Memorandum

To: Our Pension Clients

From: Actuarial Department

Date: March 25, 2011

Re: Changes in Practice for Preparing Actuarial Valuation Reports

Introduction

The purpose of this memorandum is to highlight some changes in our professional practice in the preparation of actuarial valuation reports for funding purposes which will be applicable for valuations with effective dates on or after December 31, 2010. The changes in our practice will affect two key aspects of the valuation: the disclosures in our report and the assumption setting process.

You will be given an opportunity to provide input into the assumption setting process and therefore it is important that you review this memorandum.

The changes in our practice have been heavily influenced by the new Standards of Practice ("SOP") for the preparation of actuarial valuation reports for funding purposes which has been recently issued by the Canadian Institute of Actuaries ("CIA"). In addition, the CIA has issued a number of Educational Notes ("ENs") which provide additional guidance on the application of the new SOP. The new SOP is effective for actuarial valuation reports prepared on or after December 31, 2010.

Disclosures

A key requirement of the new SOP is the disclosure of additional information relevant to the financial position of a pension plan at a valuation date. Specifically, the new SOP requires the following additional disclosures in an actuarial valuation report for funding purposes:

- The effect of using a discount rate which is lower by 1.0% on the following measures:
    - The actuarial liabilities on the going-concern basis;
    - The current service cost (on the going-concern basis); and
    - The actuarial liabilities on the hypothetical wind-up or solvency basis.
- The "incremental cost" (which is the expected increase) of the hypothetical wind-up liability or solvency liability from the valuation date to the date of the next required valuation.

The additional disclosures are relatively straight forward and will appear in your next valuation report. The rest of this memorandum will discuss the impact the new SOP has on the selection of the assumptions used for the going-concern valuation.

Assumption Setting Process

The new SOP requires that the going-concern valuation be performed using either:

1. best estimate assumptions; or
2. best estimate assumptions modified to incorporate margins for adverse deviations to the extent, if any, they are required by law or by the terms of the engagement.

Therefore, a key decision in the selection of the going-concern assumptions is whether or not to include margins for adverse deviations.

Margins for Adverse Deviations

Margins for adverse deviations result in a conservative bias in the going-concern assumptions; and are used to mitigate the effect of the uncertainty in the assumptions and can provide some additional level of benefit security to plan members.

It is noted that margins for adverse deviations do not need to be included in each assumption. Typically, the best estimate assumptions are adopted for all contingencies except the discount rate, and a margin for adverse deviations is used to reduce the best estimate discount rate assumption.

Our Practice – Historically

In recent years our firm has typically prepared going-concern valuation reports stating that the assumptions do not include any margins for adverse deviations (and as a result, it could be said that our reports have typically been prepared using best estimate assumptions).

It is noted that the selection of both best estimate assumptions and margins for adverse deviations involves professional judgment. Prior to the release of the new SOP and associated ENs, it was our belief that there was insufficient guidance in the existing SOP and ENs on the difference between 1) best estimate assumptions, and 2) best estimate assumptions modified to incorporate margins for adverse deviations.

As a result, it was our practice to prepare going-concern valuations using best estimate assumptions (or to prepare the going-concern valuation without any margins for adverse deviations). With that said, it has always been our belief that the assumptions used in our going-concern valuations were within a reasonable range, consistent with those used by other actuaries practicing in Canada, and most importantly, appropriate for the purposes of the valuation.

Actuarial Guidance

With the release of the new SOP and associated ENs, the CIA now has guidance on the selection of best estimate assumptions. Furthermore, guidance on the selection of margins for adverse deviations may be released in the future.

While the guidance provided in the new SOP and associated ENs does rely heavily on professional judgment, there is now some guidance to differentiate between 1) best estimate assumptions, and 2) best estimate assumptions modified to incorporate margins for adverse deviations.

However, even with the new guidance, it is important to realize that there is a range for the best estimate assumptions (and likewise a range for the margins for adverse deviations). As a result, there can be multiple sets of best estimate assumptions (and margins for adverse deviations) which can be considered appropriate within accepted actuarial practice.

Guidance from Regulatory Authorities

Pension regulators want to ensure that Plan Sponsors have considered their fiduciary responsibilities as the Plan Administrator when preparing actuarial valuations for funding purposes. A component of their fiduciary responsibility is the consideration of the use of an appropriate margin for adverse deviations in the going-concern valuation.

Increasingly, pension regulators are expecting going-concern valuations to be prepared with margins for adverse deviations. In some jurisdictions, pension regulators have confirmed that they will require the use of margins for adverse deviations in going-concern valuations. Also, with the new SOP now in effect, we anticipate greater regulatory oversight of the margins for adverse deviations in going-concern valuations.

Finally, we note that pension regulators are typically concerned with any decision made by the Plan Sponsors to decrease the level of benefit security for plan members. As a result, Plan Sponsors who wish to have going-concern valuations prepared without margins for adverse deviations may face increased scrutiny from the pension regulators.

Financial Implications

It is noted that the best estimate assumptions developed using the guidance provided in the new SOP and ENs will likely be more aggressive than the best estimate assumptions which were developed using the holistic approach in our historical practice. After modifying these new best estimate assumptions to reflect an appropriate margin for adverse deviations, the resulting going-concern assumption set may not be significantly different than the best estimate going-concern assumption set which would have been developed using our historical practice. **As a result, following the guidance provided in the new SOP and ENs may not have a material financial impact on your pension plan.**

In the current economic environment, the contributions requirements for many pension plans are being determined by the results of the hypothetical wind-up or solvency valuation. For such pension plans, the changes to the going-concern assumption setting process will have a minimal or no impact on the contribution requirements

Our Practice – Going Forward

In light of the issues noted above, our firm has decided to change our practice when preparing valuation reports for funding purposes. We note that it would be our expectation that the majority of our clients wish to prepare actuarial valuation reports that are readily accepted by pension regulators, and are not prepared using methods or assumptions which, in aggregate, are overly aggressive.

As a result, when preparing the first draft of a valuation report (which is used for discussion purposes), our firm will prepare the going-concern valuation using best estimate assumptions modified to incorporate margins for adverse deviations. In reviewing the draft reports, the Plan Administrator/Plan Sponsor should review the margins for adverse deviations, and confirm if they are appropriate for the terms of the engagement.

We understand that some Plan Sponsor's may wish to prepare their valuation reports without any margins for adverse deviations. Plan Sponsor's that wish to exclude margins for adverse deviations entirely from the going-concern valuation will need to instruct us to do so. Prior to providing those instructions we encourage the Plan Sponsor to be satisfied that they have considered their fiduciary responsibilities as Plan Administrator, and be comfortable with the potential criticism of the valuation report from the pension regulators.

Developing a Funding Policy

Either as a result of the changes described above, or as a matter of better plan governance, we recommend that clients consider developing a Funding Policy. A Funding Policy is a plan governance tool which, after considering factors that are relevant to the plan and the Plan Sponsor, establishes a framework for funding a pension plan. Such factors include:

- benefit security;
- stability and affordability of contributions;
- the duration of the pension promise;
- the financial position of the sponsor and competing organization demands for cash;
- the plan's investment policy;
- the demographics of the plan's beneficiaries; and
- the minimum funding requirements under applicable legislation.

While a formal Funding Policy is not required, it may be useful for Plan Sponsors in support of the careful and consistent management of the funding of the pension plan.

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Please feel free to contact your consultant (Jason, Dean or Joe) if you have any questions or concerns with the information above. We would be pleased to schedule a call with you to discuss the changes in our practice in greater depth, or to work with you in developing a Funding Policy.