

Statutory Issue Paper No. 132

Accounting for Pensions, A Replacement of SSAP No. 89

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Type of Issue:

Common Area

SUMMARY OF ISSUE:

1. In September 2006, the Financial Accounting Standards Board (FASB) issued *FASB Statement No. 158: Accounting for Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106 and 132(R)* (FAS 158). The adoption with modification of FAS 158 requires entities that sponsor one or more single-employer defined benefit plan to:
 - a. Recognize the overfunded or underfunded status of a defined benefit postretirement plan (other than a multiemployer plan) as an asset or liability in the statement of financial position.
 - b. Aggregate the statuses of all overfunded plans and recognize that amount as a nonadmitted asset in its statement of financial position. It also shall aggregate the statuses of all underfunded plans and recognize that amount as a liability in its statement of financial position.
 - c. Recognize as a component of unassigned funds (surplus) the gains and losses and prior service costs or credits that arise during the period but were not recognized as components of net periodic benefit cost of the period pursuant to SSAP No. 89 and SSAP No. 14.
 - d. Recognize corresponding adjustments in unassigned funds (surplus) when the gains and losses, prior service costs or credits and transition assets and obligations remaining from the initial application of SSAP No. 89 and SSAP No. 14 are subsequently recognized as components of net periodic benefit cost pursuant to the recognition and amortization provisions of SSAP No. 89 and SSAP No. 14.
2. Current statutory accounting guidance for pensions is provided within *SSAP No. 89—Accounting for Pension, A Replacement of SSAP No. 8* (SSAP No. 89). The conclusions reached in SSAP No. 89 resulted from adoption of *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 an amendment of FASB Statements No. 87, 88, and 106* (FAS 132) with certain modifications and *FASB Statement No. 132 (R), Employers' Disclosures about Pensions and Other Postretirement Benefits, and amendment of FASB Statements No. 87, 88, and 106* (FAS 132R) with certain modifications.

3. The purpose of this issue paper is to update statutory accounting principles for pensions, including both defined benefit plans and defined contribution plans. Consequently, this issue paper adopts FAS 158 with modifications considered necessary for consistent statutory reporting. The result will be a new SSAP (SSAP No. 102) superseding SSAP No. 89.

SCOPE OF STATEMENT

4. This issue paper establishes financial accounting and reporting standards for an insurer that offers pension benefits to its employees. Ordinarily, such benefits are periodic pension payments to retired employees or their survivors, but they may also include benefits payable as a single lump sum and other types of benefits, such as death benefits provided through a pension plan. (This issue paper does not apply to life insurance benefits provided outside a pension plan or postretirement health and welfare benefits.) Arrangements to provide pension benefits may take a variety of forms and may be financed in different ways. This issue paper applies to any arrangement that is similar in substance to a pension plan regardless of form or financing. This issue paper applies to a written plan and to a plan whose existence may be implied from a well-defined, although perhaps unwritten, practice of paying postretirement benefits. This issue paper supersedes the guidance in *SSAP No. 89—Accounting for Pensions, A Replacement of SSAP No. 8* (SSAP No. 89), nullifies and incorporates the guidance in *Interpretation 99-26: Offsetting Pension Assets and Liabilities* (INT 99-26), and *INT 04-12: Determining the Classification and Benefit Attribution Method for a Cash Balance Pension Plan* (INT 04-12), and nullifies *INT 01-16: Measurement Date for SSAP No. 8 Actuarial Valuations* (INT 01-16), *INT 03-18—Accounting for a Change in the Additional Minimum Liability in SSAP No. 8* (INT 03-18) and *INT 04-03: Clarification for Calculating the Additional Minimum Pension Liability under SSAP No. 89* (INT 04-03) This issue paper also modifies *INT 04-17: Impact of Medicare Modernization on Postretirement Benefits* (INT 04-17) to remove reference to pensions as this interpretation only addresses postretirement benefits other than pensions.

SUMMARY CONCLUSION

Defined Benefit Plans

Single-Employer Defined Benefit Pension Plans

5. A defined benefit pension plan is one that defines an amount of pension benefit to be provided, usually as a function of one or more factors such as age, years of service, or compensation. (Hybrid pension plans that refer to an account balance, rather than a monthly annuity at retirement (also known as cash balance plans) are considered defined benefit plans for purposes of applying this issue paper.) For defined benefit plans, reporting entities shall adopt *FAS 158: Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132(R)* and *FASB Staff Position FAS 136(R)-1, Employers' Disclosures about Postretirement Benefit Plan Assets* (FSP FAS 136(R)-1), with modifications as discussed within paragraph 83.

6. A pension benefit is part of the compensation paid to an employee for services. In a defined benefit pension plan, the employer promises to provide, in addition to current wages, retirement income payments in future years after the employee retires or terminates service. Generally, the amount of benefit to be paid depends on a number of future events that are incorporated in the plan's benefit formula, often including how long the employee and any survivors live, how many years of service the employee renders, and the employee's compensation in the years immediately before retirement or termination. In most cases, services are rendered over a number of years before an employee retires and begins collecting the pension. Even though the services rendered by an employee are complete and the employee has retired, the total amount of benefit that the employer has promised and the cost to the employer of the services rendered are not precisely determinable but can only be estimated using the benefit formula and estimates of the relevant future events, many of which the employer cannot control.

Elements of Pension Accounting

7. Net periodic pension cost is made up of several components that reflect different aspects of the employer's financial arrangements as well as the cost of benefits earned by employees. The cost of a benefit can be determined without regard to how the employer decides to finance the plan. The service cost component of net periodic pension cost is the actuarial present value of benefits attributed by the plan's benefit formula to services rendered by employees during the period. The service cost component is conceptually the same for an unfunded plan, a plan with minimal funding, and a well-funded plan. The other components of net periodic pension cost are interest cost (interest on the projected benefit obligation, which is a discounted amount), actual¹ return on plan assets, amortization of any prior service cost or credit included in unassigned funds (surplus), and gain or loss, which includes, to the extent recognized, amortization of the net gain or loss included in unassigned funds (surplus) (refer to paragraph 26).

8. The projected benefit obligation is the actuarial present value of all benefits attributed by the plan's benefit formula to employee service rendered prior to that date. The projected benefit obligation is measured using an assumption as to future compensation levels if the pension benefit formula is based on those future compensation levels. The projected benefit obligation is a measure of benefits attributed to service to date assuming that the plan continues in effect and that estimated future events (including compensation increases, turnover, and mortality) occur.

9. The accumulated benefit obligation is the actuarial present value of benefits attributed by the pension benefit formula to employee service rendered prior to that date and based on current and past compensation levels. The accumulated benefit obligation differs from the projected benefit obligation in that it includes no assumption about future compensation levels. For plans with flat-benefit or non-pay-related pension benefit formulas, the accumulated benefit obligation and the projected benefit obligation are the same.

10. Plan assets are assets that have been segregated and restricted to provide for pension benefits. The amount of plan assets includes amounts contributed by the employer and amounts earned from investing the contributions, less benefits paid. Assets not segregated in a trust or otherwise effectively restricted so that they cannot be used by the employer for other purposes are not considered plan assets even though it may be intended that such assets be used to provide for pension benefits. Amounts accrued by the employer but not yet paid to the plan are also not considered plan assets. Securities of the employer held by the plan are includable in plan assets provided they are transferable.

Recognition of Net Periodic Pension Cost

11. The following components shall be included in the net pension cost for a period by an employer sponsoring a defined benefit pension plan: a) Service cost; b) Interest cost; c) Actual return on plan assets; d) Amortization of any prior service cost or credit included in unassigned funds (surplus); e) Gain or loss (including the effects of changes in assumptions) to the extent recognized; and f) Amortization of any net transition asset or obligation existing at the date of initial application of this issue paper and remaining in unassigned funds (surplus).

¹ To address a question on how the expected return on plan assets affects the determination of net periodic pension cost if the actual return on plan assets for a period is a component of net periodic pension cost, it is noted that the expected return on plan assets generally will be different from the actual return on plan assets for the year. This statement provides for recognition of that difference (a net gain or loss) in unassigned funds in the period it arises. The amount recognized in unassigned funds is also a component of net periodic pension cost for the current period. Thus, the amount recognized in unassigned funds and the actual return on plan assets, when aggregated, equal the expected return on plan assets. The amount recognized in unassigned funds affects future net periodic pension cost through subsequent amortization, if any, of the net gain or loss. (This footnote reflects guidance included in E12 of FSP FAS 158-1.)

Service Cost

12. The service cost component recognized in a period shall be determined as the actuarial present value of benefits attributed by the pension benefit formula to employee service (including both vested and nonvested employees) during that period.

13. The prior service cost for nonvested employees not previously recognized² is not required to be included in net periodic pension cost entirely in the year this issue paper is adopted. Unrecognized prior service cost for nonvested employees shall be amortized as a component of net periodic pension cost by assigning an equal amount to each expected future period of service before vesting occurs for nonvested employees active at the date of the amendment. Unassigned funds (surplus) is adjusted each period as prior service cost is amortized (refer to paragraphs 85-87 for transition guidance related to the recognition of the prior service cost for nonvested employees though unassigned surplus).

Interest Cost

14. The interest cost component recognized in a period shall be determined as the increase in the projected benefit obligation due to the passage of time. Measuring the projected benefit obligation as a present value requires accrual of an interest cost at rates equal to the assumed discount rates.

Actual Return on Plan Assets

15. For a funded plan, the actual return on plan assets shall be determined based on the fair value of plan assets at the beginning and the end of the period, adjusted for contributions and benefit payments.

Prior Service Cost

16. Plan amendments (including initiation of a plan) often include provisions that grant increased benefits based on services rendered in prior periods. Because plan amendments are granted with the expectation that the employer will realize economic benefits in future periods, the cost of providing such retroactive benefits (prior service cost) is not required to be included in net periodic pension cost entirely in the year of the amendment but provides for recognition during the future service periods of those employees active at the date of the amendment who are expected to receive benefits under the plan.

17. A plan amendment that retroactively increases benefits (including benefits that are granted to retirees) increases the projected benefit obligation. The cost of the benefit improvement shall be recognized as a charge to unassigned funds (surplus) at the date of the amendment. Except as specified in paragraphs 18-19, that prior service cost shall be amortized as a component of net periodic pension cost by assigning an equal amount to each future period of service of each employee active at the date of the amendment who is expected to receive benefits under the plan. If all or almost all of a plan's participants are inactive, the cost of retroactive plan amendments affecting benefits of inactive participants shall be amortized based on the remaining life expectancy of those participants instead of based on the remaining service period. Unassigned funds (surplus) is adjusted each period as prior service cost is amortized.

18. Consistent use of an alternative approach that more rapidly amortizes the cost of retroactive amendments is acceptable. For example, a straight-line amortization of the cost over the average remaining service period of employees expected to receive benefits under the plan is acceptable. The alternative method used shall be disclosed.

² The previous statutory accounting guidance in *SSAP No. 89—Accounting for Pensions, A Replacement of SSAP No. 8* excluded nonvested employees from the service cost calculation. This exclusion has been eliminated with the issuance of this issue paper.

19. In some situations a history of regular plan amendments and other evidence may indicate that the period during which the employer expects to realize economic benefits from an amendment granting retroactive benefits is shorter than the entire remaining service period of the active employees. Identification of such situations requires an assessment of the individual circumstances and the substance of the particular plan situation. In those circumstances, the amortization of prior service cost shall be accelerated to reflect the more rapid expiration of the employer's economic benefits and to recognize the cost in the periods benefited.

20. A plan amendment that retroactively reduces, rather than increases, benefits decreases the projected benefit obligation. The reduction in benefits shall be recognized as a credit (prior service credit) to unassigned funds (surplus) that shall be used first to reduce any remaining prior service cost included in unassigned funds (surplus). Any remaining prior service credit shall be amortized as a component of net periodic pension cost on the same basis as the cost of a benefit increase.

