

Memorandum



To: Our Clients
From: Actuarial Department
Date: November 1, 2013

Re: The Impact of Increasing Life Expectancy on the Mortality Assumption – Update November 2013

Executive Summary

Purpose

The purposes of this memo are to provide an update on the research of the Canadian Institute of Actuaries (“CIA”) in respect of a new mortality table and projection scale, to discuss the implications of this research on upcoming actuarial work, and to recommend action that plan sponsors should consider when preparing financial statement disclosures in respect of pension and post-retirement benefit plan liabilities.

Research Update

As many of you are aware, the CIA released a draft report on Canadian pensioner mortality this summer. This study included a draft mortality table and projection scale based on recent Canadian pensioner experience. On October 9, 2013, the CIA announced that the draft mortality table and projection scale would be revised in early 2014. On October 30, 2013, the CIA issued an update confirming that while changes to the mortality table and projection scale released in the study are likely, the conclusions of the study remain valid and the draft tables remain credible.

The results of the CIA’s mortality study indicate that recent mortality rates are significantly lower than (and exhibit a different shape by age than) the widely used UP 1994 mortality table with improvements using Scale AA. In light of the CIA’s mortality study, without adequate support, we expect that many stakeholders (including auditors) will no longer view the use of the UP 1994 mortality table and projection Scale AA as an acceptable basis for a “best estimate” mortality assumption.

Impact on Funding Valuations

Funding valuation reports include a hypothetical wind-up valuation and a going-concern valuation.

The assumptions for a hypothetical wind-up valuation are largely prescribed (including the mortality assumption). A change to the mortality assumption for the hypothetical wind-up valuation is expected to occur in 2014 and is not expected to have an impact on the hypothetical wind-up valuations as at December 31, 2013.

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The assumptions for a going-concern valuation are set by the actuary. ASI intends to reflect the new mortality tables when preparing the going-concern valuation in the valuation reports for funding purposes. It is our hope that the CIA will issue the finalized mortality table and projection scale in early 2014 so that they can be used in the preparation of the December 31, 2013 funding valuation reports.

For many of our clients, special payments for hypothetical wind-up deficiency are expected to drive cash contribution requirements for 2014. As such, the adoption of the new mortality tables in the going-concern valuation will not have a significant impact on the 2014 contribution requirements for many pension plans. However, contributions will increase slightly for pension plans where the service cost for new benefits is the driver of cash contributions.

Impact on Accounting Valuations and Upcoming Accounting Disclosures

When preparing results for accounting purposes, Management is required to select “best estimate” assumptions. Given the results of the CIA’s mortality study, sponsors of pension and/or post-retirement benefit plans should consider whether a revision to their mortality assumption is appropriate for their upcoming fiscal year-end disclosures (e.g. the fiscal year-end December 31, 2013 accounting disclosures). We have spoken with several auditors and it is our expectation that some auditors will question the continued use of the UP 1994 mortality table with generational projection using Scale AA, while others may not.

Since the revisions to the draft mortality table are not expected to be released until 2014, many clients may wish to consider using the draft mortality tables for the fiscal year-end December 31, 2013 accounting disclosures. As such, **at this time, we are recommending that clients consider adopting the new draft mortality table for their upcoming fiscal year-end disclosures and/or initiating a discussion on this topic with their auditor.**

The remainder of this memorandum will provide further details on the points above.

Status Update on New Mortality Tables

As you may recall from our January 11, 2013 [client memo](#), the Canadian Institute of Actuaries (“CIA”) established a Pension Experience Subcommittee (“PES”) whose mission is to develop and maintain a mortality table and projection scale based upon Canadian pensioner mortality experience. On July 31, 2013, a new mortality table and projection scale [i.e. the Canadian Pensioners Mortality Table (CPM-RPP2014) and CPM Improvement Scale A (CPM-A)] was released in draft format by the PES.

Three distinct mortality tables were released in draft format:

- one based solely on private sector pension mortality experience (CPP-RPP2014Priv);
- one based solely on public sector pension mortality experience (CPP-RPP2014Publ); and
- one based on combined experience for public and private sector pension plans (CPP-RPP2014).



Furthermore, the draft study also provides “pension size adjustment factors” which can be used to adjust the base mortality tables to reflect socio-economic status (since it has been observed that members with higher pensions typically have lower mortality rates than members with lower pensions).

