



FINANCIAL SERVICES COMMISSION
Draft Discussion Paper
Pension Plans – Guidance on the Presentation and Calculation of
Accrued and Projected Pensions of Active Members
December 2007

The Financial Services Commission invites your comments on the following discussion paper outlining its guidance on the presentation and calculation of accrued and projected pensions of active members. This paper discusses the methods to be used for calculating accrued and projected pensions, and sets out the manner in which information should be presented. It is intended to clarify and supplement the minimum standards specified in Part I of the First Schedule of the Pensions (Superannuation Funds and Retirement Schemes) (Governance) Regulations, 2006.

Kindly forward your comments by Friday, March 16, 2008 to:

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INTRODUCTION

Regulation 12 of the Pensions (Superannuation Funds and Retirement Schemes) (Governance) Regulations, 2006 (“Regulations”), requires trustees of an approved superannuation fund (“fund”) or approved retirement scheme (“scheme”) to provide members of a fund or scheme with benefit statements. Part I of the First Schedule to the Regulations sets out the information that must be contained in benefit statements for active members of a fund or scheme. Section B – Benefits requires the disclosure of members’ accrued benefits as at the end of the statement period and projected benefits at his/her normal retirement date (“NRD”).

Funds and schemes offer many different types of benefits to their members (e.g. payments on the death or disability of a member) but their “principal purpose is the provision of a pension or annuity on retirement of members”¹. This paper is written in response to requests for guidance on the calculation of accrued and projected pensions and the presentation of the information related to these items in statements of active members.

The Financial Services Commission (‘FSC’) expects pension plan trustees to ensure that statements are prepared in accordance with the Regulations, and that plan members are educated on the content and purpose of their benefit statements. The trustees are responsible for ensuring that benefit statements are clear, accurate, complete and timely. It is recommended that if trustees are unsure of the regulatory requirements, they seek the advice of someone with the requisite knowledge to ensure that all pertinent items are included in the statements.

¹ Sections 13(2)(b) and 14(1)(b)(i) of The Pensions (Superannuation Funds and Retirement Schemes) Act, 2004

The FSC encourages trustees to prepare benefit statements that help members understand how their pensions are built up and thus help them plan for their retirement. It is recognized that the amount and type of supporting information given will depend on the design of the plan and other considerations such as the cost of preparing these statements but the main aim should be the provision of useful information, not simply compliance with the Regulations.

1. ACCRUED PENSION

A member's accrued pension is the pension attributable to the member's service in the plan up to the statement date, including any applicable transferred or past service, and is calculated either by reference to a formula or based on accumulated contributions.

1.1. Plans with pensions calculated by reference to a formula:

The FSC expects all major elements of the pension formula to be shown on a benefit statement thereby allowing a member to verify the accuracy of the calculation of the accrued pensions. For example, in the case of Average Salary plans, benefit statements should not only show pensionable salary as at the statement date, but also the average salary and pensionable service used in the calculation. Additional information may also have to be presented depending on the design of the plan.

Due to the complexity of some benefit formulae, formulae need not be shown in statements however providing a reference to the relevant section of the Member Handbook which contains the description of how the pension is calculated would be useful.

In keeping with the specifications of the First Schedule to the Regulations, the development a member's accumulated basic and voluntary contributions must be shown in addition to the information on accrued benefits. The statement must also show the member's total basic and voluntary contributions without interest.

1.2. Plans with pensions based on contributions:

A member's accrued pension is the annuity equivalent of his total account balance as at the statement date, accumulated with interest or with an amount equivalent to the appreciation in value of investment units allocated to the contributions to the statement date. In either case, statements must show the development of members' accounts from the previous statement date to the current statement date, with the member's component and the employer's component clearly identified and further broken down by source (this includes, where applicable, basic and voluntary contributions, bonuses and transferred amounts received). For plans where account balances are determined by reference to investment units, the FSC expects member statements to include a reconciliation of investment units over the statement period.