Gains and Losses

21. 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 from changes in assumptions. This issue paper does not distinguish between those sources of gains and losses. Gains and losses include amounts that have been realized, as well as amounts that are unrealized. 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, recognition of gains and losses as components of net pension cost of the period in which they arise is not required. Gains and losses that are not recognized immediately as a component of net periodic pension cost shall be recognized as increases or decreases in unassigned funds (surplus) as they arise.

22. The expected return on plan assets shall be determined based on the expected long-term rate of return on plan assets and the fair value of plan assets.

23. Asset gains and losses are differences between the actual return on assets during a period and the expected return on assets for that period. Asset gains and losses include changes reflected in the fair value of assets.

24. As a minimum, amortization of a net gain or loss included in unassigned funds (surplus) shall be included as a component of net pension cost for a year if, as of the beginning of the year, that net gain or loss exceeds 10 percent of the greater of the projected benefit obligation or the fair value of plan assets. If amortization is required, the minimum amortization shall be that excess divided by the average remaining service period of active employees expected to receive benefits under the plan. If all or almost all of a plan's participants are inactive, the average remaining life expectancy of the inactive participants shall be used instead of average remaining service.

25. Any systematic method of amortizing gains or losses may be used in lieu of the minimum specified in the previous paragraph provided that (a) the minimum is used in any period in which the minimum amortization is greater (reduces the net balance included in unassigned funds (surplus) by more), (b) the method is applied consistently, (c) the method is applied similarly to both gains and losses, and (d) the method used is disclosed.

26. The gain or loss component of net periodic pension cost shall consist of (a) the difference between the actual return on plan assets and the expected return on plan assets and (b) amortization of the net gain or loss included in unassigned funds (surplus).

Recognition of Liabilities and Assets

27. If the projected benefit obligation (considering both vested and nonvested participants) exceeds the fair value of plan assets, the employer shall recognize in its statement of financial position a liability that equals the unfunded projected benefit obligation. If the fair value of plan assets exceeds the projected benefit obligation, the employer shall recognize in its statement of financial position an asset that equals the overfunded projected benefit obligation. This prepaid asset resulting from the excess of the fair value of plan assets over the projected benefit obligation shall be nonadmitted.

28. If multiple single-employer plans exist, the employer shall aggregate the statuses of all overfunded plans and recognize that amount as an asset in its statement of financial position. It also shall aggregate the statuses of all underfunded plans and recognize that amount as a liability in its statement of financial position. It is not acceptable statutory accounting practice to offset pension or postretirement benefits other than pensions liability generated by one plan against the prepaid assets of another plan.

29. The asset or liability that is recognized pursuant to paragraph 27 may result in a temporary difference, as defined in *SSAP No. 101—Income Taxes – A Replacement of SSAP No. 10R and 10* (SSAP No. 101). The deferred tax effects of any temporary differences shall be recognized in income tax expense or benefit for the year and shall be allocated pursuant to SSAP No. 101.

30. If a new determination of the funded status of a plan to be recognized as an asset or a liability in the employer's statement of financial position is made, or when net gains or losses, prior service costs or credits, or the net transition asset or obligation existing at the date of initial application of this issue paper are amortized as components of net periodic pension cost, the related balances for those net gains or losses, prior service costs or credits, and transition asset or obligation in unassigned funds (surplus) shall be adjusted as necessary and reported in unassigned funds (surplus).

Measurement of Cost and Obligations

31. The service component of net periodic pension cost, the projected benefit obligation, and the accumulated benefit obligation are based on an attribution of pension benefits to periods of employee service and on the use of actuarial assumptions to calculate the actuarial present value of those benefits. Actuarial assumptions reflect the time value of money (discount rate) and the probability of payment (assumptions as to mortality, turnover, early retirement, and so forth).

Attribution

32. Pension benefits ordinarily shall be attributed to periods of employee service based on the plan's benefit formula to the extent that the formula states or implies an attribution. In some situations a history of regular increases and other evidence may indicate that an employer has a present commitment to make future amendments and that the substance of the plan is to provide benefits attributable to prior service that are greater than the benefits defined by the written terms of the plan. In those situations, the substantive commitment shall be the basis for the accounting, and the existence and nature of the commitment to make future amendments shall be disclosed.

33. In some situations a history of regular increases in non-pay-related benefits or benefits under a career-average-pay plan and other evidence may indicate that an employer has a present commitment to make future amendments and that the substance of the plan is to provide benefits attributable to prior service that are greater than the benefits defined by the written terms of the plan. In those situations, the substantive commitment shall be the basis for the accounting, and the existence and nature of the commitment to make future amendments shall be disclosed.

34. Some plans may have benefit formulas that attribute all or a disproportionate share of the total benefits provided to later years of service, thereby achieving in substance a delayed vesting of benefits. For such plans the total projected benefit shall be considered to accumulate in proportion to the ratio of the number of completed years of service to the number that will have been completed when the benefit is first fully vested. If a plan's benefit formula does not specify how a particular benefit relates to services rendered, the benefit shall be considered to accumulate as follows:

- a. For benefits of a type includable in vested benefits, in proportion to the ratio of the number of completed years of service to the number that will have been completed when the benefit is first fully vested.
- b. For benefits of a type not includable in vested benefits, in proportion to the ratio of completed years of service to total projected years of service.

Assumptions

35. Each significant actuarial assumption used shall reflect the best estimate solely with respect to that individual assumption. All assumptions shall presume that the plan will continue in effect in the absence of evidence that it will not continue.

36. Assumed discount rates shall reflect the rates at which the pension benefits could be effectively settled. It is appropriate in estimating those rates to look to available information about rates implicit in current prices of annuity contracts that could be used to effect settlement of the obligation. In making those estimates, employers may also look to rates of return on high-quality fixed-income investments currently available and expected to be available during the period to maturity of the pension benefits. Assumed discount rates are used in measurements of the projected, accumulated, and vested benefit obligations and the service and interest cost components of net periodic pension cost.

37. The objective of selecting assumed discount rates using the method noted in paragraph 36 is to measure the single amount that, if invested at the measurement date in a portfolio of high-quality debt instruments, would provide the necessary future cash flows to pay the pension benefits when due. Notionally, that single amount, the projected benefit obligation, would equal the fair value of a portfolio of high-quality zero coupon bonds whose maturity dates and amounts would be the same as the timing and amount of the expected future benefit payments. Because cash inflows would equal cash outflows in timing and amount, there would be no reinvestment risk in the yields to maturity of the portfolio. However, in other than a zero coupon portfolio, such as a portfolio of long-term debt instruments that pay semiannual interest payments or whose maturities do not extend far enough into the future to meet expected benefit payments, the assumed discount rates (the yield to maturity) need to incorporate expected reinvestment rates available in the future. Those rates shall be extrapolated from the existing yield curve at the measurement date. The determination of the assumed discount rate is separate from the determination of the expected rate of return on plan assets whenever the actual portfolio differs from the hypothetical portfolio above. Assumed discount rates shall be reevaluated at each measurement date. If the general level of interest rates rises or declines, the assumed discount rates shall change in a similar manner.

38. The expected long-term rate of return on plan assets shall reflect the average rate of earnings expected on the funds invested or to be invested to provide for the benefits included in the projected benefit obligation. In estimating that rate, appropriate consideration should be given to the returns being earned by the plan assets in the fund and the rates of return expected to be available for reinvestment. The expected long-term rate of return on plan assets is used to compute the expected return on assets.

39. The service cost component of net periodic pension cost and the projected benefit obligation shall reflect future compensation levels to the extent that the pension benefit formula defines pension benefits

wholly or partially as a function of future compensation levels. Future increases for which a present commitment exists shall be similarly considered. Assumed compensation levels shall reflect an estimate of the actual future compensation levels of the individual employees involved, including future changes attributed to general price levels, productivity, seniority, promotion, and other factors. All assumptions shall be consistent to the extent that each reflects expectations of the same future economic conditions, such as future rates of inflation. Measuring service cost and the projected benefit obligation based on estimated future compensation levels entails considering indirect effects, such as changes under existing law in social security benefits or benefit limitations that would affect benefits provided by the plan.

40. The accumulated benefit obligation shall be measured based on employees' history of service and compensation without an estimate of future compensation levels. Excluding estimated future compensation levels also means excluding indirect effects of future changes such as increases in the social security wage base. In measuring the accumulated benefit obligation, projected years of service shall be a factor only in determining employees' expected eligibility for particular benefits, such as:

- a. Increased benefits that are granted provided a specified number of years of service are rendered
- b. Early retirement benefits
- c. Death benefits
- d. Disability benefits

41. Automatic benefit increases specified by the plan (for example, automatic cost-of-living increases) that are expected to occur shall be included in measurements of the projected, accumulated, and vested benefit obligations, and the service cost component. Also, retroactive plan amendments shall be included in the computation of the projected and accumulated benefit obligations once they have been contractually agreed to, even if some provisions take effect only in future periods.

Measurement of Plan Assets

42. Plan investments, whether equity or debt securities, real estate, or other, shall be measured at their fair value as of the measurement date. The fair value of an investment shall be reduced by brokerage commissions and other costs normally incurred in a sale, if those costs are significant (similar to fair value less costs to sell).

43. Plan assets used in plan operations (for example, buildings, equipment, furniture and fixtures, and leasehold improvements) shall be measured at cost less accumulated depreciation or amortization for all purposes.

44. The measurements of plan assets and benefit obligations shall be as of the date of the employer's fiscal year-end statement of financial position. Requiring that the pension measurements be as of a particular date is not intended to require that all procedures be performed after that date. As with other financial statement items requiring estimates, much of the information can be prepared as of an earlier date and projected forward to account for subsequent events (for example, employee service). Unless a business entity remeasures both its plan assets and benefit obligations during the fiscal year, the funded status it reports in its interim-period statement of financial position shall be the same asset or liability recognized in the previous year-end statement of financial position adjusted for (1) subsequent accruals of net periodic pension cost that exclude the amortization of amounts previously recognized in other unassigned funds (surplus) (for example, subsequent accruals of service cost, interest cost, and return on plan assets) and (2) contributions to a funded plan, or benefit payments. Sometimes, a business entity remeasures both plan assets and benefit obligations during the fiscal year. That is the case, for example,

when a significant event such as a plan amendment, settlement, or curtailment occurs that calls for a remeasurement. Upon remeasurement, a business entity shall adjust its statement of financial position in a subsequent interim period to reflect the overfunded or underfunded status of the plan consistent with that measurement date.

45. Measurements of net periodic pension cost for both interim and annual financial statements shall be based on the assumptions used for the previous year-end measurements unless more recent measurements of both plan assets and obligations are available or a significant event occurs, such as a plan amendment, that would ordinarily call for such measurements.

Employers with Two or More Plans

46. An employer that sponsors two or more separate defined benefit pension plans shall determine net periodic pension cost, liabilities, and assets by separately applying the provisions of this issue paper to each plan. In particular, unless an employer clearly has a right to use the assets of one plan to pay benefits of another, a liability required to be recognized for one plan shall not be reduced or eliminated because the employer has recognized an asset for another plan that has assets in excess of its projected benefit obligation. (As noted within paragraph 28, overfunded plans shall be aggregated for asset reporting (nonadmitted) and underfunded plans shall be aggregated for liability reporting.)

Annuity Contracts

47. An annuity contract is a contract in which an insurance company unconditionally undertakes a legal obligation to provide specified benefits to specific individuals in return for a fixed consideration or premium. An annuity contract is irrevocable and involves the transfer of significant risk from the employer to the insurance company. Some annuity contracts (participating annuity contracts) provide that the purchaser (either the plan or the employer) may participate in the experience of the insurance company. Under those contracts, the insurance company ordinarily pays dividends to the purchaser. If the substance of a participating contract is such that the employer remains subject to all or most of the risks and rewards associated with the benefit obligation covered and the assets transferred to the insurance company, that contract is not an annuity contract for purposes of this issue paper.

