

# Statutory Issue Paper No. 8

## Accounting for Pensions

### STATUS

Finalized December 6, 1999

### Current Authoritative Guidance for Pensions: SSAP No. 102

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

### Original SSAP from Issue Paper: SSAP No. 8

### Type of Issue:

Common Area

### SUMMARY OF ISSUE

1. The current Accounting Practices and Procedures Manuals for Life and Accident and Health and for Property and Casualty Insurance Companies do not address employers' accounting for pension plans. However, a position paper was prepared by the Study Group of EX4 on Accounting for Insurance Company-Funded Pensions and was adopted by the NAIC. The adopted position does not mandate a specific accounting method but calls for expanded disclosures with regard to pension accounting and is documented in the September 15, 1987 Accounting Practices and Procedures (EX4) Task Force minutes. Under this existing guidance, reporting entities have the option of continuing to recognize pension costs on the pay-as-you-go (Employee Retirement Income Security Act funding) method or adopting the provisions of *FASB Statement No. 87, Employers' Accounting for Pensions* (FAS 87), which requires recognition of pension costs over the period a participant renders service to the reporting entity and recognition of a liability for unfunded costs.

2. FAS 87 requires recognition of pension costs over the period a participant renders service to the reporting entity and recognition of a liability for unfunded costs. It also permits the recognition of an asset when the pension plan is over funded (i.e., plan assets exceed plan liabilities). *FASB Statement No. 88, Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits* (FAS 88), requires recognition of previously unrecognized amounts when a reporting entity settles or curtails a defined benefit plan or provides benefits in connection with the termination of an employee. *FASB Statement No. 132, Employers' Disclosures about Pensions and Other Postretirement Benefits* (FAS 132), specifies disclosure requirements for pension and other postretirement benefit plans.

3. The purpose of this issue paper is to establish statutory accounting principles for an employer's pension obligations that are consistent with the Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy (Statement of Concepts).

### SUMMARY CONCLUSION

#### Defined Benefit Plans

4. A defined benefit plan defines the amount of the pension benefit that will be provided to the plan participant at retirement or termination. For such benefit plans, reporting entities shall adopt FAS 87 with a modification to exclude non-vested employees. Therefore, the cost related to services rendered prior to becoming eligible and vested in the plan are recognized as a component of the net periodic pension cost in the period the employee becomes vested. Any intangible asset or prepaid expense resulting from adoption of the provisions of this issue paper shall be considered a nonadmitted asset, as such an asset cannot be readily converted to cash to satisfy policyholder obligations. This is consistent with the

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 among the plan participants. If an employer's contributions to a defined contribution plan are in excess of those required under the plan and required to be allocated to individual participants, such amounts are recorded as a prepaid expense and nonadmitted under statutory accounting principles.

#### **Disclosures**

9. The disclosures required by paragraph 5 of FAS 132 shall be included in the notes to the statutory financial statements considering the modification in this issue paper to include only vested employees. Paragraph 5 of FAS 132 is included in the Relevant GAAP Guidance section of this issue paper.

10. The disclosures required by paragraph 5 of FAS 132 shall be made when an employer recognizes a gain or loss related to a settlement or curtailment of a defined benefit plan or when providing termination benefits.

#### **Transition**

11. At the effective date of Codification, the transition obligation or asset shall be determined as the difference between the vested projected benefit obligation and the fair value of plan assets. If prior to the effective date of Codification, the reporting entity has adopted FAS 87 for statutory accounting purposes,

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 under FAS 87 should first reduce the recorded liability. Any remaining incremental asset shall be recorded as nonadmitted.

### **Consolidated/Holding Company Plans**

14. The employees of many reporting entities are members of a plan sponsored by a parent company or holding company. A reporting entity who participates in these plans and is not directly liable for obligations under the plan shall recognize pension expense equal to its allocation from the holding company or parent company of the required contribution to the plan for the period. A liability shall be established for any such contributions due and unpaid. Furthermore, the reporting entity shall disclose in the notes to the financial statements that its employees participate in a plan sponsored by the holding company for which the reporting entity has no legal obligation. The amount of expense incurred and the allocation methodology utilized by the provider of such benefits shall also be disclosed. If the reporting entity is directly liable for obligations under the plan, then the requirements outlined above in paragraphs 4 to 13 of this issue paper shall be applied.

