Statutory Issue Paper No. 8

Accounting for Pensions

STATUS
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Current Authoritative Guidance for Pensions: SSAP No. 102

This issue paper may not be directly related to the current authoritative statement.

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Type of Issue:
Common Area

definition of assets and nonadmitted assets set forth in *Issue Paper No. 4—Definition of Assets and Nonadmitted Assets*.

5. If a reporting entity settles or curtails a defined benefit plan, the reporting entity shall immediately recognize all previously unrecognized amounts as discussed below. A settlement is a transaction which is irrevocable and releases the employer from responsibility for the pension obligation by eliminating the risks relative to the obligation and the assets associated with the plan (e.g., making lump-sum cash payments to plan participants in exchange for their rights to receive specified pension benefits or purchasing nonparticipating annuity contracts to cover vested benefits). If a settlement occurs and the net result is a loss, such loss is recognized at the time of the settlement. If the net result is a gain, such gain is not recognized until the proceeds are received by the reporting entity. A curtailment is an event which significantly alters the make up of the pension plan (e.g., a reduction in the years of service required or the employees covered). If a curtailment occurs, there are generally two components to any gain or loss. Any unrecognized prior service cost shall be recognized as a loss. An increase or decrease in pension benefit obligations due to the curtailment will also result in a gain or loss, and is combined with the prior service cost loss. If the net result of the curtailment is a loss, such loss shall be recognized when it is probable that the curtailment will occur and that the effects can be reasonably estimated. If the net result is a gain, such gain shall not be recognized in earnings until the employees terminate or the plan suspension or amendment is adopted and the proceeds are received by the reporting entity. When such gains are recognized, any excess tax surcharges shall also be recognized.

Defined Contribution Plans

6. A defined contribution plan defines the amount of the employer's contributions to the plan and its allocation to plan participants. The pension benefit provided to the plan participant at retirement or termination depends on the amount of employer and employee contributions, earnings on plan investments and, in some plans, other participant forfeitures.

7. For defined contribution plans, the reporting entity shall expense contributions required by the plan over the period in which the employee vests in those contributions. Contributions to plan participants' accounts made prior to vesting shall be treated as prepaid expenses, and shall be nonadmitted. Contributions required after participants terminate or retire shall be accrued and an expense shall be recorded over the working lives of the participants beginning at the date the participant initially vests in plan contributions.

8. Certain defined contribution plans may define the employer’s contribution as a percentage of the plan participants’ individual compensation rather than as a specific dollar amount which is allocated

the transition obligation or asset calculated above shall be compared to those amounts previously recorded under FAS 87. The difference between these amounts represents an incremental asset or liability. If the reporting entity has not previously adopted FAS 87 for statutory accounting purposes, the entire transition asset or obligation represents the incremental asset or liability.

12. At the effective date of Codification, if the reporting entity calculates an incremental liability, this liability shall be recognized according to one of the two following methods:

a. The reporting entity may elect to record the entire incremental liability as a direct charge to surplus;

b. Alternatively, the reporting entity may elect to amortize the incremental liability as a component of net periodic pension cost over a period not to exceed 20 years.

13. At the effective date of Codification, if the reporting entity calculates an incremental asset, this asset shall be recognized according to one of the two following methods:

a. The reporting entity may elect to record the entire incremental asset as a direct credit to surplus;

b. Alternatively, the reporting entity may elect to accrue the incremental asset as a component of net periodic pension cost in an amount each period such that total net periodic pension cost may be reduced to an amount not less than zero (i.e., the accrual of the incremental asset may be used to offset current period net periodic pension cost).

An incremental asset resulting from a transition obligation that is less than an amount previously recorded

c. At the date of adoption of this accounting principle, the pension obligation or asset not previously recognized related to vested employees may be recorded immediately or may be amortized over future periods.

d. A net gain (net of excess tax surcharge) resulting from the settlement or curtailment of a pension plan is not recognized until the proceeds are received by the reporting entity.

e. The reduced disclosure requirements for nonpublic entities described in paragraph 8 of FAS 132 are rejected. All reporting entities shall follow the disclosure requirements included in paragraph 5 of FAS 132.

f.

