benefit differently is not conceptually supportable.

.092 If a classification approach is retained, PSAB believes that:

(a) there must be a clear distinction among the different classifications; and

(b) the distinguishing factor should result in employers reporting accrued benefit obligations that reflect the risk and ultimate cost borne in different types of plans.

.093 Classifying pension plans into defined contribution plans and other plans (referred to as “defined benefit plans” in other equivalent standards) as described in paragraphs .083-.084 appears to meet the criteria described in paragraph .092. This two-classification approach would be practical, conceptually sound and provide a clear boundary without unnecessary complication. The employer either has or does not have an obligation to make additional contributions in the event plan assets are insufficient to pay for benefits. When the employer has an obligation, it may or may not share the obligation with employees and other parties (such as other employers and their employees). Most of the public sector pension plans share a certain degree of risk with others, as the indexation benefit in many plans is somewhat contingent on certain conditions.

.094 As discussed in paragraph .084, most public sector pension plans would likely fall into the other plans (or defined benefit plans) classification. A simple two-classification approach may not be meaningful because it may merely give each pension plan a label that does not necessarily communicate the risks the employer bears in that type of plan. The risk and cost the employer bears can vary from plan to plan depending on the plan’s specific terms. Ultimately, the employer would be required to reflect the cost and risk it bears in the pension arrangement in the accrued benefit obligation.

.095 PSAB is interested in knowing whether stakeholders agree that:

(a) an expanded classification approach (see paragraph .090) would not be viable to address the accounting for non-traditional pension plans; and

(b) a simple two-classification approach (see paragraphs .093-.094) would be unnecessary for the application of the potential accounting guidance described in paragraphs .097-.155.

.096 The potential accounting principles and guidance in the next section would be applicable to a two-classification approach as follows:

(a) paragraphs .102-.103 for defined contributions plans; and

(b) all the other paragraphs (i.e., paragraphs .097-.155, except paragraphs .102-.103) for other plans (or defined benefit plans).

Potential accounting guidance

.097 The potential accounting guidance discussed below does not represent PSAB’s position at this stage of the project. It is meant to solicit feedback from stakeholders on whether the Board should further develop the potential principles and guidance described below.

.098 The objective of the potential accounting principles and guidance is to help the employer determine its accrued benefit obligation related to its pension plan at a reporting date. The accounting principles and guidance can be applied with or without a classification approach. They are based on the measurement approach prescribed in Section PS 3250; that is, the projected benefit method prorated on services.

.099 In general, the effects of the potential accounting principles and guidance (discussed below) on the five types of pension plans in Section PS 3250 can be summarized as follows:

(a) Principles for plans with fixed employer contribution — paragraph .102 is essentially the same as the "defined contribution accounting" in Section PS 3250 and would apply to traditional defined contribution plans and other plans as described in paragraphs .102-.103;

(b) Principles for other plans without risk-sharing or plan surplus/deficit-sharing provisions — paragraphs .104-.107 are essentially the same as the "defined benefit accounting" in Section PS 3250 and would apply to traditional defined benefit plans and multiple-employer defined benefit plans that do not have any risk-sharing or plan surplus/deficit-sharing provisions;

(c) Principles for non-traditional plans — paragraphs .100-.155 (except paragraphs .102-.103) would apply to all applicable non-traditional plans, including joint defined benefit plans and multiemployer defined benefit plans in Section PS 3250;

(d) Principles for plans with plan surplus/deficit sharing with employees — paragraphs .136-.140 and paragraphs .150-.154 would replace the "joint defined benefit accounting" in Section PS 3250;

(e) Principles for multiemployer plans — paragraphs .141-.155 would apply to the multiemployer defined benefit plans in Section PS 3250.

General principle

.100 The entity[10] should recognize its share of the accrued benefit obligation of the pension plan in its financial statements, reflecting the substance of the terms in the plan and taking into consideration relevant factors, facts, events and circumstances.

.101 When applying the general principle described in paragraph .100, determining the economic substance of the terms of the plan may involve consideration of changes in plan benefits and contributions that are driven by the plan's funded status or other triggering events.

Principle for plans with fixed employer contribution

.102 If the terms of the plan direct the employer to make specified contributions for employee services rendered in each period, and the employer:

(a) has no legal or constructive obligation to make additional contributions now or in the future for the related services; and

(b) has no right to a future refund or reduction in future contributions with respect to the related services,

the employer's share of the accrued benefit obligation of the plan would be nil. This is because the employer bears no risk of any further changes in the costs of pension benefits related to past services. The employer may have a liability that is limited to any unpaid contributions required at the reporting date for the current and past services rendered by the employees.