### **DISCUSSION**

15. The conclusions in paragraphs 4 to 13 above adopt FAS 87, FAS 88, and FAS 132 with the following modifications:

- a. Calculation of the pension obligation shall exclude non-vested employees. Partially vested employees are included only to the extent of their vested amounts.
- b. Any asset which results from an excess of the fair value of plan assets over the pension obligation shall be recorded as a nonadmitted asset.

- 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. Disclosures relating to other comprehensive income in paragraph 5 of FAS 132 shall be made for income on a statutory basis.

This is consistent with the definition of liabilities as defined in *Issue Paper No. 5—Definition of Liabilities, Loss Contingencies and Impairments of Assets*.

16. This issue paper also adopts *FASB Emerging Issues Task Force No. 88-1, Determination of Vested Benefit Obligation for a Defined Benefit Pension Plan*, *FASB Emerging Issues Task Force No. 90-3, Accounting for Employers' Obligations for Future Contributions to a Multiemployer Pension Plan*, *FASB Emerging Issues Task Force No. 91-7, Accounting for Pension Benefits Paid by Employers after Insurance Companies Fail to Provide Annuity Benefits*, and *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*.

17. Accounting for any intangible asset or prepaid expense resulting from application of the provisions of this issue paper as a nonadmitted asset is consistent with the recognition concept in the Statement of Concepts which states that:

The ability to meet policyholder obligations is predicated on the existence of readily marketable assets available when both current and future obligations are due. Assets having economic value other than those which can be used to fulfill policyholder obligations, or those assets which may be unavailable due to encumbrances or other third party interests should not be recognized on the balance sheet but rather should be charged against surplus when acquired or when availability otherwise becomes questionable.

18. The transition rules have been modified from FAS 87. For an incremental asset or liability which is not recorded immediately upon adoption of the above provisions, an employer is permitted to amortize the incremental asset or liability as a component of net periodic pension cost over future periods in accordance with paragraphs 12 and 13. FAS 87 requires that any transition amount be amortized on a straight-line basis over the average remaining service period of employees expected to receive benefits (except for employers with all or nearly all inactive employees or those with an average remaining service period of less than 15 years).

19. The guidance as discussed in paragraph 1 above, requires expanded disclosures rather than mandating a specific accounting method. However, this adopted position is inconsistent with the concept of recognition outlined in the Statutory Statement of Concepts which states: "*Liabilities require recognition as they are incurred.*" Therefore, adoption of FAS 87, with modifications, will be required for statutory accounting and reporting.

#### **Drafting Notes/Comments**

- Postemployment benefits are addressed in *Issue Paper No. 13—Employers' Accounting for Postemployment Benefits*.

- 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 accordance with accepted actuarial methods.

For companies which report on a GAAP basis, but choose to retain statutory accounting methods for state regulatory reporting, additional footnote disclosures supplementing those outlined below are encouraged but not required.

21. The following observations, among others, were made by the Study Group of EX4:

One of the principal reasons that FAS 87 and 88 were adopted under GAAP was to improve income statement comparability. This comparability has a stronger emphasis on a GAAP income statement than is typical for statutory reporting which is balance sheet oriented.

The liquidation priority of a pension plan liability appears to be behind policyholder liabilities. It appears that unless there is a perfected interest by the pension plan participants or the Pension Benefit Guaranty Corp., that the pension plan stands as a general creditor behind the policyholder. The FASB is less interested in this aspect since the thrust of its position was one of economic over legal substance. However, statutory accounting is on a modified going-concern basis. In addition, the interest of the policyholder is of utmost importance and is primarily responsible for the rationale used in statutory reporting. Nevertheless, the responsibility of the insurance company to live up to its pension plan obligations on an ongoing basis must be recognized.

If FAS 87 were adopted for SAP, certain issues would need to be addressed such as whether the assets (prepaid pension cost and an intangible asset) and liabilities (accrued pension cost) that may arise should be permitted or required to be reported in the financial statements. It would appear that the prepaid and intangible assets would be considered nonadmitted assets since they represent assets, potential or otherwise, not available to satisfy policyholder obligations. Furthermore, companies with unfunded pension plans could be impaired or rendered insolvent by implementing GAAP basis accounting for pensions.

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:

Liabilities for Benefits for Employees and Agents

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 accounts. Examples include: 1. It may be desirable to hold the liability for a nonqualified pension plan in this category in order to assist the tax department in adjusting their tax deductions.