- Postretirement benefits other than pensions are addressed in *Issue Paper No. 14—Employers' Accounting for Postretirement Benefits Other Than Pensions*.
- Other deferred compensation plans, such as Rabbi Trusts and ESOPs, are addressed in a separate issue paper.
- The tax attributes associated with the accounting principles discussed in this paper (i.e., deferred income taxes) are not currently recognized in existing statutory accounting guidance. Accounting principles for federal income taxes are addressed in a separate issue paper.
- Holding company obligations are addressed in a separate issue paper.

RELEVANT STATUTORY ACCOUNTING AND GAAP GUIDANCE

Statutory Accounting

20. The position adopted by the Accounting Practices and Procedures (EX4) Task Force is summarized in the minutes from its September 15, 1987 meeting. Key points are paraphrased below:

> For multi-company plans sponsored by a parent company, the pension expenses would be the amount contributed by the company to the parent company related to the pension plan. This is comparable to the treatment of multi-employer and similar plans under FAS 87.
>
> For plans sponsored by the reporting company, pension expense is the amount to be funded for the period. If the company chooses to adopt FAS 87 and 88, any resulting intangible or prepaid asset would be considered nonadmitted unless approved by the insurer's state of domicile as appropriate. For self-funded plans, i.e. where the company reflects the assets of the pension plan among its own assets, the amount of accrued pension costs and its location in the balance sheet should be disclosed. Accrued pension costs related to the pension plan would be determined in

22. The NAIC Annual Statement Instructions for Life and Accident and Health and for Property and Casualty Insurance Companies specify the required disclosures developed by the Study Group of EX4 and adopted by EX4 which include:

a. a description of the plan's funding policy,
b. the method of determination and the amount of pension expense,
c. the amount of the accumulated benefit obligation, the amount of vested benefits and the fair value of the plan assets valued as of the most recent actuarial valuation date,
d. any funding waiver requested or obtained from the IRS,
e. for an unfunded plan, the method of funding the obligation and how the deficiency will be met,
f. significant matters affecting the year-to-year comparability of the pension information and
g. the location(s) and amount(s) of liabilities for benefits.

Illustrations of sample disclosures are also provided in the Annual Statement Instructions.

23. The Accounting Practices and Procedures Manual for Life and Accident and Health Insurance Companies, Chapter 17, Other Liabilities, contains the following with respect to pension plans:

> <u>Liabilities for Benefits for Employees and Agents</u>
>
> A company may be required or desire to establish a liability for certain benefits to employees and agents which are not provided for in other account

any tax benefits that result from considering such losses as temporary differences for purposes of applying the provisions of FASB Statement No. 109, Accounting for Income Taxes.

The intangible asset representing the unrecognized prior service cost (which at the date of initial adoption would be the unrecognized net obligation) is amortized as a component of the net periodic pension cost on a straight-line basis over the average remaining service period of employees expected to receive benefits under the plan, except that, (a) if the average remaining service period is less than 15 years, the employer may elect to use a 15-year period, and (b) if all or almost all of a plan's participants are inactive, the employer shall use the inactive participants' average remaining life expectancy period.

26. FAS 88 prescribes a method for determining the amount to be recognized in earnings when a pension obligation is settled, a plan is curtailed or benefits are provided to employees in connection with 2

rate changes[4], contributions by the employer, contributions by plan participants, benefits paid, business combinations, divestitures, and settlements

[4] Refer to footnote 3.

c. The funded status of the plans, the amounts not recognized in the statement of financial position, and the amounts recognized in the statement of financial position, including:
   (1) The amount of any unamortized prior service cost
   (2) The amount of any unrecognized net gain or loss (including asset gains and losses not yet reflected in market-related value)
   (3) The amount of any remaining unamortized, unrecognized net obligation or net asset existing at the initial date of application of Statement 87 or 106
   (4) The net pension or other postretirement benefit prepaid assets or accrued liabilities
   (5) Any intangible asset and the amount of accumulated other comprehensive income recognized pursuant to paragraph 37 of Statement 87, as amended