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Example 1: Development of Contributions for a Defined Contribution Plan where interest is credited to Members' Accounts – bonuses and transferred amounts included

	Balance at Beginning of Year	Contributions During Year	Interest Credited During Year	Balance at Year End
Basic Contributions	\$320,000.00	\$35,000.00	\$35,500.00	\$390,500.00
Voluntary Contributions	\$50,000.00	\$35,000.00	\$8,500.00	\$93,500.00
Bonus on Basic	\$40,000.00	\$0.00	\$4,000.00	\$44,000.00
Bonus on Voluntary	\$2,000.00	\$0.00	\$200.00	\$2,200.00
Transfer – Member's	\$200,000.00	\$0.00	\$20,000.00	\$220,000.00
Member's Subtotal:	\$612,000.00	\$70,000.00	\$68,200.00	\$750,200.00
Employer Contributions	\$320,000.00	\$35,000.00	\$35,500.00	\$390,500.00
Bonus on Employer	\$40,000.00	\$0.00	\$4,000.00	\$44,000.00
Discretionary Bonus	\$0.00	\$0.00	\$0.00	\$0.00
Employer's Subtotal:	\$360,000.00	\$35,000.00	\$39,500.00	\$434,500.00
GRAND TOTAL	\$972,000.00	\$105,000.00	\$107,700.00	\$1,184,700.00
Total Contributions: (without interest)	\$692,000.00	\$105,000.00	N/A	\$797,000.00

This example is for illustrative purposes only, and is not a statement of how benefit statements must be presented.

Example 2: Development of Contributions for a Defined Contribution Plan where Account Balances are determined by reference to investment units – bonuses and transferred amounts not included.

	Beginning of Year			During Year		End of Year		
	No. of Units	Price per Unit	Account Balance	Conts*	Units	No. of Units	Price per Unit	Account Balance
Basic Contributions	28,021	11.420	\$320,000	\$36,800	3,068	31,089	12.562	\$390,536
Voluntary Contributions	4,378	11.420	\$50,000	\$36,800	3,068	7,446	12.562	\$93,536
Member's Subtotal:	32,399	11.420	\$370,000	\$73,600	6,136	38,535	12.562	\$484,080
Employer Contributions	28,021	11.420	\$320,000	\$36,800	3,068	31,089	12.562	\$390,536
Total Contributions:	60,420	11.420	\$690,000	\$110,400	9,204	69,624	12.562	\$874,608
Total Contributions: (without appreciation)	N/A	N/A	\$420,000	\$110,400	N/A	N/A	N/A	\$530,400

* Contributions into the plan are used to purchase units at the price in effect at that time.

This example is for illustrative purposes only, and is not a statement of how benefit statements must be presented.

2. PROJECTED PENSION

A member's projected pension is provided to illustrate to a member the amount of the pension which would likely accrue to him or be secured by him at NRD, provided that he remains an active member of the plan until his NRD and the method used to calculate his pension remains the same to his NRD. It does not represent any promise or guarantee as to the amount of benefit which may be payable to a member under the fund or scheme.

Therefore, in calculating the projected pension for a defined contribution plan it should be assumed that a member's contributions (basic and voluntary) and employer's contributions continue to be made at current rates for each member until retirement.

Projected pensions must be presented in benefit statements in the form of a replacement ratio. The replacement ratio, which is the ratio of projected annual annuity to gross earnings at NRD, gives members a good indication of the percentage of their income that their plan is expected to provide at NRD. The replacement ratio may be approximated by the ratio of projected annual annuity to *pensionable salary* at NRD, but if this method is used it should be clearly noted on the statement.

The FSC recommends that projected annuities be calculated using current pensionable salary and a long-term nominal interest rate assumption which has been adjusted for salary escalation because:

- i. the estimated projected annuity will be inflation adjusted and in a form where the purchasing power and adequacy of the pension provided can more easily be analyzed;
- ii. adjusted interest rates are more stable and therefore easier to estimate than nominal rates;
- iii. the projected annuity will be easier to and thus less costly to compute.