48. To the extent that benefits currently earned are covered by annuity contracts, the cost of those benefits shall be the cost of purchasing the contracts, except as provided in paragraph 51. That is, if all the benefits attributed by the plan's benefit formula to service in the current period are covered by nonparticipating annuity contracts, the cost of the contracts determines the service cost component of net pension cost for that period.

49. Benefits provided by the pension benefit formula beyond benefits provided by annuity contracts (for example, benefits related to future compensation levels) shall be accounted for according to the provisions of this issue paper applicable to plans not involving insurance contracts.

50. Benefits covered by annuity contracts shall be excluded from the projected benefit obligation and the accumulated benefit obligation. Except as provided in paragraph 51, annuity contracts shall be excluded from plan assets.

51. Some annuity contracts provide that the purchaser (either the plan or the employer) may participate in the experience of the insurance company. Under those contracts, the insurance company ordinarily pays dividends to the purchaser, the effect of which is to reduce the cost of the plan. The purchase price of a participating annuity contract ordinarily is higher than the price of an equivalent contract without participation rights. The difference is the cost of the participation right. The cost of the participation right shall be recognized at the date of purchase as a nonadmitted asset. In subsequent periods, the participation right shall be nonadmitted and measured at its fair value if the contract is such

that fair value is reasonably estimable. Otherwise, the participation right shall be measured at its amortized cost (not in excess of its net realizable value), and the cost shall be amortized systematically over the expected dividend period under the contract.

Other Contracts with Insurance Companies

52. Insurance contracts that are in substance equivalent to the purchase of annuities shall be accounted for as such. Other contracts with insurance companies shall be accounted for as investments and measured at fair value. For some contracts, the best available evidence of fair value may be contract value. If a contract has a determinable cash surrender value or conversion value, that is presumed to be its fair value.

Defined Benefit Plans – Settlements and Curtailments

53. A settlement is defined as a transaction that (a) is an irrevocable action, (b) relieves the employer (or the plan) of primary responsibility for a pension benefit obligation, and (c) eliminates significant risks related to the obligation and the assets used to effect the settlement. Examples of transactions that constitute a settlement include (a) making lump-sum cash payments to plan participants in exchange for their rights to receive specified pension benefits and (b) purchasing nonparticipating annuity contracts to cover vested benefits.

54. A transaction that does not meet all of the above three criteria does not constitute a settlement for purposes of this issue paper. For example, investing in a portfolio of high-quality fixed-income securities with principal and interest payment dates similar to the estimated payment dates of benefits may avoid or minimize certain risks. However, that does not constitute a settlement because the investment decision can be reversed and such a strategy does not relieve the employer (or the plan) of primary responsibility for a pension obligation nor does it eliminate significant risks related to the obligation.

Annuity Contracts

55. The definition of an annuity contract is included in paragraph 47. If the substance of a participating annuity contract is such that the employer remains subject to all or most of the risks and rewards associated with the benefit obligation covered or the assets transferred to the insurance company, the purchase of the contract does not constitute a settlement.

Curtailment

56. A curtailment is an event that significantly reduces the expected years of future service of present employees or eliminates for a significant number of employees the accrual of defined benefits for some or all of their future services. Curtailments include:

- a. Termination of employees' services earlier than expected, which may or may not involve closing a facility or discontinuing a component of an entity.
- b. Termination or suspension of a plan so that employees do not earn additional defined benefits for future services. In the latter situation, future service may be counted toward vesting of benefits accumulated based on past service.

Relationship of Settlements and Curtailments to Other Events

57. A settlement and a curtailment may occur separately or together. If benefits to be accumulated in future periods are reduced but the plan remains in existence and continues to pay benefits, to invest assets, and to receive contributions, a curtailment has occurred but not a settlement. If an employer purchases

nonparticipating annuity contracts for vested benefits and continues to provide defined benefits for future service, either in the same plan or in a successor plan, a settlement has occurred but not a curtailment. If a plan is terminated (that is, the obligation is settled and the plan ceases to exist) and not replaced by a successor defined benefit plan, both a settlement and a curtailment have occurred (whether or not the employees continue to work for the employer).

Accounting for the Settlement of the Pension Obligation

58. The maximum gain or loss subject to recognition in earnings when a pension obligation is settled is the net gain or loss remaining in unassigned funds (surplus) plus any transition asset remaining in unassigned funds (surplus) from initial application of SSAP No. 89. That maximum amount includes any gain or loss first measured at the time of settlement. The maximum amount shall be recognized in earnings if the entire projected benefit obligation is settled. If only part of the projected benefit obligation is settled, the employer shall recognize in earnings a pro rata portion of the maximum amount equal to the percentage reduction in the projected benefit obligation.

59. If the purchase of a participating annuity contract constitutes a settlement, the maximum gain (but not the maximum loss) shall be reduced by the cost of the participation right before determining the amount to be recognized in earnings.

60. If the cost of all settlements in a year is less than or equal to the sum of the service cost and interest cost components of net periodic pension cost for the plan for the year, gain or loss recognition is permitted but not required for those settlements. However, the accounting policy adopted shall be applied consistently from year to year.

Accounting for a Plan Curtailment

61. The prior service cost included in unassigned funds (surplus) associated with years of service no longer expected to be rendered as the result of a curtailment is a loss. For example, if a curtailment eliminates half of the estimated remaining future years of service of those who were employed at the date of a prior plan amendment and were expected to receive benefits under the plan, then the loss associated with the curtailment is half of the prior service cost included in unassigned funds (surplus) related to that amendment that has not been amortized as a component of net periodic pension cost. For purposes of applying the provisions of this paragraph, prior service cost includes the cost of retroactive plan amendments and any transition obligation remaining in unassigned funds (surplus) from initial application of SSAP No. 89.

62. The projected benefit obligation may be decreased (a gain) or increased (a loss) by a curtailment.
- a. To the extent that such a gain exceeds any net loss included in unassigned funds (surplus) (or the entire gain, if a net gain exists), it is a curtailment gain.
 - b. To the extent that such a loss exceeds any net gain included in unassigned funds (surplus) (or the entire loss, if a net loss exists), it is a curtailment loss.

For purposes of applying the provisions of this paragraph, any transition asset remaining in unassigned funds (surplus) from initial application of SSAP No. 89 shall be treated as a net gain and shall be combined with the net gain or loss arising subsequent to transition to SSAP No. 89.

63. If the sum of the effects identified in paragraphs 61 and 62 is a net loss, it shall be recognized in earnings when it is probable that a curtailment will occur and the effects described are reasonably estimable. If the sum of those effects is a net gain, it shall be recognized in earnings when the related employees terminate or the plan suspension or amendment is adopted.

Termination Benefits

64. An employer may provide benefits to employees in connection with their termination of employment. They may be either special termination benefits offered only for a short period of time or contractual termination benefits required by the terms of a plan only if a specified event, such as a plant closing, occurs. An employer that offers special termination benefits to employees shall recognize a liability and a loss when the employees accept the offer and the amount can be reasonably estimated. An employer that provides contractual termination benefits shall recognize a liability and a loss when it is probable that employees will be entitled to benefits and the amount can be reasonably estimated. Termination benefits may take various forms including lump-sum payments, periodic future payments, or both. They may be paid directly from an employer's assets, an existing pension plan, a new employee benefit plan, or a combination of those means. The cost of termination benefits recognized as a liability and a loss shall include the amount of any lump-sum payments and the present value of any expected future payments. A situation involving termination benefits may also involve a curtailment to be accounted for under paragraphs 61-63.

Disclosures – Single Employer Defined Benefit Plans

65. An employer that sponsors one or more defined benefit pension plans or one or more other defined benefit postretirement plans shall provide the following information, separately for pension plans and other postretirement benefit plans. Amounts related to the employer's results of operations shall be disclosed for each period for which a statement of income is presented. Amounts related to the employer's statement of financial position, shall be disclosed as of the date of each statement of financial position presented.

- a. A reconciliation of beginning and ending balances of the benefit obligation 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, benefits paid, plan amendments, business combinations, divestitures, curtailments, settlements, and special termination benefits.
- 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, contributions by the employer, contributions by plan participants, benefits paid, business combinations, divestitures, and settlements.
- c. The funded status of the plans and the amounts recognized in the statement of financial position, showing separately the assets and liabilities recognized.
- d. The objectives of the disclosures about postretirement benefit plan assets are to provide users of financial statements with an understanding of:
 - i. How investment allocation decisions are made, including the factors that are pertinent to an understanding of investment policies and strategies
 - ii. The classes of plan assets
 - iii. The inputs and valuation techniques used to measure the fair value of plan assets

- iv. The effect of fair value measurements using significant unobservable inputs (Level 3) on changes in plan assets for the period
- v. Significant concentrations of risk within plan assets.

An employer shall consider those overall objectives in providing the following information about plan assets:

- (a) A narrative description of investment policies and strategies, including target allocation percentages or range of percentages considering the classes of plan assets disclosed pursuant to 65.d.v.(b), as of the latest statement of financial position presented (on a weighted-average basis for employers with more than one plan), and other factors that are pertinent to an understanding of those policies and strategies such as investment goals, risk management practices, permitted and prohibited investments including the use of derivatives, diversification, and the relationship between plan assets and benefit obligations. For investment funds disclosed as classes as described in 65.d.v.(b), a description of the significant investment strategies of those funds shall be provided.
- (b) The fair value of each class of plan assets as of each date for which a statement of financial position is presented. Asset classes shall be based on the nature and risks of assets in an employer's plan(s). Examples of classes of assets could include, but are not limited to, the following: cash and cash equivalents; equity securities, (segregated by industry type, company size, or investment objective); debt securities, issued by national, state, and local governments; corporate debt securities; asset-backed securities; structured debt; derivatives on a gross basis (segregated by type of underlying risk in the contract, for example, interest rate contracts, foreign exchange contracts, equity contracts, commodity contracts, credit contracts, and other contracts); investment funds (segregated by type of fund); and real estate. Those examples are not meant to be all inclusive. An employer should consider the overall objectives in paragraph 65.d. in determining whether additional classes of plan assets or further disaggregation of classes should be disclosed.
- (c) A narrative description of the basis used to determine the overall expected long-term rate-of-return-on-assets assumption, such as the general approach used, the extent to which the overall rate-of-return-on-assets assumption was based on historical returns, the extent to which adjustments were made to those historical returns in order to reflect expectations of future returns, and how those adjustments were determined. The description should consider the classes of assets described in 65.d.v.(b)., as appropriate.
- (d) Information that enables users of financial statements to assess the inputs and valuation techniques used to develop fair value measurements of plan assets at the reporting date. For fair value measurements using significant unobservable inputs, an employer shall disclose the effect of the measurements on changes in plan assets for the period. To meet those objectives, the employer shall disclose the following information for each class of plan assets disclosed pursuant to 65.d.v.(b)., for each annual period:

- (1) The level within the fair value hierarchy in which the fair value measurements in their entirety fall,³ segregating fair value measurements using quoted prices in active markets for identical assets or liabilities (Level 1), significant other observable inputs (Level 2), and significant unobservable inputs (Level 3)
 - (2) For fair value measurements of plan assets using significant unobservable inputs (Level 3), a reconciliation of the beginning and ending balances, separately presenting changes during the period attributable to the following:
 - (i) Actual return on plan assets, separately identifying the amount related to assets still held at the reporting date and the amount related to assets sold during the period
 - (ii) Purchases, sales, and settlements, net
 - (iii) Transfers in and/or out of Level 3 (for example, transfers due to changes in the observability of significant inputs)
 - (3) Information about the valuation technique(s) and inputs used to measure fair value and a discussion of changes in valuation techniques and inputs, if any, during the period.
- e. For defined benefit pension plans, the accumulated benefit obligation.
 - f. The benefits (as of the date of the latest statement of financial position presented) expected to be paid in each of the next five fiscal years, and in the aggregate for the five fiscal years thereafter. The expected benefits should be estimated based on the same assumptions used to measure the company's benefit obligation at the end of the year and should include benefits attributable to estimated future employee service.
 - g. The employer's best estimate, as soon as it can reasonably be determined, of contributions expected to be paid to the plan during the next fiscal year beginning after the date of the latest statement of financial position presented. Estimated contributions may be presented in the aggregate combining (1) contributions required by funding regulations or laws, (2) discretionary contributions, and (3) noncash contributions.
 - h. The amount of net benefit cost recognized, showing separately the service cost component, the interest cost component, the expected return on plan assets for the period, the gain or loss component, the prior service cost or credit component, the transition asset or obligation component, and the gain or loss recognized due to settlements or curtailments.
 - i. Separately the net gain or loss and net prior service cost or credit recognized in unassigned funds (surplus) for the period pursuant to paragraphs 17 and 21 and reclassification adjustments of unassigned funds (surplus) for the period, as those

³ In some cases, the inputs used to measure fair value might fall in different levels of the fair value hierarchy. The level in the fair value hierarchy within which the fair value measurement in its entirety falls shall be determined based on the lowest level input that is significant to the fair value measurement in its entirety. Assessing the significance of a particular input to the fair value measurement in its entirety requires judgment, considering factors specific to the asset or liability.

amounts, including amortization of the net transition asset or obligation, are recognized as components of net periodic benefit cost.

- j. The amounts in unassigned funds (surplus) that have not yet been recognized as components of net periodic benefit cost, showing separately the net gain or loss, net prior service cost or credit, and net transition asset or obligation.
- k. On a weighted-average basis, the following assumptions used in the accounting for the plans: assumed discount rates, rates of compensation increase (for pay-related plans), and expected long-term rates of return on plan assets specifying, in a tabular format, the assumptions used to determine the benefit obligation and the assumptions used to determine net benefit cost.
- l. 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.
- m. If applicable, any alternative method used to amortize prior service amounts or net gains and losses pursuant to paragraphs 18 and 25.
- n. 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.
- o. If applicable, the cost of providing special or contractual termination benefits recognized during the period and a description of the nature of the event.
- p. An explanation of any significant change in the benefit obligation or plan assets not otherwise apparent in the other disclosures required by this issue paper.
- q. The amounts in unassigned funds (surplus) expected to be recognized as components of net periodic benefit cost over the fiscal year that follows the most recent annual statement of financial position presented, showing separately the net gain or loss, net prior service cost or credit, and net transition asset or obligation.
- r. The amount and timing of any plan assets expected to be returned to the employer during the 12-month period, or operating cycle if longer, that follows the most recent annual statement of financial position presented.

Disclosures – Employers with Two or More Defined Benefit Plans

66. The disclosures required by this issue paper shall be aggregated for all of an employer's defined benefit pension plans and for all of an employer's other defined benefit postretirement plans unless disaggregating in groups is considered to provide useful information or is otherwise required by this paragraph and paragraph 67. Disclosures shall be as of the date of each statement of financial position presented. 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 other postretirement benefit plans. If aggregate disclosures are presented, an employer shall disclose:

- a. The aggregate benefit obligation and aggregate fair value of plan assets for plans with benefit obligations in excess of plan assets as of the measurement date of each statement of financial position presented.
- b. 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.

67. A U.S. reporting entity may combine disclosures about pension plans or other 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.

Interim Financial Disclosures –Defined Benefit Plans

68. The following shall be disclosed within interim financial statements that include a statement of income:

- a. The amount of net periodic benefit cost recognized, for each period for which a statement of income is presented, showing separately the service cost component, the interest cost component, the expected return on plan assets for the period, the gain or loss component, the amount of prior service cost or credit component, the transition asset or obligation component, and the gain or loss recognized due to a settlement or curtailment.
- b. The total amount of the employer's contributions paid, and expected to be paid, during the current fiscal year, if significantly different from amounts previously disclosed pursuant to paragraph 65.g. Estimated contributions may be presented in the aggregate combining (1) contributions required by funding regulations or laws, (2) discretionary contributions, and (3) noncash contributions.

Defined Contribution Plans

69. A defined contribution pension plan is a plan that provides pension benefits in return for services rendered, provides an individual account for each participant, and has terms that specify how contributions to the individual's account are to be determined rather than the amount of pension benefits the individual is to receive. Under a defined contribution plan, the pension benefits a participant will receive depend only on the amount contributed to the participant's account, the returns earned on investments of those contributions, and forfeitures of other participants' benefits that may be allocated to the participant's account.

70. To the extent that a plan's defined contributions to an individual's account are to be made for periods in which that individual renders services, the net pension cost for a period shall be the contribution called for in that period. If a plan calls for contributions for periods after an individual retires or terminates, the estimated cost shall be accrued during the employee's service period.

71. A pension plan having characteristics of both a defined benefit plan and a defined contribution plan requires careful analysis. If the substance of the plan is to provide a defined benefit, as may be the case with some "target benefit" plans, the accounting requirements shall be determined in accordance with the provisions applicable to a defined benefit plan and the disclosure requirements within paragraph 65 shall be followed.

Disclosures - Defined Contribution Plans

72. An employer shall disclose the amount of cost recognized for defined contribution pension plans and for other defined contribution postretirement benefit plans for all periods presented 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

73. A multiemployer plan is a pension plan to which two or more unrelated employers contribute, usually pursuant to one or more collective-bargaining agreements. A characteristic of multiemployer plans is that assets contributed by one participating employer may be used to provide benefits to employees of other participating employers since assets contributed by an employer are not segregated in a separate account or restricted to provide benefits only to employees of that employer.

74. A reporting entity participating in a multiemployer plan shall recognize as net pension cost the required contribution for the period and shall recognize as a liability any contributions due and unpaid.

75. In some situations, withdrawal from a multiemployer plan may result in a reporting entity 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 *SSAP No. 5—Liabilities, Contingencies and Impairment of Assets – Revised* (SSAP No. 5R) shall apply.

Disclosures - Multiemployers Plans

76. A reporting entity shall disclose the amount of contributions to multiemployer plans for each annual period for which a statement of income is presented. A reporting entity may disclose total contributions to multiemployer plans without disaggregating the amounts attributable to pension plans and other postretirement benefit plans. 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.

77. In some situations, withdrawal from a multiemployer plan may result in a reporting entity having an obligation to the plan for a portion of the unfunded benefit obligation of the pension plans and other postretirement benefit plans. If withdrawal under circumstances that would give rise to an obligation is either probable or reasonably possible, the provisions of SSAP No. 5R shall apply. 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 SSAP No. 5R.

Multiple Employer Plans

78. Some pension plans to which two or more unrelated employers contribute are not multiemployer plans. Rather, they are in substance aggregations of single-employer plans combined to allow participating employers to pool their assets for investment purposes and to reduce the costs of plan administration. Those plans ordinarily do not involve collective-bargaining agreements. They may also have features that allow participating employers to have different benefit formulas, with the employer's contributions to the plan based on the benefit formula selected by the employer. Such plans shall be

considered single-employer plans rather than multiemployer plans, and each reporting entity's accounting shall be based on its respective interest in the plan.

Non-U.S. Pension Plans

79. Except for its effective date, this issue paper includes no special provisions applicable to pension arrangements outside the United States. To the extent that those arrangements are in substance similar to pension plans in the United States, they are subject to the provisions of this issue paper. The substance of an arrangement is determined by the nature of the obligation and by the terms or conditions that define the amount of benefits to be paid, not by whether (or how) a plan is funded, whether benefits are payable at intervals or as a single amount, or whether the benefits are required by law or custom or are provided under a plan the employer has elected to sponsor.

80. It is customary or required in some countries to provide benefits in the event of a voluntary or involuntary severance of employment (also called termination indemnities). If such an arrangement is in substance a pension plan (for example, if the benefits are paid for virtually all terminations), it is subject to the provisions of this issue paper.

Business Combinations

81. When an employer is acquired in a business combination and that employer sponsors a single-employer defined benefit pension plan, the assignment of the purchase price to individual assets acquired and liabilities assumed shall include a liability for the projected benefit obligation in excess of plan assets or an asset for plan assets in excess of the projected benefit obligation, thereby eliminating any previously existing net gain or loss, prior service cost or credit, or transition asset or obligation recognized in unassigned funds (surplus). If it is expected that the plan will be terminated or curtailed, the effects of those actions shall be considered in measuring the projected benefit obligation.

Consolidated/Holding Company Plans

82. The employees of many reporting entities are members of a plan sponsored by a parent company or holding company. A reporting entity that 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 4-81 and 84-92 of this issue paper shall be applied.

Relevant Literature

83. This issue paper adopts with modification paragraphs 1-7 and 16-17 as well as Appendix C – Amendments to Statements 87 and 88 and Appendix E – Amendments to Statement 132(R) of *FASB Statement No. 158, Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106 and 132(R)* (FAS 158). Paragraphs 8-10 providing specific guidance for not-for-profit organizations is rejected. Paragraphs 11-15 regarding the effective dates for FAS 158 is rejected and paragraph 19 providing an alternative method for rereasuring plan assets and benefits obligations as of the fiscal year the measurement date provisions are applied is also rejected. Appendix D – Amendments to Statement 106 has not been incorporated within this statutory statement as it will be considered in accordance with revisions to *SSAP No. 14—Postretirement Benefits Other Than Pensions* (SSAP No. 14). Disclosures included within FAS 132 (R), as amended by FAS 158,

pertaining to health care (paragraphs 5.l. and 5.m.) have been rejected for inclusion within this standard, but will also be considered in accordance with revisions to SSAP No. 14. This issue paper adopts the revisions to paragraph 5.d. of FAS 132(R) as amended by *FASB Staff Position FAS 132(R)-1, Employers' Disclosures about Postretirement Benefit Plan Assets* (FSP FAS 132(R)-1) and *ASU 2010-06, Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements* (ASU 2010-06). Other revisions to disclosures requirements as amended by FSP FAS 132(R)-1 relate to nonpublic entities and are rejected. This Statement adopts by reference *FSP FASB 158-1, Conforming Amendments to the Illustrations in FASB Statements No. 87, No. 88, and No. 106 and to the Related Staff Implementation Guides* (FSP FAS 158-1) to the extent that the examples and related implementation guides comply with the adopted GAAP guidance previously identified within this statement, as modified for statutory accounting. The following modifications from the adopted paragraphs of FAS 158 have been incorporated within this standard:

- a. All references to 'other comprehensive income' or 'accumulated other comprehensive income' within FAS 158 have been revised to reflect unassigned funds (surplus).
- b. Any prepaid asset resulting from the excess of the fair value of plan assets over the projected benefit obligation shall be nonadmitted. Furthermore, any asset recognized from the cost of a 'participation right' of an annuity contract per paragraph 5l shall also be nonadmitted.
- c. Provisions within paragraph 30 of FAS 87, as amended by FAS 158, permitting a market-related value of plan assets have been eliminated with only the fair value measurement method for plan assets being retained.
- d. The reduced disclosure requirements for nonpublic entities described in paragraph 8 of FAS 132(R), as amended by FAS 158, are rejected. All reporting entities shall follow the disclosure requirements included in paragraph 5 of FAS 132(R) as amended by FAS 158.
- e. Clarification has been included within this standard to ensure both vested and nonvested employees are included within the recognition of net periodic pension cost and in the pension benefit obligation. Although this is consistent with GAAP, this is a change from previous statutory accounting. As nonvested employees were excluded from statutory accounting under SSAP No. 89, guidance has been included to indicate that the unrecognized prior service cost attributed to nonvested individuals is not required to be included in net periodic pension cost entirely in the year this standard is adopted. The unrecognized prior service cost for nonvested employees shall be amortized as a component of net periodic pension cost by assigning an equal amount to each expected future period of service before vesting occurs for nonvested employees active at the date of the amendment. Unassigned funds (surplus) is then adjusted each period as prior service cost is amortized. (Guidance is included within the transition related to the recognition of the prior service cost for nonvested employees through unassigned funds (surplus).)
- f. Conclusion of Interpretation 04-12: *EITF 03-4: Determining the Classification and Benefit Attribution Method for a "Cash Balance" Pension Plan* (INT 04-12) indicating that 'cash balance' plans are considered defined benefit plans has been incorporated within paragraph 5 of this issue paper.
- g. Conclusion of Interpretation 99-26: *Offsetting Pension Assets and Liabilities* (INT 99-26) prohibiting the offset of defined benefit liabilities of one plan with prepaid assets of another plan has been incorporated within paragraph 28 of this issue paper.