d. The amount of net periodic benefit cost recognized, showing separately the service cost component, the interest cost component, the expected return on plan assets for the period, the amortization of the unrecognized transition obligation or transition asset, the amount of recognized gains and losses, the amount of prior service cost recognized, and the amount of gain or loss recognized due to a settlement or curtailment

e. The amount included within other comprehensive income for the period arising from a change in the additional minimum pension liability recognized pursuant to paragraph 37 of Statement 87, as amended

f. On a weighted-average basis, the following assumptions used in the accounting for the plans: assumed discount rate, rate of compensation increase (for pay-related plans), and expected long-term rate of return on plan assets

g. The assumed health care cost trend rate(s) for the next year used to measure the expected cost of benefits covered by the plan (gross eligible charges) and a general description of the direction and pattern of change in the assumed trend rates thereafter, together with the ultimate trend rate(s) and when that rate is expected to be achieved

h. The effect of a one-percentage-point increase and the effect of a one-percentage point decrease in the assumed health care cost trend rates on (1) the aggregate of the service and interest cost components of net periodic postretirement health care benefit cost and (2) the accumulated postretirement benefit obligation for health care benefits (For purposes of this disclosure, all other assumptions shall be held constant, and the effects shall be measured based on the substantive plan that is the basis for the accounting.)

i. If applicable, the amounts and types of securities of the employer and related parties included in plan assets, the approximate amount of future annual benefits of plan participants covered by insurance contracts issued by the employer or related parties, and any significant transactions between the employer or related parties and the plan during the period

j. If applicable, any alternative amortization method used to amortize prior service amounts or unrecognized net gains and losses pursuant to paragraphs 26 and 33 of Statement 87 or paragraphs 53 and 60 of Statement 106

k. If applicable, any substantive commitment, such as past practice or a history of regular benefit increases, used as the basis for accounting for the benefit obligation

l. If applicable, the cost of providing special or contractual termination benefits recognized during the period and a description of the nature of the event

m. An explanation of any significant change in the benefit obligation or plan assets not otherwise apparent in the other disclosures required by this Statement.

Amounts related to the employer's results of operations shall be disclosed for each period for which an income statement is presented. Amounts related to the employer's statement of financial position shall be disclosed for each balance sheet presented.

Employers with Two or More Plans

6. The disclosures required by this Statement may be aggregated for all of an employer's defined benefit pension plans and may be aggregated for all of an employer's defined benefit postretirement plans or may be disaggregated in groups if that is considered to provide the most useful information or is otherwise required by paragraph 7. Disclosures about pension plans with assets in excess of the accumulated benefit obligation generally may be aggregated with disclosures about pension plans with accumulated benefit obligations in excess of assets. The same aggregation is permitted for postretirement plans. However, if those disclosures are combined, an employer shall disclose the aggregate benefit obligation and aggregate fair value of plan assets for plans with benefit obligations in excess of plan assets. The aggregate pension accumulated benefit obligation and aggregate fair value of plan assets for pension plans with accumulated benefit obligations in excess of plan assets also shall be disclosed. Disclosure of amounts recognized in the statement of financial position shall present prepaid benefit costs and accrued benefit liabilities separately.

7. An employer may combine disclosures about pension or postretirement benefit plans outside the United States with those for U.S. plans unless the benefit obligations of the plans

g. If applicable, the amounts and types of securities of the employer and related parties included in plan assets, the approximate amount of future annual benefits of plan participants covered by insurance contracts issued by the employer or related parties, and any significant transactions between the employer or related parties and the plan during the period

h. The nature and effect of significant nonroutine events, such as amendments, combinations, divestitures, curtailments, and settlements.

Defined Contribution Plans

9. An employer shall disclose the amount of cost recognized for defined contribution pension or other postretirement benefit plans during the period separately from the amount of cost recognized for defined benefit plans. The disclosures shall include a description of the nature and effect of any significant changes during the period affecting comparability, such as a change in the rate of employer contributions, a business combination, or a divestiture.

