1. **Do you agree that PSAB needs to consider whether the discount rate guidance in RETIREMENT BENEFITS, Section PS 3250, is appropriate and sufficient?**

   Yes. Ontario supports PSAB's efforts to review Sections PS 3250 and PS 3255 considering these standards have been in effect for over 15 years. Canadian public sector pension plans need to remain current and consider changes in the way that benefit plans are structured as well as changes made to benefits accounting standards by other major standard setters.

   It is however a challenge to review and comment on elements of Sections PS 3250 and PS 3255 without understanding the overall direction being taken by PSAB on these standards. In addition, responding to this Invitation to Comment while PSAB continues to review the reporting model through its Concepts Underlying Financial Performance is challenging.

   It will therefore be important for PSAB, after issuance of Invitation to Comments on specific matters, and after the conceptual framework project is complete, to allow the public sector community an opportunity to comment on the matters being covered collectively to ensure consistency between recommendations and with the underlying concepts in the Handbook.

2. **What challenges do you have, if any, in applying the discount rate guidance in Section PS 3250?**

   Ontario has followed the PSAB guidance to develop discount rate assumptions for both funded and unfunded benefit plans. For funded plans, Ontario determines the discount rate by referencing the long term expected return on plan assets. For unfunded plans, the discount rate is tied to the province's borrowing cost. The approach is consistent with the funding model of the plan and has worked well. Therefore, Ontario is supportive of the current discount rate guidance.

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3. **What discount rate bases do you use in estimating accrued benefit obligation? If different discount rate bases are used for fully funded, partially funded and unfunded benefit plans, please identify them separately.**

For funded pension plans, Ontario uses a discount rate based on the expected return on plan assets. For unfunded benefit plans, Ontario uses a discount rate based on the borrowing rate of the Province.

4. If you use the expected return on plan assets as the discount rate basis in estimating accrued benefit obligation, please answer the following: (a) How do you determine the discount rate? (b) Do you find the discount rate guidance in Section PS 3250 sufficient? (c) What additional discount rate guidance would be helpful?

a. Significant analysis is done to develop the expected rate of return used to determine the obligation to ensure it is a reasonable expectation in the long-run. The assumption used takes into account the asset allocation of the particular pension plan and the expectation of the long-term return for each of the asset classes. Each asset class expectation is carefully analyzed with the assistance of experts to ensure that this is a reasonable assumption of the return on each asset class.
b. Additional guidance should be provided on:
   - Accounting partially funded plans; and
   - Determining the best estimate in a range of possible discount rates.

Commented [TI(1]: Suggest to take out b as per Allan's comments. For c, there is no such plan in Ontario. The only plan we can think of is the Federal public Service Pension plan. All public sector pension plans in Ontario are either funded (such as the PSPP) or unfunded (such as the above max or CRF accounts).

5. If you use the entity's cost of borrowing as the discount rate basis in estimating accrued benefit obligation, please answer the following: (a) How do you determine the discount rate? (b) Do you find the discount rate guidance in Section PS 3250 sufficient? (c) What additional discount rate guidance would be helpful?

Ontario uses the cost of borrowing as the discount rate for its unfunded plans. a) The discount rate is determined based on Ontario's borrowing rate for an obligation of similar maturity b) The guidance provided in Section PS 3250 is sufficient for our purposes. c

Commented [TI(2]: Suggest to take out C as per comments by Allan, the consultant. As well, MOF staff has no difficulty following the current guidance in setting discount rate. Allan has advised that we don't open up the floodgate by seeking more guidance. In our opinion, the current guidance is sufficient.

6. Which of the discount rate bases identified in paragraphs .052-.092 is most appropriate for estimating the fulfillment value of the accrued benefit obligation? Please identify any guidance that may need to be considered.

Ontario supports using the expected return on plan assets as the discount rate for funded plans and the government's cost of borrowing for unfunded plans.

The nature of pension plans in the public sector in Canada is often very different from pension plans in the private sector, and for that matter public sector pension plans in other countries:

- Most public sector pension plans require member contributions, with member and employer contributions at or close to 50/50;

- Many public sector pensions plan have levers to share cost/risk with members, including increased member contributions or reduction in future benefits; they have demonstrated the ability to self-adjust over time;

- Governance structures are very robust, with the investment management and risk management of the pension funds often performed by an external Board that is separate from the Plan Sponsor(s); and

- Most of the public sector pension plans are not subject to solvency funding requirements and in fact for many of the plans, in the highly unlikely event of plan wind-up, the benefits can be reduced if there are insufficient assets.