- h. Provisions within paragraph 36 of FAS 87, as amended by FAS 158, regarding the classification of underfunded liabilities as current or noncurrent liabilities and the classification of assets from overfunded plans as noncurrent assets has been rejected as inconsistent with statutory accounting.
- i. Provisions within paragraph 49 of FAS 87, as amended by FAS 158, defining the fair value of investments have been rejected. Fair value definitions and measurement for investments shall be determined in accordance with statutory accounting guidance.
- j. Provisions within paragraph 52 of FAS 87, as amended by FAS 158, regarding the plan assets measurement date for consolidating subsidiaries or entities utilizing the equity method under APB Opinion No. 18 has been rejected. For statutory accounting, all entities shall follow the measurement date guidance within paragraph 44 of this statement.
- k. Transition under FAS 158 is different from this issue paper. FAS 158 requires entities with publicly traded equity securities to initially apply the requirement to recognize the funded status of a benefit plan; the gains/losses, prior service costs/credits and transition obligations/assets that have not yet been included in net periodic benefit cost; and the disclosure requirements as of the end of the fiscal year ending after December 15, 2006. Transition guidelines for statutory accounting are defined in paragraphs 84-92.
- l. FAS 158 provided two approaches for an employer to transition to a fiscal year-end measurement date. For purposes of statutory accounting, the second approach permitting reporting entities to use earlier measurements determined for year-end reporting as of the fiscal year immediately preceding the year that the measurement date provisions is rejected. For consistency purposes, all reporting entities shall follow the first approach and remeasure plan assets and benefit obligations as of the beginning of the fiscal year that the measurement date provisions are applied.

Effective Date and Transition

84. Reporting entities are required to disclose the projected benefit obligation, the accumulated benefit obligation and the fair value of plan assets for defined benefit pension plans in the first reporting period after the effective date of this standard and in each subsequent reporting period. This disclosure shall specifically note the funded/underfunded status of the pension plan based on the projected benefit obligation. Reporting entities shall also specifically note the surplus impact necessary, at each reporting date, to reflect the full projected benefit obligation within the financial statements.

85. The SSAP that results from this issue paper is effective for quarterly and annual reporting periods beginning on or after January 1, 2013 (transition date) with early adoption permitted. Any unfunded defined benefit pension amounts, as determined when the projected benefit obligation exceeds the fair value of plan assets, is a liability under SSAP No. 5R and shall be reported in the first quarter statutory financial statements after the transition date with a corresponding entry to unassigned funds (surplus). If the fair value of plan assets exceeds the projected benefit obligation, the asset shall be considered a nonadmitted asset. Net periodic pension cost shall include a component for unrecognized prior service cost for nonvested employees beginning in 2013.

86. Gains or losses, prior service costs or credits (including prior service costs for non-vested participants pursuant to paragraph 13), and remaining transition assets or obligations from prior application of SSAP No. 89 (collectively referred to as “unrecognized items”) that have not yet been

included in net periodic benefit cost as of December 31, 2012⁴ shall be recognized as components of the balance of unassigned funds (surplus), net of tax, as of January 1, 2013 (provided that alternative transition is not elected per paragraph 87.b.). The offset to unassigned funds is reported separately as an “Aggregate Write-In for Other-Than-Invested Assets” or as an “Aggregate Write-In for Other Liabilities”. After recognition, the full unfunded or overfunded status of the plan shall be reflected within the financial statements⁵. Any prepaid asset resulting from an overfunded plan shall be nonadmitted.

87. Due to the potential impact to surplus as a result of immediately applying the accounting guidance in paragraph 86, reporting entities may elect one of the following two methods, on an individual plan basis, to recognize the transition surplus impact:

- a. Reporting entities may elect to recognize the entire transition surplus impact calculated from applying paragraph 86, on an individual plan basis, as of January 1, 2013.
- b. Alternatively, reporting entities may elect to recognize the entire surplus impact from applying paragraph 86, on an individual plan basis, over a period not to exceed ten (10) years. The surplus impact initially recognized as of January 1, 2013, under this transition option, and subsequently over the transition period, shall be the greater of:
 - i. Ten percent of the calculated surplus impact as of the transition date;
 - ii. Amortization⁶ of the “unrecognized items” (defined in paragraph 86) into net periodic pension cost, including any accelerated amortization of these items from curtailments or settlements that occur after the transition date. (If the amortization cannot be determined at transition, at a minimum, the amount amortized for “unrecognized items” during the prior year shall be utilized for this component of the calculation. If the amount recognized for transition (greater of all three components in paragraph 87.b.) is subsequently determined to be less than what is amortized for the year (87.b.ii.), the difference between what was recognized for transition, and what is amortized must immediately be recognized as an adjustment to the transition impact to unassigned funds (surplus).);

⁴ The intent of the guidance is to recognize the unrecognized amounts as of December 31, 2012 annual statements, even if new actuarial projections (accumulated benefit obligation/projected benefit obligation amounts) are calculated as of January 1, 2013. (These projections would be considered in the recognition of the 2013 pension cost.)

⁵ Upon the effective date of this statement, reporting entities are required to reflect the full unfunded or overfunded status of their defined benefit pension plans. As such, the concept of an “additional minimum liability” previously reflected in *SSAP No. 89—Pensions* is not incorporated within this Statement. If an additional minimum liability (and a corresponding intangible asset) had been recognized under SSAP No. 89, such items shall be eliminated with the implementation of this Statement, and the guidance in paragraph 87 shall be followed. The elimination of any additional minimum liability and corresponding intangible asset shall also occur if the entity elects the transition option reflected in paragraph 87.b.

⁶ Unless otherwise impacted from the provisions within this Statement or in accordance with changes to the pension plan, the amortization of the unrecognized items into net periodic pension cost shall continue to follow the existing amortization schedules in effect on the transition date.

- iii. Amount necessary to establish a total liability that is equal to any unfunded accumulated benefit obligation (the accumulated benefit obligation less the fair value of plan assets)⁷.

If the surplus deferral is elected at the transition date, subsequently, starting with the 2014 year-end financial statement, the reporting entity shall annually recognize the remaining surplus impact (collectively referred to as the “transition liability”⁸) on a systematic basis over a period not to exceed nine years. The minimum amount recognized each subsequent year shall be an amount that reflects the conditions within paragraph 87.b. Additionally, reporting entities must recognize any remaining transition liability to the extent that the plan reflects a prepaid benefit cost. (For example, if changes in circumstances have resulted with the plan reflecting an overfunded status, the remaining transition liability must be recognized to the extent that the plan is overfunded.) Furthermore, if circumstances result with a subsequent gain attributed to the plan that will be recognized in earnings, the entity must recognize an additional amount of the remaining transition liability to offset the recognized gain. Reporting entities are permitted to recognize the remaining transition liability, or an amount in excess of the minimum requirement, at any time after the transition date. This transition guidance is specific to the transition surplus impact from initially applying this statement on Jan. 1, 2013. Thus, this transition guidance does not apply to additional liability calculated from subsequent comparison of the fair value of plan assets to the projected benefit obligation, or the impact of subsequent plan amendments.

88. Reporting entities electing to apply the transition guidance in paragraph 87.b. must disclose the full transition surplus impact calculated from applying paragraph 86 in the first quarter statutory financial statements after the transition date and each reporting period thereafter. This disclosure shall include the initial “transition liability” calculated under paragraph 86, the annual amortization amount of the “unrecognized items” into net periodic pension cost, the amount of the unfunded accumulated benefit obligation, and the remaining unrecognized transition impact. This disclosure shall include a schedule of the entity’s anticipated recognition of the remaining surplus impact over the transition period.

89. The requirement to measure plan assets and benefit obligations as of the date of the reporting entity’s financial statement year-end is effective in SSAP No. 102 for financial statement years beginning January 1, 2014. (The measurement date change will be initially reflected in the Dec. 31, 2014, financial statements.)

90. In order to transition to a fiscal year-end measurement date, the reporting entity shall remeasure plan assets and benefit obligations as of the beginning of the fiscal year that the measurement date provisions are applied. The reporting entity shall use those new measurements to determine the effects of the measurement date change as of the beginning of the fiscal year that the measurement date provisions are applied.

⁷ The intent of this standard is to ensure that under the deferral option the liability initially recognized for an unfunded plan reflects the minimum liability previously recognized under SSAP No. 89. For any instances in which an additional minimum liability recognized under SSAP No. 89 is greater than the unfunded ABO at transition, an amount equal to the previously recognized additional minimum liability shall be used in determining this component of 87.b.iii. The deferral option under this standard is not intended to allow a surplus benefit to be recognized at initial transition for an unfunded plan.

⁸ If the surplus deferral from paragraph 87.b. is elected, the deferred liability, although comprised of the previous “unrecognized items” shall be collectively referred to as the “transition liability”. Although reporting entities will need to continue to track the unrecognized items for amortization into net periodic cost (offset through unassigned funds), reporting entities shall not allocate the recognized surplus impact from transition to these categories. As noted in paragraph 87.b.ii., the minimum amount of liability recognized under the deferral option must cover the annual amortization of the “unrecognized items” into net periodic pension cost to prevent a surplus benefit.

91. The reporting entity shall measure plan assets and benefit obligations as of the beginning of the fiscal year that the measurement date provisions are applied. This would result with the following:

- a. Net periodic benefit cost for the period between the measurement date that is used for the immediately preceding fiscal year-end and the beginning of the fiscal year that the measurement date provisions are applied, exclusive of any curtailment or settlement gain or loss, shall be recognized, net of tax, as a separate adjustment of the opening balance unassigned funds (surplus). That is, the pretax amount recognized as an adjustment to unassigned funds (surplus) is the net periodic benefit cost that without a change in measurement date otherwise would have been recognized on a delayed basis during the first interim period for the fiscal year that the measurement date provisions are applied.
- b. Any gain or loss arising from a curtailment or settlement between the measurement date that is used for the immediately preceding fiscal year-end and the beginning of the fiscal year that the measurement date provisions are applied shall be recognized in earnings in that period and not as an adjustment to unassigned funds (surplus). This provision prohibits a reporting entity from early application of the measurement date provisions when the reporting entity has issued financial statements for the prior year without recognition of such a settlement or curtailment.
- c. Other changes in the fair value of plan assets and the benefit obligations (for example, gains or losses) for the period between the measurement date that is used for the immediately preceding fiscal year-end and the beginning of the fiscal year that the measurement date provisions are applied shall be recognized, net of tax, as a separate adjustment of the opening balance of unassigned funds (surplus) for the fiscal year that the measurement date provisions are applied.

