

# Case Study - Defined Benefit Pension Valuations

20<sup>th</sup> India Fellowship Seminar  
4<sup>th</sup> December 2013

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# Facts of the Case (Part I)

- New Assignment for Valuation of a DB Pension Scheme of a listed Indian Company as per AS 15 issued by ICAI.
- Conversation with the CFO (The Client)
- The client dissatisfied with services of previous Actuary.
- A copy of the outgoing actuary's valuation report for previous year is made available by the client.
- Observation on content of previous valuation report:
  - Aggressive set of assumptions(Particularly salary growth rate on a lower side).
  - The above has resulted in seemingly lower liability
  - Salary growth rate needs to be revised upwards
  - Client insists on the maintaining the same salary growth rate.

## *Q1. What would you do regarding the setting of new assumptions?*

1. Needs of key stakeholders
2. The assumption setting process
3. Pointers on the specific assumptions
4. May provide scenario analysis for better understanding

# Relevant Standards, APSs and GNs..

- ❑ AS<sub>15</sub> R: Accounting of employee benefits issued by ICAI
- ❑ APS/GN Issued by the IAI
  
- APS<sub>12</sub>: Guidance on limits on values of different assumptions
  
- APS 15: Pension Fund Terminology
- APS 18: Retirement Benefit schemes: Actuarial Report
  
- APS<sub>26</sub>: Guidance on valuation and reporting under the AS<sub>15</sub> R
  
- GN<sub>11</sub>: General principles on reporting of Retirement Benefit Schemes

# Key Stakeholders Involved

- Employer
  - Ultimate responsibility of the assumptions used
  - Interested in the cost as well as the accounting impact of the benefits
  - Would like to have costs reasonably smooth year by year
- Actuary
  - To comply with AS15(R), GN11, and relevant APSs issued by the profession
  - More concerned about reasonableness/ long term impact of the assumptions rather than the short term accounting impact.
  - To guard the image of the Profession and behave in a professional manner
- Auditor
  - Interested in the 'True & Fair View'
  - Sufficiently detailed report and disclosures

# Assumption Setting Process

- Objective of the valuation (accounting in this case)
- Previous assumptions as starting point
- Historical Data made available???
- Account for events during the inter-valuation period.
- Discussion with enterprise if assumptions are to be changed.
- Check compliance with AS15, APS12, APS26 and GN11
- **Assumptions finally adopted are decided by enterprise...  
Actuary can only make recommendation and comment on  
the reasonableness of the assumptions**

# Specific Assumptions

- **Discount Rate:**
  - Clearly prescribed. Little room for disagreement
  - If chosen rate not as per standard: quantify and qualify
- **Salary Growth Rate and Attrition Rates:**
  - Indicated by enterprise
  - Actuary to comment on reasonableness of the assumption
  - Restate the value of Obligation at alternative assumptions (scenarios)
- **Annuity Rates:**
  - Unfunded or if benefits paid from fund – Use LIC's Annuitants table
  - Funded – Prevailing annuity rates of LIC/other annuity provider
  - Decide on extent of allowance for mortality improvements in the future (A very critical assumption)

# Specific Assumptions

- Other assumptions required:
  - Expected return on assets
  - Inflation Rate
  - Pre-retirement mortality
- ❖ If the assumptions adopted by the enterprise differ from the new actuary's assessment – state the value of Obligation on :
  - Preferred basis as well as
  - Finalized basis
  - Sensitivity Analysis/Scenario Analysis (optional)

## ***Q2. On which matters, if at all, would you communicate with the outgoing valuation actuary?***

- PCS States that

*"...the actuary should contact the other actuary at as early a stage as possible to ask whether, he is aware of any professional reasons to be considered in accepting the appointment or any particular considerations which ought to be borne in mind before giving advice."*

- The communication has to be initiated before the assignment is undertaken
- The communication has to be in writing (as per the Actuaries Act, 2006)

## *Q2. On which matters, if at all, would you communicate with the outgoing valuation actuary?*

- It is the responsibility of the outgoing actuary
  - to disclose key facts
  - respond within a reasonable time frame
- No comments on previous assumptions
  - The assumptions were set in his professional capacity
  - The report is already adopted by the management and auditors
  - Reasonability of the assumptions may change with time

# Facts of the Case (Part II)

- Outgoing actuary has written qualification as 'FIA, FIAI'
- Outgoing actuary is
  - Partially regulated by the IFA
  - Fully regulated under IAI

# What does the Standard say...?

- APS-26 says
  - *...the AS 15 (R) recognizes "that for doing so the enterprise would normally use the services of a **Fellow of Institute of Actuaries of India** " (link para 49 of AS 15 (R))*
- The actual wordings in para 49 of AS-15R
  - *"that for doing so the enterprise would normally use the services of a **qualified actuary**"*
  - AS-15R does not define the term "qualified actuary"
  - No guidance from ICAI (currently)
  - Issue discussed in comments on exposure draft on Ind AS19

## *Q3. What would you do?*

- The valuation is of the nature of Reserved Work.
- The member can sign the reports only as a FIAI (in this case)
- Existence of multiple qualifications can be shown in the letter-head etc.
- Bring this fact to the notice of the member (informally)
- Communicate with IAI: The case may help the Institute to issue guidance for the benefit of other members

## ***Q4. If you were in the same position, how would you write your credentials in the valuation report?***

- As per latest developments in employee benefits consulting space:

(was mentioned in the 9<sup>th</sup> CIRB seminar conducted in Oct-2013)

The Actuary must mention:

- Qualification & Membership number (under the Primary Regulator)
- COP number (whenever it comes into force)
- Email ID
- Mobile number

# Special Requirements for Partially Regulated Members

- Compliance on annual basis rather than as a one-off
- Cannot take up any work where the member is required to be qualified under IFA
- Mention and clarify which is the Primary Regulator wherever the qualification under the IFA is referred.
- Attend the professional Skills Course (as and when required)

***Q5. How would these requirements affect your representation of credentials on the AS 15 valuation report?***

- Valuation reports under AS15 are of the nature of Reserved Work
- Mention credentials under the Primary Regulator (IAI)
- Along with other details mentioned earlier

***Q6. If you were consulting with an actuarial firm, is it necessary to identify yourself with your name and membership number of primary regulator while signing the AS 15 valuation report?***

- The Actuarial Firm cannot sign the reports
- Reports are signed in the professional capacity of the Actuary
- Actuary has to identify himself/herself in the report
- If more than one actuary is responsible for the work, all of them should sign
- Mention the details as discussed earlier

**Questions??**