The purpose of financial statements for a commercial enterprise in the private sector is to focus on the pricing of that enterprise at a particular point in time. Alternatively, the purpose of financial statement in the public sector is to demonstrate accountability by the government to the public and its legislature. Financial statements are a vehicle by which governments demonstrate whether they did or did not do what they intended and why or why not. Government financial statements should therefore be clear and understandable to the public. Pension plans are long-term in nature. Because of the long-term nature of pension plans, government's long-term accountability should be demonstrated to the public with respect to pension plans. Standards on retirement benefits in the PSA Handbook should consider the long-term accountability of government to the public.

For public sector pension plans, the public is interested in knowing whether the assets segregated for pension purposes are sufficient to meet the government's current pension obligations. If not, how much of a pension shortfall exists.

Most of Ontario's pension plans are funded plans. The Province does not need to borrow or raise additional funds to pay for their current pension obligations. The pension assets set aside by government are expected to earn a rate of return over future years, which along with future contributions, will be sufficient to meet the pension obligations as they come due.

Discounting the future pension payments to be made by the expected return on plan assets (projected over the period of the pension plan) represents the plan assets required to be held by the government to fully fund the pension plan. The expected return on plan assets represents the cost of funding the pension obligation and best reflects the current obligation of the Province.

If a government has set aside sufficient assets to fund its current pension obligations, the benefit of treating the pension obligation as if it needs to be debt financed is not clear. Recording the pension obligation assuming the government will need to borrow to fund the obligation will result in reporting an obligation and an unfunded balance not reflective of the current needs of government. It does not accurately reflect the future financial needs of the government; it does not accurately reflect how well the government has been in funding its long-term obligations. Using an assumption that the pension obligation needs to be debt financed will increase the net debt of the Province as compared to that presented valuing the accrued benefit obligation at the long-term expected rate of return. As noted in Section PS 1100.28, "Net debt provides a measure of the future revenues required to pay for past transactions and events." If the pension plan has sufficient assets set aside to fund its pension obligations, future revenues will not be required to be raised for the pension plan obligation, and yet the financial statements of the Province will suggest otherwise.

For those plans that are not funded, using the cost of borrowing is appropriate. It reflects the borrowing rate the government must pay for its debt. Other PSAS require use of the government's average borrowing rate, for example PS 3050, PS 3270 and PS 3310.

7. **Which of the discount rate views identified in paragraphs .093-.106 is most appropriate for estimating the fulfillment value of the accrued benefit obligation? Please identify any guidance that may need to be considered.**

As pension plans are long term in nature and to be funded through assets set aside to generate returns, projected rates of return on plan assets are most appropriate for funded plans. The current borrowing rate is most appropriate for unfunded plans, the current rate being the best estimate of future borrowing costs.

8. **Are there any discount rate bases that may be used to estimate accrued benefit obligation that have not been identified in paragraphs .052-.092?**

None noted.

9. If you support a discount rate basis that includes adjustments for risks, which risks should be included in determining the discount rate (paragraphs .040-.046 and .080-.082)?

Ontario uses the expected return on plan assets as the discount rate for funded plans and the government's cost of borrowing for unfunded plans and continues to support this approach.. The government's cost of borrowing already reflect risks such as credit risk and liquidity risk through the rates established by the market. Again, Ontario supports the current guidance and believe the resulting obligation properly reflects the benefit obligations of the government.

Commented [TI(3]: Allan suggests taken out this details so that language is consistent with other places.

Commented [TI(4]: Allan suggests that we emphasis on Ontario's support of the current guidance and not to open up the floodgate for further changes.

10. Are there any practical issues related to determining discount rates for which further guidance may need to be considered that have not been identified in the Invitation to Comment (specifically in paragraphs .065, .070, .076, .101, .105 and .107-.110)?

One of the distinct characteristics of Ontario public sector plans is that they all have robust governance structure with investment management and risk management of the pension funds often performed by external professional Boards. The Pension Benefits Act and regulations require that all plans must establish an investment policy statement and goal and the document must be reviewed annually. Therefore, both the investment policy and actual investment itself must be appropriate to the plan and such policy and investment also need to be assessed frequently to ensure it is still appropriate. This further supports the appropriateness of the current guidance.

11. Do you support using different discount rate bases/views for fully funded, partially funded and unfunded benefit plans? If yes, should it be based on: (a) the entity's funding policy as described in paragraph .116; or (b) the benefit plan's funding level as described in paragraph .121?