92. Earlier application of the recognition or measurement date provisions is encouraged, however, early applications must be for all of the reporting entity's benefit plans. If early application is elected, the transition date shall reflect the January 1st of the year in which SSAP No. 102 is initially applied. Retrospective application is not permitted.

93. After adoption of this issue paper, the NAIC will release a Statement of Statutory Accounting Principles (SSAP) for comment. The initial draft of the SSAP will contain the adopted Summary Conclusion of this issue paper. Users of the *Accounting Practices and Procedures Manual* should note that issue papers are not represented in the Statutory Hierarchy (see Section IV of the Preamble) and therefore the conclusions reached in this issue paper should not be applied until the corresponding SSAP has been adopted by the Plenary of the NAIC. It is expected that the SSAP will be effective for reporting periods beginning on or after January 1, 2013.

DISCUSSION:

94. The FASB issued FAS 158 to address concerns that existing accounting for postretirement benefit plans failed to communicate the funded status of those plans in a complete and understandable way. The prior standards did not require an employer to report in its statement of financial position the overfunded or underfunded status of a defined benefit postretirement plan. The prior standards also did not require an employer to recognize completely in earnings or other comprehensive income the financial effects of certain events affecting the plan's funded status when those events occurred.

95. Within the prior GAAP standards, an employer was allowed to recognize in its statement of financial position an asset or liability arising from the defined benefit postretirement plan, which almost always differed from the plan's overfunded or underfunded status. Those standards allowed an employer to delay recognition of economic events that affected the costs of providing postretirement benefits—

changes in plan assets and benefit obligations—and recognize a liability that was sometimes significantly less than the underfunded status of the plan as well as recognize an asset in its statement of financial position, in some situations, for a plan that was underfunded. Furthermore, information regarding the overfunded or underfunded status of a plan was relegated to the notes to the financial statements. That information was in the form of a reconciliation of the overfunded or underfunded status to amounts recognized in the employer’s statement of financial position. By presenting this information only in the notes it was difficult for users of financial statements to assess an employer’s financial position and ability to satisfy postretirement benefits.

96. In issuing FAS 158, the FASB concluded that the reporting requirements of other standards did not provide representationally faithful and understandable financial information and might lead to the inefficient allocation of resources in capital markets. The issuance of FAS 158 is the first step of a project to comprehensively reconsider FAS 87, 88, 106, 132(R), and related pronouncements.

97. In accordance with the Statutory Accounting Principles Statement of Concepts, the conservatism concept supports the adoption of FAS 158 to ensure proper liability recognition and in accordance with the responsibility to regulate financial solvency.

98. Modifications to FAS 158 have been established primarily to clarify the components for liability consideration and to ensure consistency within reporting and recognition among reporting entities. Guidance related to not-for-profit entities, transition, and alternative methods for remeasuring plan assets and benefit obligations for the first year application have been rejected to ensure consistent application for statutory purposes. Revisions incorporated within FAS 158 specifically attributed to FAS 106 or postretirement benefits other than pensions have not been addressed within this issue paper and will be considered in accordance with revisions to SSAP No. 14. Modifications from FAS 158 incorporated within this issue paper include:

- a. All references to ‘other comprehensive income’ or ‘accumulated other comprehensive income’ within FAS 158 have been revised to reflect ‘unassigned funds (surplus)’. This modification simply alters the guidance within FAS 158 to adhere to the reporting captions for statutory accounting.
- b. Any prepaid asset resulting from the excess of the fair value of plan assets over the projected benefit obligation shall be nonadmitted. Furthermore, any asset recognized from the cost of a “participation right” of an annuity contract per paragraph 51 shall also be nonadmitted. These modifications are consistent with the definition of assets and nonadmitted assets set forth in *SSAP No. 4—Assets and Nonadmitted Assets* as assets recognized from overfunding postretirement plans or participating rights from annuity contracts cannot be readily converted to cash to satisfy policyholder obligations.
- c. Provisions within paragraph 30 of FAS 87, as amended by FAS 158, permitting a calculated market-related value of plan assets has been eliminated with only the fair value measurement method for plan assets being retained. The calculated market-related value is a process to systematically and rationally recognize changes in fair value over a period of five years. This modification eliminates the potential for inconsistent measurement methods among reporting entities.
- d. The reduced disclosure requirements for nonpublic entities described in paragraph 8 of FAS 132(R), as amended by FAS 158, are rejected. All reporting entities shall follow the disclosure requirements in paragraph 5 of FAS 132(R), as amended by FAS 158.
- e. Clarification has been included within this standard to ensure both vested and nonvested employees are included within the recognition of net periodic pension cost and in the

pension benefit obligation. Although this is consistent with GAAP, this is a change from previous statutory accounting. As nonvested employees were excluded from statutory accounting under SSAP No. 89, guidance has been included to indicate that the unrecognized prior service cost attributed to nonvested individuals is not required to be included in net periodic pension cost entirely in the year this standard is adopted. The unrecognized prior service cost for nonvested employees shall be amortized as a component of net periodic pension cost by assigning an equal amount to each expected future period of service before vesting occurs for nonvested employees active at the date of the amendment. Unassigned funds (surplus) is then adjusted each period as prior service cost is amortized.

- f. Conclusion of Interpretation 04-12: *EITF 03-4: Determining the Classification and Benefit Attribution Method for a "Cash Balance" Pension Plan* (INT 04-12) indicating that 'cash balance' plans are considered defined benefit plans has been incorporated within paragraph 5 of this issue paper.
- g. Conclusion of Interpretation 99-26: *Offsetting Pension Assets and Liabilities* (INT 99-26) prohibiting the offset of defined benefit liabilities of one plan with prepaid assets of another plan has been incorporated within paragraph 28 of this issue paper.
- h. Provisions within paragraph 36 of FAS 87, as amended by FAS 158, regarding the classification of underfunded liabilities as current or noncurrent liabilities and the classification of assets from overfunded plans as noncurrent assets has been rejected as inconsistent with statutory accounting.
- i. Provisions within paragraph 49 of FAS 87, as amended by FAS 158, defining the fair value of investments have been rejected. Fair value definitions and measurement for investments shall be determined in accordance with statutory accounting guidance.
- j. Provisions within paragraph 52 of FAS 87, as amended by FAS 158, regarding the plan assets measurement date for consolidating subsidiaries or entities utilizing the equity method under APB Opinion No. 18 has been rejected. For statutory accounting, all entities shall follow the measurement date guidance within paragraph 44 of this statement.
- k. Transition under FAS 158 is different from this issue paper. FAS 158 requires entities with publicly traded equity securities to initially apply the requirement to recognize the funded status of a benefit plan; the gains/losses, prior service costs/credits and transition obligations/assets that have not yet been included in net periodic benefit cost; and the disclosure requirements as of the end of the fiscal year ending after December 15, 2006. Transition guidelines for statutory accounting are defined in paragraphs 84-92.
- l. FAS 158 provided two approaches for an employer to transition to a fiscal year-end measurement date. For purposes of statutory accounting, the second approach permitting reporting entities to use earlier measurements determined for year-end reporting as of the fiscal year immediately preceding the year that the measurement date provisions was rejected. For consistency purposes, all reporting entities shall follow the first approach and shall remeasure plan assets and benefit obligations as of the beginning of the fiscal year that the measurement date provisions are applied.

99. Application of this issue paper as a new Statutory Accounting Principle is expected to generate an increased projected benefit obligation as a result of the inclusion of nonvested participants. (In SSAP No. 89, nonvested participants were excluded from the projected benefit obligation. This exclusion has been

eliminated.) The increase to the projected benefit obligation is not anticipated to be significant for pension plans as federal legislature already exists that requires vesting within a fairly short timeframe after the start of employment (seven years maximum).

WORKING GROUP RESEARCH AND KEY ISSUES CONSIDERED:

100. During the Statutory Accounting Principles (E) Working Group's discussions on this issue paper, the Working Group conducted research and considered key issues to determine the appropriate course of action in response to comments received. Summaries of the key topics discussed, the research conducted, and the Working Group's conclusions have been detailed in the paragraphs below:

101. *Admittance of Prepaid Pension Costs for Overfunded Assets* – During the Spring 2008 Hearing, comments were received that prohibiting admittance of the asset established from overfunded plans would be punitive in comparison to GAAP reporting. A comment was also received proposing an offsetting admission for overfunded plan assets, whereas, an asset from overfunded plans would be admitted to the extent that a separate plan was underfunded. In considering these comments, the Working Group identified that there is a punitive tax that significantly hinders a company's ability to reclaim overfunded defined benefit assets. The 4980 Excise Tax on Reversions is a punitive, non-deductible excise tax imposed on the reversion of excess defined benefit assets to the employer. In 2008, the law imposed a confiscatory 50% tax on a simple reversion of excess assets to the employer. Because the excise tax is not deductible, ordinary income tax also applies on the entire amount of the reversion. Assuming federal and states income taxes total 40%, with the excise tax, a combined 90% tax is levied on the reversion. The Working Group identified that there are exceptions to when the tax is reduced to 20% and if the excess assets of a terminating defined benefit plan are transferred to a qualifying replacement plan, no excise tax would be due on the transferred assets.

102. In considering this research, the Working Group agreed that continued nonadmittance of overfunded plan assets was appropriate as the excise tax would significantly reduce the amount of assets that could be reclaimed by the company and utilized for policyholder claims. This conclusion is consistent with the existing statutory guidance in *SSAP No. 29—Prepaid Expenses*, in which prepaid assets were previously concluded to be nonadmitted assets as they are not readily available to satisfy policyholder obligations. The Working Group did further consider whether admittance of overfunded assets could occur if the company had plans to transfer the overfunded assets into a qualified replacement plan. However, after identifying that plan assets can only be transferred excise tax-free to a qualified replacement plan if in connection with a qualified plan termination, it was noted that no allowance should be permitted to admit overfunded plan assets for such circumstances or to offset an underfunded plan's liability. (A transfer of overfunded plan assets from an existing plan to a new or different plan would not be excise-tax free as the original plan would not meet the requirements of a qualified plan termination.)

103. *Admission of Deferred Tax Assets from Pension Liabilities* – During the Spring 2008 Hearing, comments were received regarding how reporting the full liabilities for pension or OPEB plans would result in a need to consider revisions to *SSAP No. 10—Income Taxes* (SSAP No. 10) as statutory guidance currently limits the amount of deferred tax assets (DTAs) that can be admitted. In considering these comments, the Working Group identified that the Pension Protection Act of 2006 would seem to reduce the extent of deferred tax assets for defined benefit pension plans and that existing SSAP No. 10 guidance would allow companies to admit additional DTAs if they have a tax-planning strategy. (A DTA is created when pension/OPEB liabilities are accrued in the financial statements, but are only recognized/removed when contributions are made to the plan.)

104. The Pension Protection Act of 2006 (PPA), which goes into effect in 2008, is anticipated to reduce the extent that DTAs are created. Under the PPA funding requirements, plans must stay fully funded (assets must equal or exceed liabilities). If the plan is not fully funded, the funding contribution must also include the amount necessary to amortize over seven years the difference between the fund's

liabilities and assets. Although the establishment of the PPA is not anticipated to eliminate DTAs (the PPA liability calculation to which funds must be contributed is a different calculation from one that compares funded plan assets to the projected benefit obligation as required by FAS 158 and this issue paper), it is anticipated that DTAs for pensions will be reduced in accordance with contributions required by the PPA.