.103 If the employer is required to make additional contributions as a result of actuarial and investment experiences related to past services, paragraph .102 does not apply. When applying the principle described in paragraph .102, the substance of the plan's terms, as well as relevant factors, facts, events and circumstances, should be considered. As new information, facts, events and circumstances surface, the substance of the plan should be reviewed and reassessed against the description in paragraph .102(a) and (b). For example, the employer's share of the accrued benefit

[10] The entity may include the employer, the participating employer, the sponsoring entity or the government reporting entity.

obligation of the plan may change as circumstances change or when the facts, historical patterns and events indicate that the employer's obligation no longer satisfies paragraph .102 (a) and (b).

Guidance on applying the general principle in other plans

.104 As the specific terms can vary from plan to plan, the potential guidance in paragraphs .108-.155 is meant to support the estimate of the entity's share of the accrued benefit obligation of the plan where applicable. As stated in the general principle, the substance of the plan arrangement as a whole, as well as any relevant factors, facts, events, circumstances and historical patterns, would need to be considered in applying the potential guidance. The ultimate objective is to determine the share of the accrued benefit obligation that reflects the risk and ultimate cost related to pension benefits for services rendered up to the reporting date that are borne by the entity, whether it is the employer, the participating employer, the sponsoring entity or the government reporting entity.

.105 The accrued benefit obligation of a defined benefit plan is defined in Section PS 3250 as the value of retirement benefits attributed to services rendered by employees and former employees to the financial statement date. The accrued benefit obligation includes both legal and constructive obligations to provide pension benefits to employees and former employees for services rendered up to the financial statement date.

.106 The accrued benefit obligation is the present value of the expected future benefit payments related to past services. Future benefit payments include:

(a) benefits specified in the benefit formula and other benefit provisions set out in the terms of the plan; and

(b) any benefits beyond the benefit provisions in the plan if past practices and communications have created a valid expectation that would leave the employer with little or no discretion not to provide the benefits (i.e., benefits created by constructive obligation).

.107 Determining the expected future benefit payments involves forecasts of future factors and events. Actuarial assumptions are made about future factors and events that can affect the accrued benefit obligation. Section PS 3250 requires the actuarial assumptions be based on the entity's best estimates. The best estimate is often determined after consideration of different possible scenarios.

Guidance on risk-sharing provisions

.108 Chart 2 on page 21 summarizes the potential effects of risk-sharing provisions on determining the accrued benefit obligation of a plan at a high level. In general, risk-sharing provisions may affect the determination of the accrued benefit obligation of the plan. Plan surplus/deficit-sharing provisions would affect the determination of the entity's share of the accrued benefit obligation of the plan.

.109 When risk-sharing provisions like target benefits, contingent benefits, contingent contributions and contribution limits are included in the terms of the plan, the expected future benefit payments may differ from what is specified in the benefit formula. The effects of these risk-sharing provisions, and other relevant factors, facts, events and circumstances on the ultimate future benefit payments should be reflected in the actuarial assumptions used to determine the accrued benefit obligation of the plan.

.110 Information that would help estimate and reflect the effects of risk-sharing provisions in the accrued benefit obligation of the plan may include:

(a) the corrective actions in the risk-sharing provisions in the plan;

(b) the sequence in which the corrective actions would be triggered;

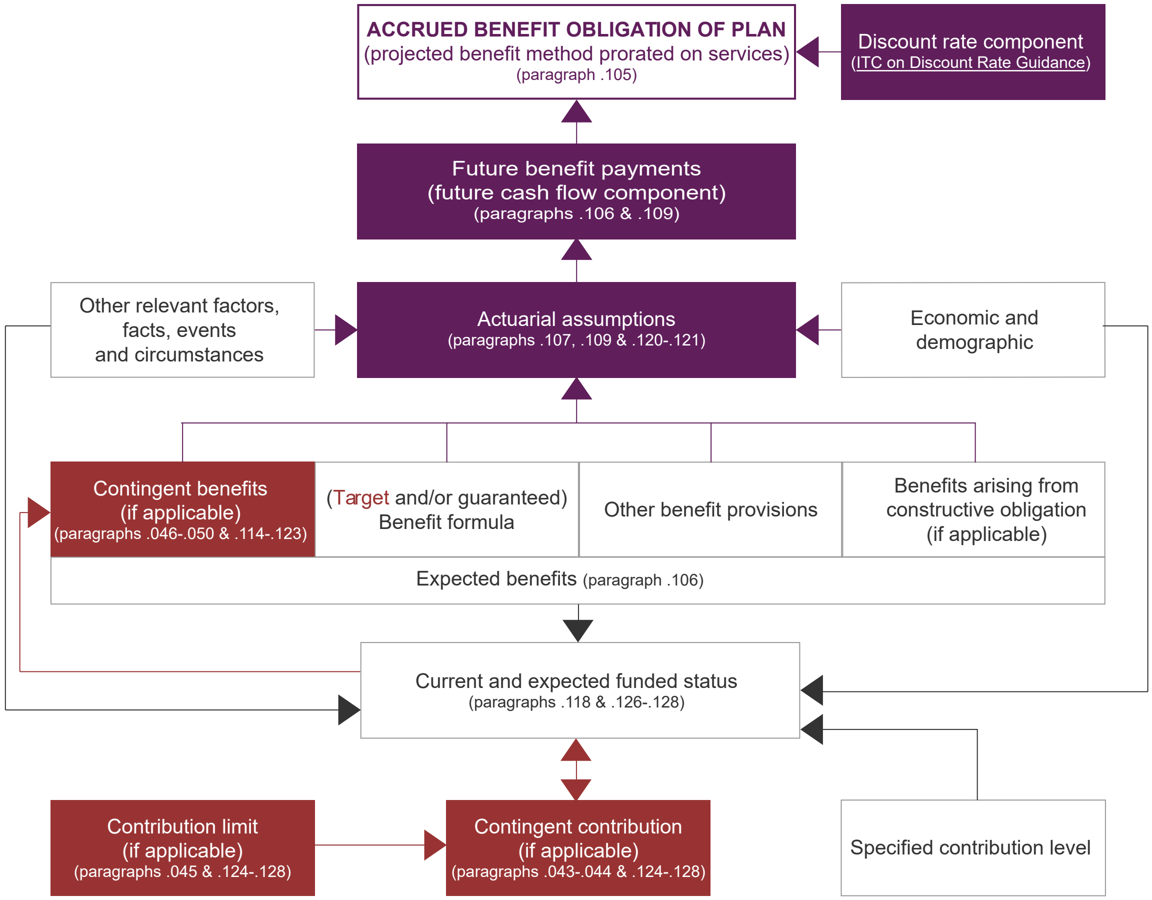
(c) any interactions among the corrective actions;

