

Statutory Issue Paper No. 123

Accounting for Pensions, A Replacement of SSAP No. 8

STATUS

Finalized September 15, 2003

Current Authoritative Guidance for Accounting 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. 89

Type of Issue:

Common Area

SUMMARY OF ISSUE

1. Current statutory accounting guidance for employers' pension obligations is provided in *SSAP No. 8—Pensions* (SSAP No. 8). This issue paper supersedes the conclusions reached in SSAP No. 8 and incorporates the guidance in *INT 99-24: Accounting for Restructuring Charges*, *INT 99-26: Offsetting Pension Assets and Liabilities*, *INT 01-16: Measurement Date for SSAP No. 8 Actuarial Valuations*, *INT 01-17: Accounting for Nonqualified Retirement Plans, Nonvested Ancillary Benefits Within Retirement Plans, and Protected Benefits Such as Early Retirement Subsidies in Retirement Plans*, as well as some of the guidance in *INT 02-18: Accounting for the Intangible Asset as Described in SSAP No. 8 Paragraph 9.d.v. and 9.f.*
2. The changes made in this issue paper regarding the accounting treatment of the additional minimum pension liability will create a nonsubstantive change to *SSAP No. 72—Surplus and Quasi-reorganizations*. Unassigned funds (surplus) will include changes in the additional minimum pension liability.
3. Generally Accepted Accounting Principles (GAAP) guidance for these issues is established in *Financial Accounting Standards Board (FASB) Statement No. 87, Employers' Accounting for Pensions* (FAS 87), *FASB Statement No. 88, Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits* (FAS 88), *FASB Statement No. 132, Employers' Disclosures about Pensions and Other Postretirement Benefits* (FAS 132), and *FASB Statement No. 130, Other Comprehensive Income* (FAS 130).
4. 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

5. 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 modifications to exclude non-vested employees and to account for the additional minimum pension liability. 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, other than the intangible asset associated with the transition obligation recorded as of January 1, 2001, 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 *SSAP No. 4—Assets and Nonadmitted Assets*.

6. If the accumulated benefit obligation exceeds the fair value of plan assets, the reporting entity shall recognize a liability (including unfunded accrued pension cost) that is at least equal to the unfunded accumulated benefit obligation. Recognition of an additional minimum liability is required if an unfunded accumulated benefit obligation exists and (a) a prepaid pension cost asset has been recognized as a nonadmitted asset, (b) the liability already recognized as unfunded accrued pension cost is less than the unfunded accumulated benefit obligation, or (c) no accrued or prepaid pension cost has been recognized.

7. If an additional minimum 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 (unrecognized prior service cost shall include unamortized incremental liability). If an intangible asset generated by the additional minimum liability is recognized, only that portion in excess of the unamortized incremental liability associated with the transition shall be nonadmitted. 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) shall be reported as a component of unassigned funds (surplus), net of any tax benefits that result from considering such losses as temporary differences for purposes of applying the provisions of *SSAP No. 10—Income Taxes*.

8. When a new determination of the amount of additional liability is made, the related intangible asset and the balance accumulated in unassigned funds (surplus) shall be eliminated or adjusted as necessary.

9. 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 makeup of the pension plan. If a curtailment occurs, there are generally two components to any gain or loss (e.g., a reduction in the years of service required or the employees covered). 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 settlement or curtailment gains are recognized, any excess tax surcharges shall also be recognized.

Defined Contribution Plans

10. 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.

11. 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.

12. 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

13. The following disclosures shall be made for defined benefit pension plans for which the reporting entity is directly liable:

- a. A reconciliation of beginning and ending balances of the benefit obligation showing separately, if applicable, the effects during the period attributable to service cost, interest cost, contributions by plan participants, actuarial gains and losses, foreign currency exchange rate changes, benefits paid, plan amendments, business combinations, divestitures, curtailments, settlements, and special termination benefits;
- b. The amount of the pension obligation for non-vested employees as of the most recent actuarial valuation date;
- c. 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 actual return on plan assets, foreign currency exchange rate changes, contributions by the reporting entity, contributions by plan participants, benefits paid, business combinations, divestitures, and settlements;
- d. The funded status of the plan, the amounts not recognized in the statement of financial position, and the amounts recognized in the statement of financial position, including:
 - i. The amount of any unamortized prior service cost;
 - ii. The amount of any unrecognized net gain or loss (including asset gains and losses not yet reflected in market-related value);
 - iii. The amount of any remaining unamortized, unrecognized net obligation or net asset existing at the initial date of application of this statement;
 - iv. The net pension or other postretirement benefit prepaid assets or accrued liabilities; and
 - v. Any intangible asset;
- e. 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 incremental liability or incremental asset (see paragraph 20), 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;

- f. The amount included in unassigned funds (surplus) for the period arising from a change in the additional minimum pension liability recognized pursuant to paragraph 7;
- g. On a weighted-average basis, the following assumptions used in the accounting for the plan: assumed discount rate, rate of compensation increase (for pay-related plans), and expected long-term rate of return on plan assets;
- h. If applicable, the amounts and types of securities of the reporting entity and related parties included in plan assets, the approximate amount of future annual benefits of plan participants covered by insurance contracts issued by the reporting entity or related parties, and any significant transactions between the reporting entity or related parties and the plan during the period;
- i. 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 FAS 87;
- j. 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;
- k. If applicable, the cost of providing special or contractual termination benefits recognized during the period and a description of the nature of the event; and
- l. 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 reporting entity's results of operations shall be disclosed for each period for which an income statement is presented. Amounts related to the reporting entity's statement of financial position shall be disclosed for each balance sheet presented.

14. The reporting entity shall disclose the amount of cost recognized for defined contribution pension 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.

15. The reporting entity shall disclose the amount of contributions to multiemployer plans during the period. The reporting entity 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.

16. Refer to the preamble for further discussion regarding disclosure requirements.

Consolidated/Holding Company Plans

17. 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 5-13 and 20-24 of this issue paper shall be applied.

DISCUSSION

18. The conclusions in paragraphs 5-13 and 20-24 adopt FAS 87, FAS 88, and FAS 132 with certain modifications. Those modifications and additional information from nullified interpretations are listed below:

- 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. A liability for ancillary benefits (primarily death and disability benefits) shall be accrued prior to the triggering event of these benefits for purposes of Projected Benefit Obligation (PBO) and Service Cost (SC) in accordance with the guidance in FAS 87 (use of a general vesting standard rather than an Internal Revenue Service income tax vesting standard);
- c. A liability for protected, nonvested benefits shall be accrued for purposes of PBO and SC in accordance with the guidance in FAS 87 (use of a general vesting standard rather than an Internal Revenue Service income tax vesting standard);
- d. A liability for nonvested, nonqualified benefits prior to retirement or when there is no longer a substantial risk of forfeiture, shall be accrued for purposes of PBO and SC in accordance with the guidance in FAS 87 (use of a general vesting standard rather than an Internal Revenue Service income tax vesting standard);
- e. Entities shall perform actuarial analysis consistent with the three month guideline contained within FAS 87;
- f. A reporting entity that utilizes an actuarial valuation as of a date prior to the financial statement date to measure plan assets and obligations, and determines that an additional minimum liability is required to be established in accordance with paragraph 37 of FAS 87, and if the reporting entity contributes amounts to the plan to fund that additional minimum liability prior to the financial statement date, such amount funded may be used to reduce the additional minimum liability recognized in the reporting entity's financial statements;
- g. It is not acceptable statutory accounting practice to offset pension or postretirement benefits other than pensions (OPEB) liability generated by one plan against the prepaid asset of another plan;
- h. Reporting entities may downsize their operations and in doing so, often offer severance pay and other benefits to displaced workers. Costs associated with downsizing shall be recorded as an expense in the financial statements;
- i. The prepaid asset which results from an excess of the fair value of plan assets over the pension obligation shall be recorded as a nonadmitted asset;
- j. Any intangible asset offsetting the minimum pension liability (excluding the unamortized incremental liability associated with transition) shall be nonadmitted and charged to surplus;