Yes. Ontario supports using the expected return on plan assets as the discount rate for funded plans and the government's cost of borrowing for unfunded plans. A blended rate should be used for partially funded plans. The discount rate should be based on the funding level of the plan which best demonstrates the funding source of the pension obligation.

12. If you support using different discount rate bases/views for fully funded, partially funded and unfunded benefit plans, which of the discount rate

basis/view (paragraphs .050-.106) is most appropriate for estimating the fulfillment value of the accrued benefit obligation of: (a) a fully funded benefit plan; (b) a partially funded benefit plan; and (c) an unfunded benefit plan?

Ontario supports using the expected return on plan assets as the discount rate for funded plans and the government's cost of borrowing for unfunded plans. A blended rate should be used for partially funded plans. Additionally see the response to question 7.

13. **Are there any reasons that a discount rate approach taken for estimating accrued pension benefit obligation would not be appropriate for estimating accrued non-pension benefit obligation?**

See response to question 6. For those plans that are not funded, using the cost of borrowing is appropriate. It reflects the borrowing rate the government will pay for debt borrowed to finance its current obligation. Other PSAS require use of the government's average borrowing rate, for example PS 3050, PS 3270 and PS 3310. We believe that this methodology is appropriate and consistency in practice exists across the sector.

14. **As shown in Chart 2, market yields of high-quality debt instruments at the reporting date is a discount rate used in most other equivalent standards reviewed by PSAB. Are there any reasons that can justify that the public sector in Canada is different from the others?**

Yes. The overwhelming prevalence of the use of "market yields of high-quality debt instruments at the reporting date" is shown in other standards including IASB, US FASB, UK ASB and IPSASB. What is not noted in the document is the difficulty of the applicability of that methodology in most major markets as well as the lack of guidance. In the late 1980s, a position statement by a staff of the SEC defined high quality debt as a debt that was of higher quality than Aa and from that point, regardless of the standard, that opinion has been the guiding principle in establishing the accounting discount rate. The economic environment has changed significantly since the late 1980s when that opinion was published such that the number of AA corporate bonds at longer durations decreased significantly but the methods to rate these bonds has also changed. The main issue facing the Canadian as well as most major economies is the lack of depth of the Aa market past the 10 year maturity mark. In Canada, only one Corporate Aa bond exits past 10 years. Under IASB and US FASB, issuers extrapolate rates from existing market information to determine the "pseudo" Aa rate past the 10 year mark for an obligation with cash flows that stretches more than 100 years. In the wake of these issues that spreads beyond Canada, standard setters have tried to resolve the imperfect methodology that relies on market yields of high-quality debt and continue to question the validity of that methodology. These difficulties should be considered in thinking about implementing that methodology and the potential of other standard setters eventually moving away from it.

15. **ADDED QUESTION (Include response in opening comment section on the online response form): Are there any specific issues with, or related to, Sections PS 3250 and PS 3255 that have not been identified in the “Background to the project” section (page ii) that PSAB should consider in this project?**

Ontario would additionally like to highlight the follow areas which should be considered by PSAB's Employment Benefits Task Force:

- Inconsistencies between the employment benefit standards and other standards in the PSA Handbook. For example, the deferral mechanisms in Section PS 3250 are inconsistent with the definitions of assets and liabilities and with the recognition guidance in Section PS 1000. Such conceptual inconsistency makes it more difficult to apply the concepts in developing appropriate accounting policies when Section PS 3250 is not clear on a particular issue or different interpretations could be made.
- Application of the guidance on defined benefit plans to joint defined benefit plans, specifically whether to apply the standard’s measurement guidance to the plan as a whole or to the government’s portion of the plan.
- How “minimum contributions” and “regardless of any surplus” should be interpreted in the context of the Asset Ceiling Test, including whether the surplus considered is a funding surplus or an accounting surplus.
- Significant differences that can exist between the financial position of a plan reported in its own financial statements and that reported in the financial statements of the government sponsor, largely because of different discount rates required by different accounting frameworks. This can be confusing to users trying to assess the underlying financial health of the plan and the assets and liabilities of the sponsor in respect of that plan. Significant differences can arise between the amounts reported for accounting purposes and those reported for funding purposes that can also be confusing to users when both valuations are made publicly available sometimes in the same document. PSAB's Employment Benefits Task Force should consider whether additional disclosures regarding the purpose of the accounting valuation compared to a funding valuation may be helpful to users of government financial statements.

- A review should be performed of the valuation allowance guidance in the standards to ensure the guidance is clear and complete.
- A review should be performed of the guidance on accounting for multi-employer plans in the standards to ensure the guidance is clear and complete.