(d) the trigger for each corrective action;

(e) whether each corrective action would be automatically activated; and

(f) any limitation on each corrective action.

Chart 2: Effects of risk-sharing provisions on accrued benefit obligation of the plan



.111 The information listed in paragraph .110 may be identified from:

(a) benefit provisions including any targeted benefit formula in the terms of plan documents and agreements;

(b) benefit funding policy (including deficit recovery policy and surplus utilization policy) in the terms of plan documents and agreements; and

(c) the applicable regulatory framework.

Funding basis versus accounting basis

.112 Risk-sharing corrective actions are usually triggered based on the plan's funded status. The plan's funded status that is determined on a funding basis can be different from the plan's financial position on an accounting basis. For example, risk-sharing corrective actions may be triggered by a plan deficit on a funding basis even when the value of plan assets exceeds the accrued benefit obligation on an accounting basis.

.113 Different funded status scenarios could trigger different combinations of risk-sharing corrective actions. The extent of each corrective action that would be applied to reduce or eliminate a funding deficit (or to utilize a funding surplus) would be determined on a funding basis. The effects of each risk-sharing corrective action or combination of corrective actions on the plan's funded status can be different from their respective effects on the accrued benefit obligation (or the net benefit liability or asset) of the plan on an accounting basis. For example:

(a) A reduction in benefits related to future services may reduce or eliminate the funding deficit, but it would not affect the accrued benefit obligation (or the net benefit liability or asset) because financial statements focus on benefits for services rendered up to the reporting date.

(b) The extent that conditional indexation would be granted may be determined by the funding surplus of the plan calculated without indexation. The respective effect of the indexation on an accounting basis would be determined by the incremental increase in the expected future benefit payments resulting from the indexation.

Reflecting target benefit and contingent benefit provisions in actuarial assumptions

.114 A plan that has target benefit provisions usually defines the basic benefit in a formula that is similar to the benefit formula in traditional defined benefit plans. The terms would also indicate that the benefits payable to plan members may be higher or lower than the benefit formula. When a plan has target benefit provisions, the actuarial assumptions used to determine the accrued benefit obligation may need to be adjusted to reflect the possibility that future benefit payments may be higher or lower depending on the design and circumstances of the plan. The following paragraphs discuss potential guidance on when and how the actuarial assumptions may be adjusted.

.115 As explained in paragraph .113(a), only changes in benefits related to past services would affect the accrued benefit obligation. When there is a contingent benefit provision in the plan that can result in a change in accrued benefits, the entity would assess the likelihood and the related effects on the expected future benefit payments.

.116 The existence of a provision that can result in a change in accrued benefits does not necessarily mean that accrued benefits will be changed in the future, particularly when a change in accrued benefits is the last corrective action to be triggered. Many factors may affect the likelihood, timing and circumstances under which a change in accrued benefits may occur, including:

(a) the plan design (see paragraph .117);

(b) the current and expected funded status of the plan (see paragraph .118);

(c) the current and expected demographic composition of plan membership; and

(d) any minimum funding requirements in the applicable regulatory framework.