105. Current statutory accounting guidance in SSAP No. 10 does not make specific allowances for deferred tax assets resulting from pension obligations. However, SSAP No. 10 currently allows the admittance of deferred tax assets expected to be realized within one year, if less than 10% of capital and surplus, as well as tax-planning strategies to be considered in determining admitted DTAs. Pursuant to the guidance within SSAP No. 10, an entity is permitted to admit a DTA in response to a prudent and feasible tax-planning strategy that if implemented would result in realization of DTAs within one year of the balance sheet date. The entity is not required to implement the strategy within the 12-month period, but it must have the ability to implement the strategy within such time period. The entity must demonstrate that while it ordinarily might not take such actions, it would do so to prevent an operating loss credit carryforward or other similar item from expiring unused. If the tax-planning strategy criteria is met, an entity may recognize as admitted assets the related DTAs that are realizable as a result of the available tax-planning strategy in accordance with paragraphs SSAP No. 10.

106. As a result of the above information, the Working Group agreed not to further consider revisions to SSAP No. 10 to add specific guidance to admit DTAs resulting from pension or OPEB plans. Update 2012⁹: SSAP No. 10 has been superseded by *SSAP No. 101—Income Taxes* (SSAP No. 101). Guidance in SSAP No. 101 is similar to SSAP No. 10 as it also does not make specific allowances for deferred tax assets resulting from pension obligations. Although, the DTA admittance calculation has been revised from SSAP No. 10 – allowing greater timeframes for recovery and realization of DTAs, and a higher percentage for a realization threshold – SSAP No. 101 continues with the approach to determine admittance of DTAs in accordance with a three-component admittance calculation. Also, tax planning-strategies are still permitted to be considered in admitting DTAs.

107. *Inclusion of Nonvested Employees in Determining Pension Liability* - During the 2008 Spring Hearing, the Working Group received comments that nonvested employees in a pension or OPEB plan do not have a current claim, and should be excluded from pension and OPEB obligation determinations. In considering this issue, the Working Group identified current requirements under federal statute regarding company obligations for nonvested employees in terminated pension plans. Additionally, the Working Group identified that the exclusion of nonvested participants would result in less conservative liability requirements for statutory accounting in comparison to other regulations.

108. The Working Group identified guidelines within the Employee Retirement Income Security Act of 1974 (ERISA) and the Pension Benefit Guaranty Corporation (PBGC) that limit the vesting period for defined benefit plans and require consideration of nonvested employees if such plans are terminated. As of 2007, employees' benefits in a defined benefit pension plan must become vested at 100% after five years, or under a seven-year graded-vesting schedule. Furthermore, an employer may terminate a single-employer plan under a standard termination if the plan's assets equal or exceed its liabilities. If the assets are less than the liabilities, the employer must contribute the amount necessary to fully fund the plan. In a standard termination, all accrued benefits under the plan become 100% vested and the plan must purchase annuity contracts for all participants. This means that employees have a right to all the benefits that were earned at the time of the plan termination, even benefits in which they were not vested and would have lost if the employee had left the employer.

⁹ Issue papers are considered non-authoritative and provide historical discussion for the development of a SSAP. Issue papers are generally updated after the initial adoption of the related SSAP but not typically thereafter. SSAP No. 102 was adopted in March 2012; the Working Group directed staff to update this issue paper to reflect the final decisions in that SSAP.

109. The Working Group identified that the Financial Accounting Standards Board (FASB) has concluded that accrual accounting (recognition when events and circumstances occur – i.e., employee service) is more representationally faithful and more relevant to financial statement users. Furthermore, actuarial assumptions used in determining pension liabilities already consider that some existing or future retirees will live longer than others and that some individuals will terminate employment before becoming eligible for the benefits. Based on the requirements by FASB, if the statutory accounting guidelines were to require liability determination based on vested employees only, the statutory accounting liabilities for pension plans would be inconsistent and less conservative than GAAP.

110. As a result of the above information, the Working Group agreed that all employees (vested and nonvested) should be included in the pension plan liability determination for statutory accounting. Update 2012: During the development of SSAP No. 102, the Working Group heard additional comments regarding the inclusion of non-vested participants from the American Academy of Actuaries. These comments addressed the inclusion of liabilities within statutory financial statements that are not binding and that may be discontinued when insolvency is imminent, and therefore not a solvency obligation. In considering these comments, the Working Group responded that obligations for pension and other postemployment benefits should be reflected in the financial statements, even if the employer has the discretion to unilaterally freeze, reduce or withdraw those benefits. When the employer or reporting entity freezes or reduces the pension or other postemployment benefit, then it would be appropriate to adjust the obligation accordingly.

111. *Consideration of Using ABO Versus PBO in Establishing Liability* – During the 2008 Spring Hearing, comments were received that the movement to utilize the projected benefit obligation (PBO) instead of the accumulated benefit obligation (ABO) continues to remain a controversial issue. It was noted that the American Academy of Actuaries had previously submitted comments to the FASB indicating that the ABO was a better measure than the PBO as the ABO does not include estimated future increases in compensation which have not yet occurred. In considering these comments, the Working Group identified information included within FASB statements that detail the FASB's considerations of utilizing either the ABO or the PBO, and their decision to require use of the PBO for the liability determination in FAS 158.

112. In discussing the FASB conclusions, the Working Group identified that pension obligations are considered to meet the GAAP definition of a liability and that the PBO is considered to be the most relevant measure of the pension obligation. It was noted that the FASB perceives a difference between an employer promise to pay a benefit of 1% of an employee's final pay and a promise to pay an employee a fixed amount that happens to equal 1% of current pay. If the ABO was utilized, this would result with a practice that ignores the future variable (future pay) and not recognizing a difference between these commitments.

113. Although additional discussion was considered by the Working Group, including comments that ABO is better for a statutory accounting solvency focus as it reflects an obligation at a point of time, the Working Group agreed to be consistent with GAAP on this issue.

114. *Transition and Effective Date* – With the adoption of Issue Paper No. 132 in December 2008, the Statutory Accounting Principles (E) Working Group directed NAIC staff to draft SSAP No. 102 with reconsideration of the effective date to 2011 and expanding the proposed transition period from 5 years to 10 years. In discussing the draft SSAP, an effective date of Jan. 1, 2013, was ultimately adopted.

115. The transition guidance originally proposed in Issue Paper No. 132 required companies with a surplus impact of less than 1% from initial application of the standard to recognize the full surplus impact, including a liability that equaled the full unfunded projected benefit obligation. Reporting entities with a surplus impact of greater than 1% from initial application of the standard would have the option to defer

recognition of the full surplus impact for a period not to exceed five years. This guidance required a minimum of 20% to be recognized in subsequent years. In working with interested parties, actuaries, plan administrators, representatives of the AICPA, and members of the Working Group, the transition guidance was revised to include the following elements:

- a. In the first reporting period after transition, reporting entities are required to disclose the obligation and the fair value of plan assets. This disclosure shall specifically note the funded/unfunded status of the plan, and the surplus impact necessary to reflect the full unfunded benefit obligation. Any unfunded defined benefit amounts are considered a liability under SSAP No. 5R and are to be reported in the first quarter financial statements with a corresponding entry to surplus. If the fair value of plan assets exceeds the obligation, the asset is nonadmitted. Items previously recognized from SSAP No. 14 or SSAP No. 89 (gains or losses, prior service costs or credits, and remaining transition items from the original application of those standards) are to be recognized in unassigned funds (surplus). After this recognition, the full unfunded or overfunded status of the plan shall be reflected in the financial statements.
- b. Transition Election: Due to the potential surplus impact, reporting entities may elect one of two methods in initially applying the standards:
 - i. Reporting entities may elect to recognize the entire transition surplus impact calculated, on an individual plan basis, as of January 1, 2013 (no transition).
 - ii. Alternatively, reporting entities may elect to recognize the entire surplus impact, on an individual plan basis, over a period not to exceed ten (10) years. The surplus impact initially recognized as of January 1, 2013, under this transition option, and subsequently over the transition period, shall be the greater of:
 - (a) Ten percent of the calculated surplus impact as of the transition date;
 - (b) Amortization¹⁰ of the “unrecognized items” into net periodic pension cost, including any accelerated amortization of these items from curtailments or settlements that occur after the transition date. (If the amortization cannot be determined at transition, at a minimum, the amount amortized for “unrecognized items” during the prior year shall be utilized for this component of the calculation. If the amount recognized for transition (greater of all three components) is subsequently determined to be less than what is amortized for the year, the difference between what was recognized for transition, and what is amortized must immediately be recognized as an adjustment to the transition impact to unassigned funds (surplus).);
 - (c) Amount necessary to establish a total liability that is equal to any unfunded accumulated benefit obligation (the accumulated benefit obligation less the fair value of plan assets).

If the surplus deferral is elected at the transition date, subsequently, starting with the 2014 year-end financial statement, the reporting entity shall annually recognize the remaining surplus

¹⁰ Unless otherwise impacted from the provisions within this issue paper or in accordance with changes to the pension plan, the amortization of the unrecognized items into net periodic pension cost shall continue to follow the existing amortization schedules in effect on the transition date.

impact (collectively referred to as the “transition liability”¹¹) on a systematic basis over a period not to exceed nine years. The minimum amount recognized each subsequent year shall be an amount that reflects the three components identified above. Additionally, reporting entities must recognize any remaining transition liability to the extent that the plan reflects a prepaid benefit cost. (For example, if changes in circumstances have resulted with the plan reflecting an overfunded status, the remaining transition liability must be recognized to the extent that the plan is overfunded.) Furthermore, if circumstances result with a subsequent gain attributed to the plan that will be recognized in earnings, the entity must recognize an additional amount of the remaining transition liability to offset the recognized gain. Reporting entities are permitted to recognize the remaining transition liability, or an amount in excess of the minimum requirement, at any time after the transition date. This transition guidance is specific to the transition surplus impact from initially applying this statement on Jan. 1, 2013. Thus, this transition guidance does not apply to additional liability calculated from subsequent comparison of the fair value of plan assets to the projected benefit obligation, or the impact of subsequent plan amendments.

116. Reporting entities electing to apply the transition guidance must disclose the full transition surplus impact calculated in the first quarter statutory financial statements after the transition date and each reporting period thereafter. This disclosure shall include the initial “transition liability” calculated, the annual amortization amount of the “unrecognized items” into net periodic pension cost, the amount of the unfunded accumulated benefit obligation, and the remaining unrecognized transition impact. This disclosure shall include a schedule of the entity’s anticipated recognition of the remaining surplus impact over the transition period.

117. In establishing the final transition guidance, the following key elements were noted:

- a. All reporting entities are equally allowed to participate in the transition election. However, reporting entities are not required to elect the surplus deferral, and at transition, or at any time subsequent to transition, reporting entities are permitted to recognize the full transition surplus impact.
- b. A 10% minimum surplus recognition threshold provides the potential for a longer transition period (potentially 10 years) to mitigate the surplus impact. However, the transition guidance is not intended to allow reporting entities to improve their surplus position simply by electing to defer recognition of the surplus impact at initial application. Therefore, reporting entities electing the transition option must consider a three-component calculation to determine the minimum surplus impact that must be recognized. This calculation is utilized each time recognition is required for the transition surplus impact to determine the minimum required. Although the guidance allows up to a 10-year transition timeframe, the actual transition timeframe permitted for each reporting entity will depend on the three-component calculation.
- c. The transition guidance is specific that it requires a minimum of 10% of the “surplus impact” to be recognized at each reporting period. This guidance was written to prevent an interpretation that would allow a systematic reduction of nonadmitted prepaid benefit cost over the transition timeframe before recognition of any unfunded liability. (As the prepaid benefit cost is nonadmitted, a reduction of this amount is offset by an equal

¹¹ If the surplus deferral is elected, the deferred liability, although comprised of the previous “unrecognized items” shall be collectively referred to as the “transition liability”. Although reporting entities will need to continue to track the unrecognized items for amortization into net periodic cost (offset through unassigned funds), reporting entities shall not allocate the recognized surplus impact from transition to these categories. The minimum amount of liability recognized under the deferral option must cover the annual amortization of the “unrecognized items” into net periodic pension cost to prevent a surplus benefit.

change to the nonadmitted assets. As such, this action alone results in a zero surplus impact.)