**Generally Accepted Accounting Principles**

24. FAS 87 focuses primarily on single-employer defined benefit plans and requires:

- a. a standardized method for measuring net periodic pension cost (unit credit actuarial method or projected unit credit actuarial method depending on the type of plan),
- b. immediate recognition of a liability (the minimum liability) when the accumulated benefit obligation exceeds the fair value of plan assets with delayed recognition of the offsetting amount as an increase in net periodic pension cost, and
- c. various disclosures about the plan including the components of net pension cost and of the projected benefit obligation in the financial statements. (Paraphrased from the "Fundamentals of Pension Accounting" section of the "Summary" section immediately preceding the FAS 87 statement.)

25. The following is a brief paraphrased summary of the key provisions under FAS 87:

FAS 87 requires the recognition of a liability (unfunded accrued pension cost) if net periodic pension cost as determined under FAS 87 exceeds amounts the employer has contributed to the plan. An asset (prepaid pension cost) is recognized if net periodic pension cost is less than amounts the employer has contributed to the plan.

For defined benefit pension plans, an additional pension liability (referred to as the minimum liability) must be recognized when the accumulated benefit obligation (defined in FAS 87) for plan participants exceeds the fair value of the plan assets plus or minus any accrued or prepaid pension expense. If an additional liability is recognized, an equal amount shall be recognized as an intangible asset, provided that the asset recognized shall not exceed the amount of unrecognized prior service cost (defined in FAS 87). If an additional liability required to be recognized exceeds unrecognized prior service cost, the excess (which would represent a net loss not yet recognized as net periodic pension cost) is reported as a reduction in equity, net of

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 their termination of employment. 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. 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).

27. FAS 88 requires recognition of certain previously unrecognized amounts when certain transactions or events occur, the source and timing of the amount to be recognized in earnings will vary with the nature of the transaction. Generally, if a settlement occurs, a gain or loss is recognized related to previously unrecognized gains or losses from either changes in assumptions or actual results which were different from that assumed. In addition, any unamortized net asset from the implementation of FAS 87 is recognized as a gain. If a curtailment occurs, there are generally two components to any gain or loss. Any unrecognized prior service cost is recognized as a loss. An increase or decrease in pension benefit obligations due to the curtailment will also result in a gain or a loss, and is combined with the prior service cost loss. If the net result of the curtailment is a loss, it is recognized when it is probable that the curtailment will occur and that the effects are reasonably estimable. If the net result is a gain, it is not recognized in earnings until the employees terminate or the plan suspension or amendment is adopted.

28. FAS 132 requires the following disclosures:

#### Disclosures about Pensions and Other Postretirement Benefits

5. An employer that sponsors one or more defined benefit pension plans or one or more defined benefit postretirement plans shall provide the following information:

- a. A reconciliation of beginning and ending balances of the benefit obligation<sup>2</sup> showing separately, if applicable, the effects during the period attributable to each of the following: service cost, interest cost, contributions by plan participants, actuarial gains and losses, foreign currency exchange rate changes<sup>3</sup>, benefits paid, plan amendments, business combinations, divestitures, curtailments, settlements, and special termination benefits

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<sup>2</sup> For defined benefit pension plans, the benefit obligation is the projected benefit obligation—the actuarial present value as of a date of all benefits attributed by the pension benefit formula to employee service rendered prior to that date. For defined benefit postretirement plans, the benefit obligation is the accumulated postretirement benefit obligation—the actuarial present value of benefits attributed to employee service rendered to a particular date.

<sup>3</sup> The effects of foreign currency exchange rate changes that are to be disclosed are those applicable to plans of a foreign operation whose functional currency is not the reporting currency pursuant to *FASB Statement No. 52, Foreign Currency Translation*.

- b. A reconciliation of beginning and ending balances of the fair value of plan assets showing separately, if applicable, the effects during the period attributable to each of the following: actual return on plan assets, foreign currency exchange

rate changes<sup>4</sup>, contributions by the employer, contributions by plan participants, benefits paid, business combinations, divestitures, and settlements

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<sup>4</sup> Refer to footnote 3.

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- 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 outside the United States are significant relative to the total benefit obligation and those plans use significantly different assumptions.

#### Reduced Disclosure Requirements for Nonpublic Entities

8. A nonpublic entity<sup>5</sup> may elect to disclose the following for its pension and other postretirement benefit plans in lieu of the disclosures required by paragraph 5 of this Statement:

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<sup>5</sup> A nonpublic entity is any entity other than one (a) whose debt or equity securities trade in a public market either on a stock exchange (domestic or foreign) or in the over-the-counter market, including securities quoted only locally or regionally, (b) that makes a filing with a regulatory agency in preparation for the sale of any class of debt or equity securities in a public market, or (c) that is controlled by an entity covered by (a) or (b).