.117 An acceptable level of contributions and variability in benefits is usually established to guide the design of the terms in the plan. The existence or absence of the following terms may affect the likelihood of a change in accrued benefits:

(a) the specified contribution level;

(b) whether contributions can be adjusted;

(c) the contribution limit within which contributions may be adjusted;

(d) whether future benefits can be adjusted;

(e) the limit within which future benefits may be adjusted; and

(f) the relative order of a change in accrued benefits versus changes in contributions and future benefits.

.118 Factors that can affect the future funded status of a plan may include:

(a) current funded status of the plan;

(b) current and projected maturity of plan membership (such as current and expected future retiree-to-active-member ratio);

(c) current and projected contributions versus benefits payment ratio;

(d) investment policy and expected return on investments; and

(e) other relevant current and expected future economic and demographic factors.

.119 Under Section PS 3250, a plan amendment occurs when a benefit plan is changed or initiated. Any resulting changes in past service costs would be recognized in the period of the plan amendments. However, when contingent benefits and the related triggers are set out in the terms of a plan, they become part of the benefit provisions. Changes in benefits triggered by such provisions would not constitute plan amendments because the terms of the plan have not changed.

.120 The best estimate of the likelihood, timing and extent of changes in accrued benefits under contingent benefit provisions should be reflected in the actuarial assumptions used to determine the accrued benefit obligation. The resulting accrued benefit obligation would reflect the expected future benefit payments based on the design and the unique circumstances of the plan.

.121 The actuarial assumptions should be reviewed and reassessed regularly and/or as new information, facts, events and circumstances surface. What constitutes best estimate actuarial assumptions may change from time to time, and as circumstances change.

.122 Whether the potential changes in accrued benefits are specifically set out in the terms of the plan may affect if there is sufficient information and a reasonable basis to estimate the extent that future benefit payments may be affected. If there is insufficient information for a reasonable estimate, it may not be appropriate to reflect any effects of the contingent benefit provisions in the accrued benefit obligation until sufficient specificity of the potential changes in accrued benefits are known.

.123 Also, whether the potential changes in accrued benefits would be activated automatically needs to be considered. For example, granting of indexation may be automatic or subject to decisions of the employer, employees or third parties such as trustees or administrators of the plan. The nature and significance of such decisions may need to be evaluated to determine whether the potential changes in accrued benefits are in substance part of the benefit provisions or represent plan amendments. For example, it may not be appropriate to reflect potential changes in accrued benefits that would be subject to negotiations between the employer and employees until the benefit change is agreed to by both parties.

Reflecting contingent contribution and contribution limit provisions in actuarial assumptions

.124 Changes in contributions would affect the current and expected funded status of the plan, which could affect the likelihood, timing and extent that accrued benefits may be changed.

.125 The existence of a contribution limit could affect the current and expected funded status of the plan because it could restrict the extent that contributions can be changed. It could therefore affect the likelihood, timing and extent that accrued benefits may be changed.

.126 Current and expected future funded status of the plan, on the other hand, could affect:

(a) whether, when and to what extent contingent contribution provisions in the plan would be triggered; and

(b) whether and when a contribution limit would be reached.

.127 The interaction between the plan's funded status with the contingent contribution and contribution limit provisions should be taken into account in determining the likelihood and the extent that accrued benefits may change. Different combinations of scenarios and related probabilities should be considered in formulating the actuarial assumptions. There is no additional separate effect of contingent contribution and contribution limit provisions that need to be reflected in the accrued benefit obligation.

.128 Whether the possible changes in contributions are specifically set out in the terms of the plan may affect if there is sufficient information and a reasonable basis to estimate how the expected future funded status of the plan may be affected. Also, whether the potential changes in contributions would be activated automatically may affect if there is a reasonable basis to incorporate the potential changes in the expected funded status of the plan before they are activated.

Illustration of a plan with risk-sharing provisions

.129 The example in Chart 3 on page 25 shows how the different scenarios of funded statuses of the plan can trigger different combinations of risk-sharing corrective actions, assuming the corrective actions would be activated in the following order when there is a funding surplus/deficit:

(a) conditional indexation would be granted based on the funding surplus in the plan;

(b) changes in employer and employee contributions subject to a predefined contribution limit;