Multiemployer Plans

10. An employer shall disclose the amount of contributions to multiemployer plans during the period. An employer may disclose total contributions to multiemployer plans without disaggregating the amounts attributable to pensions and other postretirement benefits. The disclosures shall include a description of the nature and effect of any changes affecting comparability, such as a change in the rate of employer contributions, a business combination, or a divestiture.

11. Paragraph 70 of Statement 87 and paragraph 83 of Statement 106 are carried forward without reconsideration. Paragraphs 70 and 83 read as follows:

> In some situations, withdrawal from a multiemployer plan may result in an employer's having an obligation to the plan for a portion of its unfunded benefit obligations. If withdrawal under circumstances that would give rise to an obligation is either probable or reasonably possible, the provisions of FASB Statement No. 5, , shall apply.

> In some situations, withdrawal from a multiemployer plan may result in an employer's having an obligation to the plan for a portion of the plan's unfunded accumulated postretirement benefit obligation. If it is either probable or reasonably possible that (a) an employer would withdraw from the plan under circumstances that would give rise to an obligation or (b) an employer's contribution to the fund would be increased during the remainder of the contract period to make up a shortfall in the funds necessary to maintain the negotiated level of benefit coverage (a "maintenance of benefits" clause), the employer shall apply the provisions of , .

Financial Accounting Standard (FAS) No. 87, “Employers' Accounting for Pensions,” or based upon funding required under the Employee Retirement Income Security Act (ERISA).

If FAS 87 is adopted, pension service costs must be recognized over the period a participant renders service to the company for qualified and non-qualified (e.g. Top Hat Plans) defined benefit pension plans.

If the ERISA funding method is elected, an insurance company will record the pension service costs for defined benefit pension plans based upon requirements of ERISA for qualified pension plans. Pension service costs will then be recorded in conjunction with funding required by ERISA for such qualified plans on a pay-as-you-go basis. When ERISA dictates additional funding is required, the employer will recognize this funding as a corresponding expense.

If the ERISA funding method is elected for qualified defined benefit pension plans, pension service costs associated with any non-qualified plans must be accrued as earned. Those service costs must be accrued over the working lives of the participants covered under the non-qualified plan.

For defined contribution benefit plans, the insurance company is responsible for making specific contributions to a participant's pension plan account. The insurance company must accrue the contributions required by the plan in the period in which those contributions are earned. Contributions to plan participants' accounts required during the participants' working lives must be expensed over that period. The contributions required after participants terminate or retire require an expense be accrued and a liability established over the working lives of the participants.

If a company makes contributions to the defined contribution plan in excess of those allocated to individual participants, the excess is recorded as a prepaid asset.

<u>Settlements and Curtailments of Pension Plans</u>

Companies that offer their employees defined benefit pension plans periodically settle or curtail the plan.

A settlement is a transaction which is irrevocable, releases the employer from responsibility for the pension, and eliminates the risks relative to the obligation and the assets associated with the plan. For example, lump-sum cash payout to the employees in lieu of their pension rights.

A curtailment is an event which significantly alters the make up of the pension plan. For example, the years of service required is reduced or the employees covered under the plan is decreased.

Settlements and curtailments of pension plans should be accounted for using generally accepted accounting principles.

30. The chapter on Non-Claim Operating Expenses included in the draft discussion material from previous Property/Casualty codification projects contains the following language which contradicts some of the Life Codification language:

Statement of the Financial Accounting Standards Board (“FASB”) No. 87, “Employers' Accounting for Pensions” was issued in December 1985 and superseded Accounting Principles Board (“APB”) Opinion 8 “Accounting for the Cost of Pension Plans”. FASB 87 should be followed in accounting for pension plans. FASB 87 requires that pension plans be accounted for on the accrual basis of accounting and any difference between “Net Period Pension Cost” incurred and the amount actually funded is accrued. GAAP permits the recognition of an asset for the excess of any pension funds over the plan's liabilities. SAP, however, does not permit the recognition of any prepaid pension expense. “Net Periodic Pension Cost” includes the following components:

- *FASB Emerging Issues Task Force No. 96-5, Recognition of Liabilities for Contractual Termination Benefits or Changing Benefit Plan Assumptions in Anticipation of a Business Combination*

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