- k. Any additional minimum liability in excess of unrecognized prior service cost that is reported as a component of unassigned funds (surplus), shall be classified as an aggregate write-in for gains and losses in surplus;
- l. As of January 1, 2001 the pension obligation or asset not previously recognized related to vested employees may be recorded immediately or may be amortized over future periods;
- m. Paragraphs 36-38 of FAS 87 are adopted with modifications described in paragraph 7 of this issue paper;
- n. 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;
- o. 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;
- p. For the disclosures relating to the initial date of application in paragraph 5 of FAS 132, January 1, 2001 shall be considered the initial date of application; and
- q. Pension disclosures relating to other comprehensive income in paragraph 5 of FAS 132 shall be made for unassigned funds (surplus) on a statutory basis.

19. 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*.

Effective Date and Transition

20. As of January 1, 2001, 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 January 1, 2001, 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.

21. As of January 1, 2001, 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.

22. As of January 1, 2001, 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).
23. An incremental asset resulting from a transition obligation that is less than an amount previously recorded under FAS 87 shall first reduce the recorded liability. Any remaining incremental asset shall be recorded as nonadmitted.
24. This issue paper is effective for years ending on or after, December 31, 2003. SSAP No. 8 applies to the calculation of the transition obligation in accordance with the adoption of FAS 87 for periods prior to the adoption of this statement. A change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*. For reporting entities that expensed the additional minimum pension liability through income prior to January 1, 2004 under SSAP No. 8, if the additional minimum pension liability subsequently decreases because of factors such as asset value recovery, the reversal of the expense shall be through unassigned funds (surplus). Restatement of previously expensed additional minimum liability amounts through the income statement is not permitted.

RELEVANT STATUTORY ACCOUNTING AND GAAP GUIDANCE

Statutory Accounting

25. The following is excerpted from Interpretation 02-18

The working group reached a consensus to require reporting entities to recognize the entire minimum pension liability in the financial statement. Further, any intangible asset offsetting the minimum pension liability shall be nonadmitted and charged to surplus.

26. See Issue Paper No. 8 for additional statutory references

Generally Accepted Accounting Principles

27. The following is excerpted from *FASB Statement No. 130, Other Comprehensive Income* (FAS 130):

10. This Statement uses the term comprehensive income to describe the total of all components of comprehensive income, including net income.⁴ This Statement uses the term other comprehensive income to refer to revenues, expenses, gains, and losses that under generally accepted accounting principles are included in comprehensive income but excluded from net income. This Statement does not require that an enterprise use the terms comprehensive income or other comprehensive income in its financial statements, even though those terms are used throughout this Statement.⁵

⁴ FAS130, Footnote 4—This Statement uses the term net income to describe a measure of financial performance resulting from the aggregation of revenues, expenses, gains, and losses that are not items of other comprehensive income as identified in this Statement. A variety of other terms such as net earnings or earnings may be used to describe that measure.

⁵ FAS130, Footnote 5—Paragraph 40 of Concepts Statement 5 states that “just as a variety of terms are used for net income in present practice, the Board anticipates that total nonowner changes in equity, comprehensive loss, and other equivalent terms will be used in future financial statements as names for comprehensive income.”

28. See Issue Paper No. 8 for additional GAAP references

OTHER SOURCES OF INFORMATION

29. See Issue Paper No. 8 for Other Sources of Information

RELEVANT LITERATURE

Statutory Accounting

- Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy
- *SSAP No. 8—Pensions*
- *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*
- *Issue Paper No. 8—Accounting for Pensions*
- 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
- *INT 02-18: Accounting for the Intangible Asset as Described in SSAP No. 8 Paragraph 9.d.v. and 9.f.*
- *INT 01-1: Measurement Date for SSAP No. 8 Actuarial Valuations*
- *INT 01-17: Accounting for Nonqualified Retirement Plans, Nonvested Ancillary Benefits Within Retirement Plans, and Protected Benefits Such as Early Retirement Subsidies in Retirement Plans*
- *INT 99-24: Accounting for Restructuring Charges*
- *INT 99-26: Offsetting Pension Assets and Liabilities*

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*

- *FASB Statement No. 130, Other Comprehensive Income*

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

This page intentionally left blank.