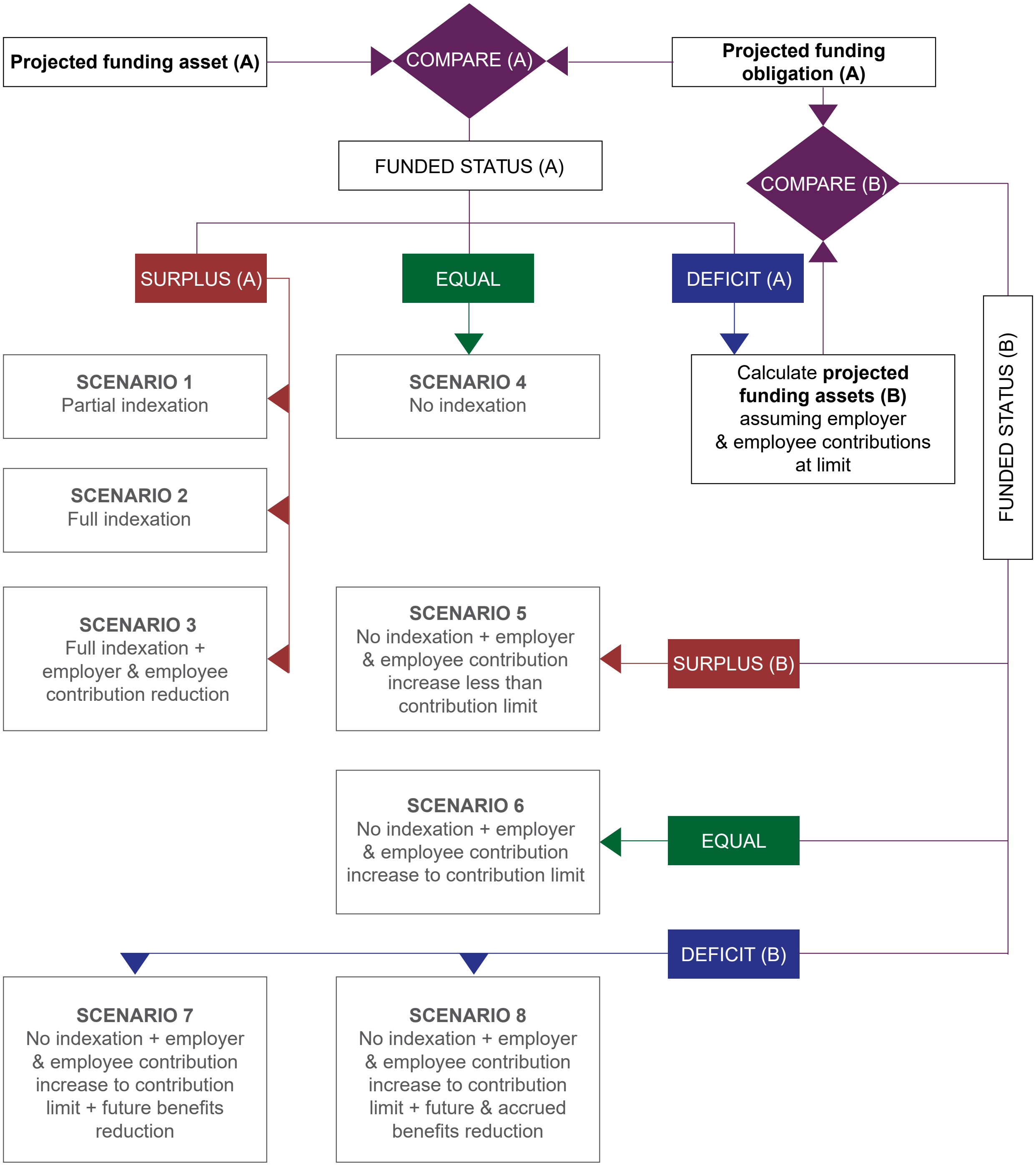
(c) changes in future benefits up to a predefined limit; and

(d) changes in accrued benefits up to a predefined limit.

.130 Chart 3 shows eight possible scenarios of the funded statuses of the plan and the related combinations of risk-sharing corrective actions that would be triggered under each scenario. In Scenarios 1, 2 and 3, different levels of funding surplus would trigger different corrective actions. Similarly, Scenarios 7 and 8 show that different levels of funding deficit would trigger different corrective actions.

.131 Scenarios 1, 2, 3 and 8 would trigger changes in benefits related to past services that have a direct effect on the accrued benefit obligation. The contribution increases and reduction in benefits related to future services under Scenarios 5, 6, 7 and 8 could affect the expected future funded status of the plan, which would affect the likelihood of changes in accrued benefits in the future. The likelihood of each of the eight scenarios and the effects of any resulting risk-sharing corrective actions would be taken into consideration in formulating the actuarial assumptions used to calculate the accrued benefit obligation of the plan.