Following the release of this new mortality table and projection scale in draft format, the actuarial and pension community in Canada provided substantive comments to the PES. The comments included questions regarding the heterogeneity of the research data and the possibility of bias, the shape and magnitude of the mortality improvement rates, and the appropriateness and application of pension size adjustments. On October 9, 2013, the PES announced that they were going to update the mortality tables and improvement scales in the draft report to better reflect the comments received and some additional information that is now available. In this communication, the PES noted that some differences to the mortality tables and improvement scales may be significant.

While the PES will be updating the mortality tables and improvement scales, the final report is not expected to be released until the first quarter of 2014. On October 30, 2013, the CIA issued an update confirming that the PES believes that the revisions will not change the overall thrust of their results: namely, that mortality rates for Canadian pension plan participants are significantly lower on average and exhibit a different pattern by age than the UP 1994 mortality table with projection Scale AA; and that mortality improvement rates have been substantially higher than those in projection Scale AA.

Even though the new mortality tables and improvement scale have only been released in draft format and are expected to be updated in the first quarter of 2014, they are viewed by many stakeholders as an improvement over the continued use of the UP 1994 mortality table and projection Scale AA.

Implications for Plan Sponsors

As was noted in our client memo dated January 11, 2013, there are different measures of a defined benefit plan’s liabilities: the benefit obligations used for financial reporting purposes, as well as the going-concern liabilities and hypothetical wind-up liabilities reported in an actuarial valuation prepared for funding purposes for a pension plan.

Actuarial Valuations for Funding Purposes

As noted in the previous memo, the assumptions for the hypothetical wind-up position are largely prescribed (including the mortality assumption). On October 22, 2013, the Actuarial Standards Board confirmed that the current mortality table (i.e. the UP 1994 mortality table with generational projection using Scale AA) will remain in effect at February 1, 2014. We expect this table to remain in effect until the mortality studies mentioned above are complete, which is expected to be later in 2014.

We intend to reflect the new mortality tables when preparing the going-concern valuation in the valuation reports for funding purposes. It is our expectation that this may lead to an increase in the current service cost contribution requirements for some pension plans.

As a result of the fact that for the majority of our clients it is the results of the hypothetical wind-up valuation that drives contribution rates, we do not anticipate a significant increase in funding costs for funding valuations prepared as at December 31, 2013 due to a change in the mortality assumption.



Actuarial Valuations for Financial Reporting Purposes

With respect to the financial reporting of pension or post-retirement benefit plans on the financial statements of a plan sponsor, management is responsible for the selection of the assumptions.

Given the release of the new mortality tables and improvement scales (even in their current draft format, with the significant revisions expected to be released in the finalized study which is expected to be released in the first quarter of 2014), and the conclusions drawn by the PES (i.e. that Canadian pension plan mortality rates are significantly lower and exhibit a different pattern by age than the UP 1994 mortality table with projection Scale AA), we expect that some auditors will question the continued use of the UP 1994 mortality table with generational projection using Scale AA.

In light of the comments above, sponsors of pension and/or post-retirement benefit plans should consider whether a revision to their mortality assumption is appropriate for any potential upcoming fiscal year-end disclosures (e.g. the fiscal year-end December 31, 2013 accounting disclosures).

Should you wish to consider adopting the new (draft) mortality table as “Management’s Best Estimate Assumption”, you will need to consider which of the three mortality tables to use, and whether to reflect the “pension size adjustment factors”. We would be pleased to discuss the merits of these options with you at your convenience. For clarity, it is noted that in most circumstances, the application of this new mortality table and projection scale will result in lower mortality rates, and higher liabilities when adopted.

Finally, it is our expectation that this new mortality table, when finalized in 2014, will become the most commonly used table for accounting valuations (especially for smaller pension plans that do not have credible mortality experience). Even though the use of the current (draft) mortality table for the upcoming fiscal year-end disclosures will likely lead to another revision of the mortality assumption next year, a change to the mortality table might be considered to be a step in the right direction.

Given the circumstances noted above, we would recommend that you discuss this issue with your auditor prior to the completion of the fiscal year 2013 accounting disclosures.

Next Steps

We would be pleased to discuss the potential impact of a change in the mortality assumption on your pension and/or post-retirement benefit plan(s) with you at your convenience. In particular, we would be pleased to discuss any potential change to the mortality assumption used for an upcoming fiscal year-end accounting disclosure calculation.

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Please feel free to contact your consultant (Jason, Dean or Joe) if you would like to discuss any of the above.

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