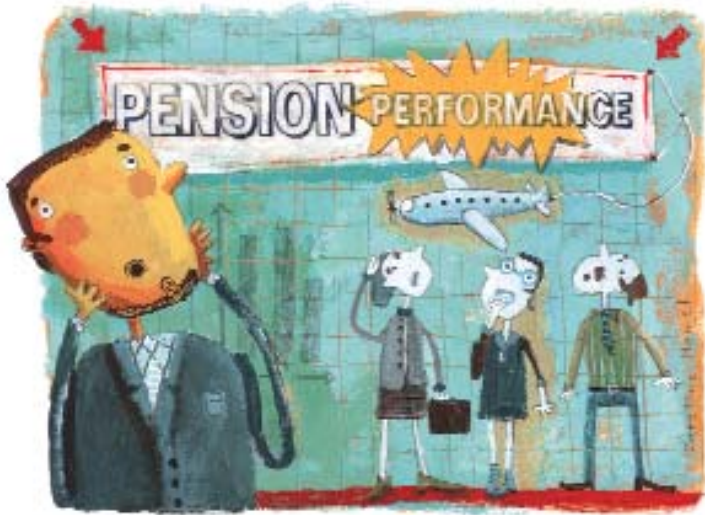


# INSIGHTS

Contrarian views, news and intrigue By Jeff Sanford



## Pension reforms could come to Canada

Hoping to avoid disclosure disasters and using U.K. pension reforms as a blueprint, international accounting regulators are reassessing pension plan accounting rules. There is speculation that the proposed changes could be adopted here in Canada in the future.

The plan is to replace the current system—which has kept the real costs of pension plans hidden in the footnotes—with something much clearer.

“One of the things we need to do is make the information much more transparent so that people can see what’s going on,” says Tricia O’Malley, the Canadian representative on the International Accounting Standards Board (IASB).

One of the suggestions is that companies with defined benefit plans report surpluses or deficits on the income statement. Another idea is to abolish the practice of smoothing—where estimated returns on pension assets are used rather than real market values to calculate the value of a pension plan.

The point of smoothing is to allow companies to avoid year-to-year market volatility by estimating a more consistent trend line. It involves making one estimate for the pension fund return and then amortizing actual returns (either gains or losses) over several years. In the end, the returns are evened out.

The problem is that some estimates, which count towards earnings, are wildly overvalued in the current bear market. The result is that corporate earnings are over-inflated in many cases. As a result, the IASB would like to see companies use real market values for reporting pension fund values from now on.

Illustration by Silvie Hamel

“There’s no reason for these liabilities to be any different from other ones in terms of dealing with changes as they happen, rather than some time in the future,” says O’Malley. “When you generally make an estimate and realize it’s inaccurate, you fix it.”

But if real values are to be used for pension funds and then included in operating earnings, even the slightest change in a large fund may cause wild fluctuations in the reported profit.

“I don’t think it’s useful to mix what’s happening on the balance sheet with operating earnings,” says Keith Ambachtsheer, president of KPA Advisory Services. “If you throw them together, you have a number that doesn’t mean much.”

O’Malley says the IASB is looking at redesigning the income statement itself so that real pension fund values will be disclosed on it but not necessarily mixed into the final earnings figure.

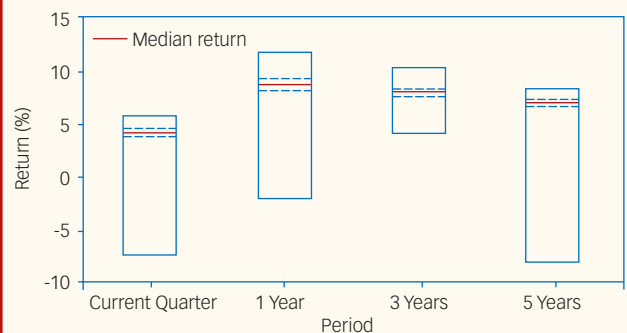
“We want to report what’s going on, but display it so that people can easily separate the effects of what’s going on in the pension plan from what’s going on in the business,” says O’Malley. “That way the investor can understand what’s going on and decide whether there’s a problem or not.”