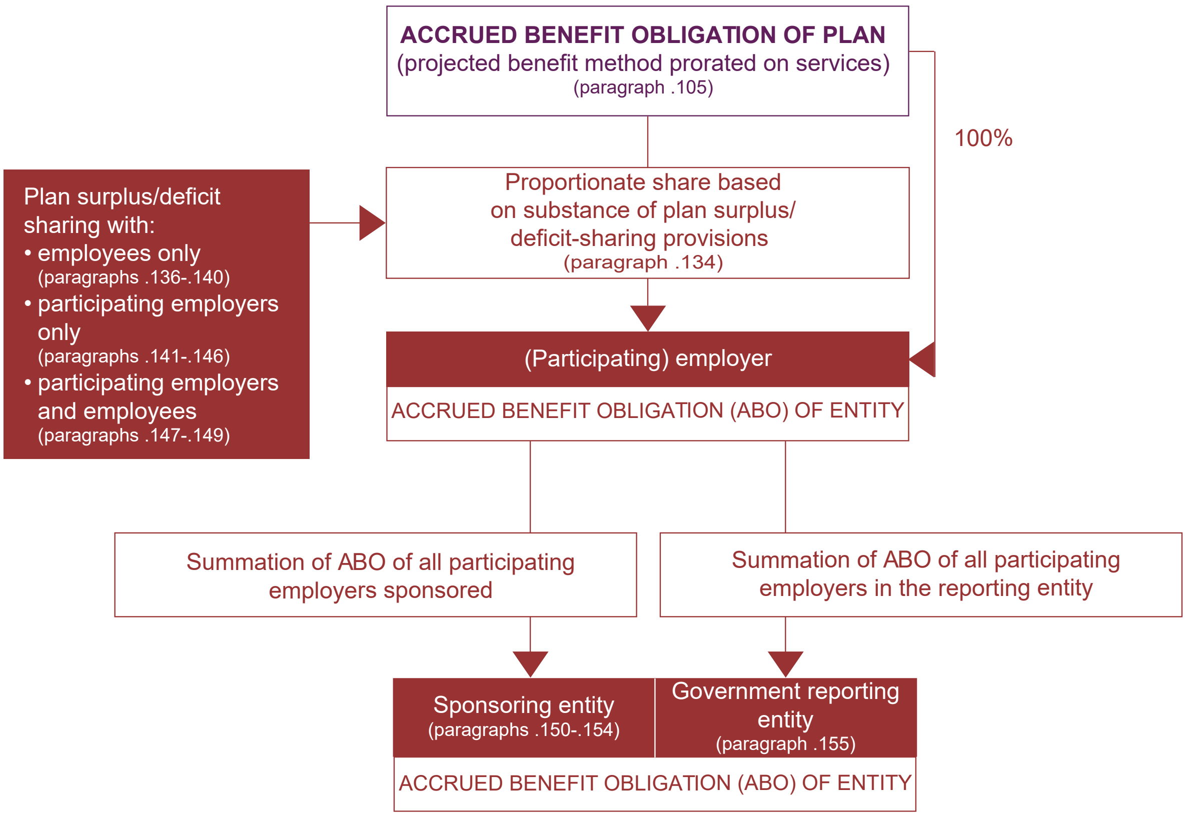
Chart 3: Illustration of funded status scenarios and resulting risk-sharing corrective actions



Guidance on plan surplus/deficit-sharing provisions

.132 Chart 4 below summarizes the effects of plan surplus/deficit-sharing provisions on determining the entity's share of the accrued benefit obligation of a plan at a high level. In general, risk-sharing provisions may affect the determination of the accrued benefit obligation of the plan. Plan surplus/deficit-sharing provisions would affect the determination of the entity's share of the accrued benefit obligation of the plan.

Chart 4: Effects of plan surplus/deficit-sharing provisions on accrued benefit obligation of the entity



.133 An employer may share the plan the surplus/deficit on a pro rata basis with:

(a) its employees;

(b) other participating employers;

(c) other participating employers and their employees; and/or

(d) a sponsoring entity.

.134 The overall objective of the potential accounting guidance in this section (see paragraphs .136-.154) is for the employer, the participating employer and the sponsoring entity to report its proportionate share of the accrued benefit obligation of the plan that reflects the substance of the plan surplus/deficit-sharing provisions in the plan. That is, its share of the ultimate costs and benefits of the plan related to past services.

.135 For plans that have both plan surplus/deficit-sharing and risk-sharing provisions, the accrued benefit obligation of the plan (before applying the proportionate share of the employer, the participating employer and the sponsoring entity) would be determined based on the potential guidance in paragraphs .100-.131.

Reflecting plan surplus/deficit sharing with employees in the employer's accrued benefit obligation

.136 Employers and employees may agree to share the benefit of a plan surplus and the cost of a plan deficit. Such agreement is usually specified in plan documents, memorandum of understanding and/or joint agreement between the two parties. The existence of a plan surplus/deficit-sharing provision is one of the key characteristics of joint defined benefit plans. However, other types of plans that do not have all the characteristics of joint defined benefit plans (see paragraphs .057-.058) may contain a surplus/deficit-sharing provision.

.137 If the terms of the plan specify the pro rata share of the plan surplus/deficit between the employer and the employees, consistent with the accounting for joint defined benefit plans in Section PS 3250, the employer would recognize its pro rata share of the accrued benefit obligation of the plan on this basis.

.138 The terms of the plan may not specify a pro rata share of the plan surplus/deficit. In these cases, the proportionate share of the accrued benefit obligation will be determined based on the substance of the plan surplus/deficit-sharing provisions. The plan surplus/deficit may be shared between the employer and employees through additional special contributions (or contribution holiday), adjustments to regular contributions, benefit changes and/or a combination of them. Changes made in contributions and benefits based on the plan's funded status may indicate the pro rata share of the plan surplus/deficit between the employer and employees.