- d. At initial adoption on Jan. 1, 2013, reporting entities are required to recognize the minimum calculated transition surplus impact. Subsequently, reporting entities are not required to recognize the minimum surplus impact until Dec. 31, 2014. This spread from the initial and first subsequent recognition prevents reporting entities from incurring a surplus impact twice in the same reporting year.
- e. Reporting entities must recognize any remaining transition liability to the extent that a plan reflects a prepaid benefit cost, overfunded plan asset or when a gain is subsequently recognized in earnings. For example, if changes in circumstances have resulted with the plan reflecting an overfunded status, the remaining transition liability must be recognized to the extent that the plan is overfunded. Additionally, if circumstances result with a subsequent gain attributed to the plan that will be recognized in earnings, the entity must recognize an additional amount of the remaining transition liability to offset the recognized gain.
- f. Transition guidance is specific to the transition surplus impact from initially applying the adopted SSAP. The transition guidance does not apply to additional liabilities calculated from subsequent comparison of the fair value of plan assets to the projected benefit obligation or the impact of subsequent plan amendments. (Subsequent plan amendments resulting in a gain would be considered under paragraph 115.e. above.)

118. *Reporting Unfunded Liabilities in the Financial Statements* – During the 2010 Summer National Meeting, the Statutory Accounting Principles (E) Working Group exposed draft SSAPs for pensions and other postretirement benefit benefits. As a result of this exposure, comments were received from interested parties on the reporting of the unfunded benefit obligations and benefits. These comments noted that the proposed SSAPs appear to commingle the accounting for prepaid and accrued pension costs with the adjustments to surplus necessary to reflect the funded status of the plan on the balance sheet date. It was noted that only some of the transactions impact the income statement, and commingling the amounts on the balance sheet would create cross-check errors with the associated general expense exhibits.

119. After researching the statutory reporting options, it was concluded that there was no viable option that would result with the use of a single financial statement line that will provide regulators with the unfunded pension obligation on the face of the financial statements in a manner similar to GAAP without significant revisions to existing schedules and cross-checks. As a result of these findings, the Working Group agreed that separate reporting will be necessary in the financial statements for “unpaid expenses” and the “transition liability” for pension and postretirement obligations. This could result in situations when a plan reflects a prepaid benefit (nonadmitted prepaid benefit cost) as well as a liability for pension benefits (unfunded obligations). To address these situations and ensure a liability presentation on the balance sheet for unfunded plans, a contra-asset is utilized as an aggregate write-in for other-than-invested assets to offset the prepaid benefit, resulting in a net zero asset presentation on the balance sheet. In order to address concerns that the reporting may be unclear, disclosures are required to separately show the assets and liabilities recognized.

120. *SSAP Amendments*— *SSAP No. 102—Accounting for Pensions* was adopted March 2012. Subsequent to adoption, but before finalization of this issue paper, two agenda items were proposed to clarify guidance:

- a. Agenda Item 2012-18: Additional Pension Examples - This agenda proposed three additional implementation examples for inclusion in SSAP No. 102. These examples

include (1) prepaid benefit cost with unfunded liability – no surplus deferral elected, (3) prepaid benefit cost with unfunded liability – surplus deferral elected with funded accumulated benefit obligation, and (3) prepaid benefit cost with unfunded liability – surplus deferral elected with unfunded accumulated benefit obligation. These examples were adopted Nov. 29, 2012, and have been reflected within the implementation guide of this issue paper.

- b. Agenda Item 2012-19: Clarification of Measurement Date Change in SSAP No. 92 & SSAP No. 102 and Applicability of INT 03-18 for SSAP No. 102 – This agenda item proposed revisions to clarify the effective date of the measurement date change for plan assets and benefit obligations reflected in paragraph 89 of this issue paper. This particular aspect is intended to have an effective date subsequent to the effective date of the SSAP. The delayed effective date for the measurement date change is consistent with GAAP. This agenda item also proposed revisions to clarify that *INT 03-18—Accounting for a Change in the Additional Minimum Liability in SSAP No. 8—Pensions* (INT 03-18) is nullified, and incorporate minor revisions to clarify how existing additional minimum liability from SSAP No. 89 is addressed with the adoption of SSAP No. 102. The revisions from agenda item 2012-19 were adopted Nov. 29, 2012, and have been reflected within paragraph 4, 89, 123 and footnote numbers 5 and 7 to paragraph 87.

RELEVANT STATUTORY ACCOUNTING AND GAAP GUIDANCE:

Statutory Accounting

121. Statutory Accounting Principles currently exist for pensions in SSAP No. 89. The conclusions reached in SSAP No. 89 resulted from adoption of *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 an amendment of FASB Statements No. 87, 88, and 106* (FAS 132) with certain modifications and *FASB Statement No. 132 (R), Employers' Disclosures about Pensions and Other Postretirement Benefits, and amendment of FASB Statements No. 87, 88, and 106* (FAS 132R) with certain modifications. SSAP No. 89 superseded previous guidance within *SSAP No. 8—Pensions* (SSAP No. 8). The guidance within SSAP No. 8 was derived from adoption of FAS 87, FAS 88 and FAS 132 with modifications.

122. The adoption of SSAP No. 89 nullified the following interpretations:

- a. *INT 99-24: Accounting for Restructuring Changes*
- b. *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*
- c. *INT 02-18: Accounting for the Intangible Asset as Described in SSAP No. 8 Paragraph 9.d.v. and 9.f.*

123. Upon the establishment of a new statutory accounting principle that adopts FAS 158 with modification and supersedes SSAP No. 89, the following interpretations will be nullified:

- a. *INT 99-26: Offsetting Pension Assets and Liabilities* (INT 99-26). This interpretation has been incorporated within paragraph 28 of this issue paper.

- b. *INT 01-16: Measurement Date for SSAP No. 8 Actuarial Valuations* (INT 01-16). The ‘measurement date’ guidance referencing FAS 87 within this interpretation has been revised in accordance with FAS 158. The measurement date guidance included within paragraphs 89-90 of the issue paper should be followed.
- c. *INT 03-18: Accounting for a Change in the Additional Minimum Liability in SSAP No. 8—Pensions. This INT will be nullified as this issue paper eliminates the additional minimum liability.*
- d. *INT 04-03: Clarification for Calculating the Additional Minimum Pension Liability Under SSAP No. 89—Accounting for Pensions, A Replacement of SSAP No. 8, paragraph 16.f.* (INT 04-03). This INT will be nullified as this issue paper eliminates the need of an additional pension liability.
- e. *INT 04-12: EITF 03-4: Determining the Classification and Benefit Attribution Method for a “Cash Balance” Pension Plan* (INT 04-12). This INT will be nullified as ‘cash balance’ pension plans have been classified as defined benefit plans for purposes of this issue paper.

124. Upon the establishment of a new statutory accounting principle that adopts FAS 158 with modification and supersedes SSAP No. 89, *INT 04-17: Impact of Medicare Modernization Act on Postretirement Benefits* will no longer provide interpretative guidance for pensions. INT 04-17 adopts with modification the FASB staff position pertaining to whether prescription drug coverage under the Medicare Prescription Drug, Improvement and Modernization Act of 2003 should impact accumulated postretirement benefit obligations. Although this interpretation is specific to postretirement benefits other than pensions, it has historically been referenced on the pension SSAP. With the adoption of SSAP No. 102, this reference will no longer occur, and INT 04-17 will be specific for *SSAP No. 92—Postretirement Benefits Other Than Pensions*.

Generally Accepted Accounting Principles

125. This issue paper adopts with modifications guidance included within FAS 158 and the resulting amended guidance within FAS 87, 88 and 132(R).

126. FAS 158 also references related EITF guidance previously adopted by statutory accounting:

- a. *EITF 88-1: Determination of a Vested Benefit Obligation for a Defined Benefit Pension Plan* (EITF 88-1) – This EITF issue is whether the vested benefit obligation is the actuarial present value of the vested benefits to which the employee is entitled if the employee separates immediately (approach 1) or the actuarial present value of the vested benefits to which the employee is currently entitled but based on the employee’s expected date of separation or retirement (approach 2). The consensus reached that either approach is acceptable for situations not specifically addressed by FAS 87 for facts and circumstances analogous to EITF 88-1.
- b. *EITF 90-3: Accounting for Employers’ Obligations for Future Contributions to a Multiemployer Pension Plan* (EITF 90-3) – This EITF issue is whether an employer must record a liability for the total future payments for prior service costs pursuant to the agreement at the date the employer enters the plan or improves benefits under the plan. The consensus reached was that, per paragraph 87 of FAS 87, as amended by FAS 158, the existence of the executed agreement does not require that a liability be reported beyond any contributions currently due and unpaid.

- c. *EITF 91-7: Accounting for Pension Benefits Paid by Employers after Insurance Companies Fail to Provide Annuity Benefits* (EITF 97-1) – This EITF issue is how an employer should account for the cost of making up the deficiency in annuity payments to the retirees. The consensus reached that the employer should recognize a loss at the time the deficiency is assumed by the employer if any gain was recognized on the original settlement. The loss recognized would be the lesser of any gain recognized on the original settlement or the amount of the benefit obligation assumed by the employer. The excess obligation assumed by the employer over the loss recognized should be accounted for as a plan amendment or plan initiation in accordance with paragraphs 24-28 of FAS 87, as amended by FAS 158.
- d. *EITF 96-5: Recognition of Liabilities for Contractual Termination Benefits or Changing Benefit Plan Assumptions in Anticipation of a Business Combination* (EITF 96-5) – This EITF issue is whether a liability for the contractual termination benefits and the curtailment losses under employee benefit plans that will be triggered by the consummation of the business combination should be recognized when it is probable that the business combination will be consummated or when the business combination is consummated. The consensus reached is that the liability for the contractual termination benefits and the curtailment losses under employee benefit plans that will be triggered by the consummation of the business commutation and should be recognized when the business combination is consummated.

127. 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

⁴FAS130, 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.

⁵FAS130, 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."

128. See Issue Paper No. 123 and Issue Paper No. 8 for additional GAAP references.

RELEVANT LITERATURE:

Statutory Accounting

- *Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy*
- *SSAP No. 8—Pensions*
- *SSAP No. 10—Income Taxes*
- *SSAP No. 89—Accounting for Pensions, A Replacement of SSAP No. 8*
- *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*

- *Issue Paper No. 123—Accounting for Pensions, A Replacement of SSAP No. 8*
- *INT 04-03: Clarification for Calculating the Additional Minimum Pension Liability Under SSAP No. 89—Accounting for Pensions, A Replacement of SSAP No. 8, paragraph 16.f.*
- *INT 04-11: EITF 03-2: Accounting for the Transfer to the Japanese Government of the Substitutional Portion of Employee Pension Fund Liabilities*
- *INT 04-12: EITF 03-4: Determining the Classification and Benefit Attribution Method for a “Cash Balance” Pension Plan.*
- *INT 04-17: Impact of Medicare Modernization Act on Postretirement Benefits*
- *INT 02-18: Accounting for the Intangible Asset as Described in SSAP No. 8 Paragraph 9.d.v. and 9.f.*
- *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*
- *INT 99-24: Accounting for Restructuring Charges*
- *INT 99-26: Offsetting Pension Assets and Liabilities*

Generally Accepted Accounting Principles

- *FASB Statement No. 158, Employers’ Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106 and 132(R)*
- *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. 130, Other Comprehensive Income*
- *FASB Statement No. 132(R), 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 Mutliemployer 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.

EXHIBIT A - IMPLEMENTATION GUIDE

Note: Implementation guidance included in SSAP No. 102 has not been duplicated within this Issue Paper.