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- a. The benefit obligation, fair value of plan assets, and funded status of the plan
- b. Employer contributions, participant contributions, and benefits paid
- c. The amounts recognized in the statement of financial position, including the net pension and other postretirement benefit prepaid assets or accrued liabilities and 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 and the amount included within other comprehensive income arising from a change in the minimum pension liability recognized pursuant to paragraph 37 of Statement 87, as amended
- e. 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
- f. 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

- 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, *Accounting for Contingencies*, 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 *FASB Statement No. 5, Accounting for Contingencies*.

### OTHER SOURCES OF INFORMATION

29. The NAIC Technical Resource Group Proposed Draft Life Codification, Chapter 23, General Expenses and Taxes, Licenses and Fees, contains the following language:

#### Pension Costs

Many insurance companies offer their employees' pension plans as part of the compensation package for service rendered. Pension plans include defined contribution or defined benefit pension plans. The accounting for each of these types differs.

For defined benefit pension plans, an insurance company is responsible for providing a specified benefit to the plan participants at retirement. The insurance company has the option of recognizing the benefit costs by adoption Financial Accounting Standards Board Statement 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.

#### Settlements and Curtailments of Pension Plans

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:

1. Current service cost. (The present value of future benefits earned for the employee's current service.)
2. Amortization of unrecognized prior service or retroactive benefit costs over the future service periods of those employees active at the inception or plan amendment date. (The present value of future benefits credited for an employee's prior service at the inception or amendment of the plan should be ratably accrued over his remaining service life.)
3. "Gains and losses are changes in the amount of either the projected benefit obligation or plan assets resulting from experience different from that assumed and changes in assumptions." "Because gains and losses may reflect refinements in estimates as well as real changes in economic values and because some gains in one period may be offset by losses in another or vice versa, ... "such gains and losses are not recognized as part of "net pension cost in the period in which they arise". FASB 87 sets forth the minimum and alternative methods of amortizing net gains and losses.

FASB 88 "Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits" should be followed when such plans are terminated.

## RELEVANT LITERATURE

### Statutory Accounting

- Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy
- *Issue Paper No. 3—Accounting Changes*
- *Issue Paper No. 4—Definition of Assets and Nonadmitted Assets*
- *Issue Paper No. 5—Definition of Liabilities, Loss Contingencies and Impairments of Assets*
- Minutes from the June 23, 1987 meeting of the Accounting Practices and Procedures (EX4) Task Force
- Minutes from the September 15, 1987 meeting of the Accounting Practices and Procedures (EX4) Task Force
- Minutes from the June 12, 1986 meeting of the Emerging Accounting Issues Working Group of the Accounting Practices and Procedures (EX4) Task Force
- Minutes from the September 8, 1986 meeting of the Emerging Accounting Issues Working Group of the Accounting Practices and Procedures (EX4) Task Force
- Accounting Practices and Procedures Manual for Life and Accident and Health Insurance Companies, Chapter 17, *Other Liabilities*
- Accounting Practices and Procedures Manual for Property and Casualty Insurance Companies
- NAIC Annual Statement Instructions for Life and Accident and Health Insurance Companies
- NAIC Annual Statement Instructions for Property and Casualty Insurance Companies
- Employers' Accounting for Postretirement Benefits Other Than Pensions - Field Test of the Statutory Proposal - prepared by the Codification Advisory Group, September 20, 1992

### Generally Accepted Accounting Principles

- *FASB Statement No. 87, Employers' Accounting for Pensions*
- *FASB Statement No. 88, Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits*
- *FASB Statement No. 132, Employers' Disclosures about Pensions and Other Postretirement Benefits*
- *FASB Emerging Issues Task Force No. 88-1, Determination of Vested Benefits Obligation for a Defined Benefit Pension Plan*
- *FASB Emerging Issues Task Force No. 90-3, Accounting for Employers' Obligations for Future Contributions to a Multiemployer Pension Plan*
- *FASB Emerging Issues Task Force No. 91-7, Accounting for Pension Benefits Paid by Employers after Insurance Companies Fail to Provide Annuity Benefits*

- *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*

**State Regulations**

- No additional guidance obtained from state statutes or regulations.

**Other Sources of Information**

- NAIC Technical Resource Group Proposed Draft Life Codification, Chapter 22, *General Expenses and Taxes, Licenses and Fees*
- Draft discussion material from previous Property/Casualty codification projects - Chapter on Non-Claim Operating Expenses

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