.139 The employer's proportionate share should be reviewed and reassessed regularly or as new fact patterns and circumstances emerge. Adjustment to the employer's proportionate share of the accrued benefit obligation may be necessary if consistent fact patterns indicate that the risk and cost the employer bears have changed.

.140 Consistent with the potential guidance in paragraphs .104-.131, where applicable, any effects of potential changes in contributions and benefits to achieve sharing of a plan surplus/deficit would be reflected in the:

(a) actuarial assumptions if specific possible changes are predetermined and can be activated automatically without further decision by the employer and employees; or

(b) accrued benefit obligation when the plan is amended.

Reflecting plan surplus/deficit sharing among participating employers in the employer's accrued benefit obligation

.141 The following potential guidance applies to the participating employers of plans that provide pension benefits to employees of more than one employer (i.e., multiemployer plans), unless the substance of the employer contribution provisions in the plan reflects the description in paragraph .102.

.142 When the employer joins a multiemployer plan and agrees to share the plan surplus/deficit with other participating employers, it has a legal or constructive obligation to make additional contributions in the event of insufficient plan assets to pay the employees of all the participating employers. The participating employer's proportionate share of the accrued benefit obligation of the plan should reflect the substance of the plan surplus/deficit-sharing provisions, in terms of its share of the ultimate costs and benefits of the plan related to past services.

.143 If a sponsoring entity (see paragraph .150) has assumed some or all of the participating employer's obligation, the participating employer would reduce its proportionate share of the accrued benefit obligation of the plan by the portion the sponsoring entity has assumed.

.144 What would be considered a reasonable allocation method and basis on which the proportionate share would be determined may vary from plan to plan. Determining the participating employer's proportionate share of the plan surplus/deficit may involve certain simplification and reasonable approximation.

.145 The participating employer's proportionate share should be reviewed and reassessed regularly or as new fact patterns and circumstances emerge. Adjustment to the participating employer's proportionate share of the accrued benefit obligation may be necessary if consistent fact patterns indicate that the risk and cost the participating employer bears have changed.

.146 Paragraphs .141-.145 apply regardless of whether:

(a) some or all of the participating employers of the multiemployer plan are entities from the same government reporting entity; or

(b) the controlling government is a participating employer of the multiemployer plan.

Reflecting plan surplus/deficit sharing among participating employers and their employees in the employer's accrued benefit obligation

.147 When the participating employers and their employees agree to share the benefits of plan surplus and the costs of plan deficit of the multiemployer plan, each participating employer's proportionate share of the accrued benefit obligation of the plan can be considered as follows:

(a) the employees of all participating employers share the benefits of plan surplus and the costs of plan deficit with all the participating employers (see paragraph .148); and

(b) each participating employer shares the all-participating employers' portion of the accrued benefit obligation (see paragraph .149).

.148 The all-participating employers' share of the accrued benefit obligation of the multiemployer plan is similar to the employer's proportionate share of the accrued benefit obligation of the plan in which employees share the plan surplus/deficit on a pro rata basis with the employer. The potential guidance described in paragraphs .136-.140 would apply to determining the all-participating employers' share of the accrued benefit obligation of the multiemployer plan.

.149 Each participating employer's proportionate share of the all-participating employers' share of the accrued benefit obligation determined in paragraph .148 is similar to each participating employer's proportionate share of the accrued benefit obligation of a multiemployer plan. The potential guidance described in paragraphs .141-.146 would apply to determining each participating employer's share of the all-participating employers' share of the accrued benefit obligation.

Reflecting plan surplus/deficit sharing by the sponsoring entity

.150 A sponsoring entity of a plan is an entity that has assumed the obligations of the (participating) employer to pay:

(a) its required contributions toward current service; and

(b) additional contributions allocated to it in the event of insufficient plan assets to pay (all participating) plan members for services rendered in the current and prior periods.

.151 The sponsoring entity's agreement to assume the obligations of the (participating) employer may be set out in plan documents, memorandum of understanding, agreement or the enabling legislation/regulation of the plan.

.152 The sponsoring entity may itself be a participating employer of the same plan. A plan can have more than one sponsoring entity.

.153 The sponsoring entity would recognize the summation of the proportionate share of the accrued benefit obligation of each of the (participating) employers it sponsors as determined in paragraphs .136-.149. It would also include its own proportionate share of the accrued benefit obligation if it is also a participating employer.

.154 The mandate of some public sector entities is to provide operating funding to other public sector or not-for-profit entities. Such a resource provider may provide resources to the (participating) employer of a (multiemployer) plan with the intent that part of the resources may be used toward the (participating) employer's contributions related to current service and/or reduction/elimination of plan deficit. The resource provider is not a sponsoring entity of the (multiemployer) plan unless it has agreed to assume the obligations of the (participating) employer (see paragraph .150), regardless of whether the (participating) employer is part of the government reporting entity of the resource provider.