The IASB hopes to have proposals out for comment no later than the end of next year and something in place for 2004. Whether or not Canadian regulators will adopt the regulations as they stand will also depend on what the U.S. accounting regulatory body (the Financial Accounting Standards Board) does.

### PORTFOLIO WATCH

#### Fixed Income

Measuring the fixed income investments of pension funds in the Russell/Mellon Canadian Trust Universe, for the quarter-, one-, three- and five-year period ended Sept. 30, 2002. Signs of short-term slippage.



Source: Russell/Mellon Analytical Services

## VIEWPOINT

## Update on CAP guidelines

By Nurez Jiwani &amp; Ann Leduc

The Joint Forum is currently hammering out guidelines for capital accumulation plans.



Last year the Joint Forum worked to revise the proposed regulatory principles for capital accumulation plans (CAPs), releasing them in mid-2002.

To ensure widespread participation, the Joint Forum kept the process transparent.

Broad involvement was cultivated and stakeholders regularly updated. All 44 stakeholder submissions were considered and the principles subsequently revised.

The new principles have since been approved by the Joint Forum and are now available, along with copies of stakeholder submissions, on the Web sites of the Canadian Association of Pension Supervisory Authorities ([www.capsa-acor.org](http://www.capsa-acor.org)), the Canadian Council of Insurance Regulators ([www.ccir-ccrra.org](http://www.ccir-ccrra.org)) and the individual securities regulators.

Both our committee and an industry task force established to help the Joint Forum, are now developing guidelines for CAPs. The task force includes representatives from pension, insurance and securities industry stakeholder associations. We are working to ensure that all interested parties have a say in the process.

Many stakeholders may be affected by the proposals.

As a result, the drafting of these guidelines requires extensive consultation. At the same time, an independent review of the nature of the judicial relationship among the stakeholders in a CAP was commissioned which may impact the application of the guidelines in Quebec.

Once finalized, the CAP guidelines should address the three overriding concerns for stakeholders:

1. Do members of CAPs have the necessary information and assistance to make informed investment decisions?
2. What are the responsibilities of employers, administrators, members and service providers with respect to CAPs?
3. Is there a similar regulatory result for all CAP products and services regardless of the regulatory regime?

The guidelines for capital accumulation plans are expected to be ready for the Joint Forum meeting in April, at which time they will be sent out for broad public consultation.

BC

*Nurez Jiwani and Ann Leduc are co-chairs of the Joint Forum of Financial Market Regulators' Working Committee on Investment Disclosure in Capital Accumulation Plans. [Ann.Leduc@cvmq.com](mailto:Ann.Leduc@cvmq.com), [njiwani@fsc.gov.on.ca](mailto:njiwani@fsc.gov.on.ca).*

VOLATILITY



Illustration by David Brown

Forget the Valentine cards—do you carry Get Well cards for money managers?

## Employers looking to DC plans to offload risk

Three years of falling markets combined with rising liabilities have done it: pension funds are exposed to more risk now than at any time in the last 30 years, according to Watson Wyatt Worldwide's Global Investment Review 2003. And that has employers looking for quick fixes.

"Just a few years ago plans had lots of surpluses, benefits improvements and contribution holidays. But we're in a situation where those

nice surpluses are gone," says John Gilfoyle, national practice director, investment consulting at Watson Wyatt Canada.

"Organizations will not be able to act as they have in the past."

That leaves pension plans wondering what to do. Many, according to the study are moving to a defined contribution (DC) model, shifting risk onto their employees and off of corporate shoulders.

Though that makes sense from an employer perspective, Gilfoyle says it's a short-term solution that may leave employees in the lurch.

"Some companies are moving to DC to shed some of the risks associated with defined benefit (DB) plans," says Gilfoyle. "But when these new DC plans mature, and [if] there is not enough money in these plans to retire with, we expect that we may see employees coming back to the compa-

ny with that complaint. We haven't come across a situation where that has happened, but we expect it will. Certainly in the U.S. where they're more litigious, but in Canada as well," he says.

Because of that, Gilfoyle is recommending that companies think carefully about whether a DC plan is the best idea. "We're telling companies to consider DB and DC plans or other combinations. Don't jump straight to DC."