Accrued benefit obligation in consolidated financial statements

.155 For greater clarity, the accrued benefit obligation reported in the consolidated financial statements of the government reporting entity would be the summation of the proportionate share of the accrued benefit obligation of the (multiemployer) plans that is attributable to all consolidated entities in their capacity as the employer, the participating employer or the sponsoring entity.

APPENDIX: ILLUSTRATIVE EXAMPLE OF A TARGET BENEFIT PLAN

The example below illustrates the key features of a target benefit plan in the public sector.

Description

A public sector entity provides a contributory target benefit pension plan (Plan) for substantially all its employees. The Plan is open to all eligible full- and part-time employees.

Basic target pension benefit formula

The Plan provides for a target pension benefit equal to 2 per cent of the member's final average earnings over the last five years of service for each year of pensionable service with indexing. Indexation is increased annually on January 1 at a minimum of 25 per cent, up to a maximum of 50 per cent, of the annual change in the consumer price index (CPI) for Canada for the 12-month period ending September 30.

Contribution levels

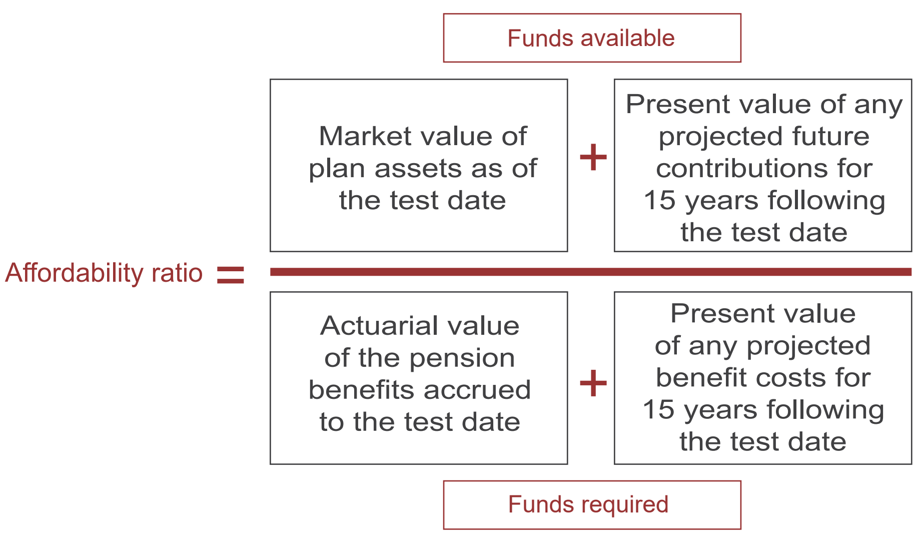
The entity and all active plan members contribute to the Plan based on a fixed range set out to provide target benefits as follows:

- Active plan members = 5 per cent base rate, up to a maximum of 6 per cent, of active plan member's salary
- Entity = 7.5 per cent base rate, up to a maximum of 8.5 per cent, of active plan member's salary

In the Plan's jurisdiction, there are no regulatory minimum funding requirements. However, contributions may increase or decrease within the range, depending on the actions deemed necessary as a result of the affordability test according to the benefit funding policy.

Affordability test

The Pension Board, which consists of employer and plan member representatives, performs an "affordability test" on the Plan at least every three years on the test date of January 1. This test assesses the Plan's long-term sustainability by considering whether its funded status determined on a going concern funding valuation is adequate to support the target benefits, and to signal any required corrective action by adjusting the benefit and/or contribution levels.



This test measures the relationship between “funds available” and “funds required” of the Plan as of the test date (i.e., January 1) to determine the “affordability ratio” as shown on page 37.

Benefit funding policy: Affordability ratio < 1.20

Following an affordability test in which the affordability ratio is < 1.20, mandatory actions shall be taken in the following order of priority until a ratio of 1.20 is reached:

- Increase contributions of active plan members and the Entity up to the specified maximum rates.
- Reduce the level of future indexing on an annual basis down to a minimum of 25 per cent change in the CPI.
- Reduce benefits.

Benefit funding policy: Affordability ratio ≥ 1.20

- When the affordability ratio is ≥ 1.20 and ≤ 1.40, actions are optional.
- When the affordability ratio is > 1.40, actions are mandatory until a ratio of 1.20 to 1.40 is reached.

Actions shall be taken in the following order of priority:

- Reinstate any previous benefit reductions.
- Reverse any previous contribution increases.
- Build a contingency reserve to the level recommended by the Actuary and approved by the Pension Board.
- Improve the target pension benefit formula.

Illustration of affordability ratio and resulting corrective actions