Trustees must exercise caution in the presentation of projected pensions to ensure members are not misled. It is recommended that Trustees develop strategies, such as but not limited to the following, in order to minimize this risk:

- (a) including the term '*estimated*' when referring to projected pensions
- (b) adopting appropriate wording that emphasizes that the projected pensions are not guaranteed and that they are estimates which will change if the assumptions used in the calculation are not realized, or if the plan formula is modified.
- (c) referring members to the description of the method and assumptions used in the calculation of the projected pension and placing that description as close to the projected pension as possible.
- (d) Providing an explanation of how the projected pension should be interpreted and again placing that explanation as close to the projected pension as possible.

2.1 Plans with pensions calculated by reference to a formula:

Members' projected pension should be calculated by using members' total *expected* pensionable service to NRD. Appendix A contains an example of the calculation of a member's projected pension for a three-year final average pension plan using the recommended approach.

2.2 Plans with benefits based on contributions:

A member's projected pension is the pension equivalent of his Member's Account Balance at the statement date projected at an expected average net rate of return on the fund to normal retirement date *plus* his expected future contributions, accumulated at the same rate of return from the date paid to normal retirement date. Appendix B contains an example of the calculation of a member's projected pension for a defined contribution plan using the recommended approach.

Assumptions

The Jamaican economic environment is volatile, and economic variables will fluctuate with time. As pension projections are highly dependent upon the assumptions chosen, the FSC expects the assumptions used to represent a reasonable long-term view of these variables.

APPENDIX A - Projection for a Final Average Pension Plan

In this example it is assumed that the member has transferred additional service from his prior membership in another plan.

Plan information:

Plan Accrual Rate:	1.5%
Salary averaging period:	3 years
Normal Retirement Age:	65 years

Member information at statement date:

Age:	40 years
Pensionable Salary:	\$700,000 per annum
Average Pensionable Salary:	\$650,000 per annum
Accumulated Voluntary Contributions	\$0
Years of Membership Service:	8 years
Additional Service Credited From Transfer:	2 years
Total Pensionable Service:	10 years
Future Service to NRD:	25 years
Total Expected Pensionable Service at NRD:	35 years

Estimated Projected Annuity

$$\begin{aligned}
 &= \text{Accrual Rate} \times \text{Average Salary} \times \text{Total Expected Pensionable Service at NRD} \\
 &= 1.5\% \times \$650,000 \times 35 \\
 &= \$341,250 \text{ per annum}
 \end{aligned}$$

Estimated Projected Pension, Replacement Ratio

$$\begin{aligned}
 &= \text{Estimated Projected Annuity} / \text{Pensionable Salary at statement date} \\
 &= \$341,250 / \$700,000 \\
 &= 48.75\%
 \end{aligned}$$

If the member had also made voluntary contributions to the plan the replacement ratio for his voluntary benefit would be calculated using the method described in Appendix B.

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APPENDIX B - Projection for a Defined Contribution Plan**Plan information:**

Normal Retirement Age: 60 years

Member information at statement date:

Age: 42 years
 Pensionable Salary: \$770,000 per annum
 Accumulated Basic Contributions: \$100,000
 Accumulated Voluntary Contributions: \$51,000
 Accumulated Employer Contributions: \$100,000
 Total Accumulated Account Balance: \$251,000
 Future Service to NRD: 18 years

Assumptions:

Expected Fund Rate of Return net of expenses 9% p.a.
 Expected Pensionable Salary Escalation 8% p.a.
 Expected Fund Rate adjusted for Salary Escalation 1% p.a.
 Interest Rate after Projection Period: 9% p.a.
 Mortality Table: PA(90)-6
 Annuity factor at NRD: 10.039

Contributions continue until retirement at the current rate of 5% of Pensionable Salary for basic, voluntary and employer.

	Basic	Voluntary	Employer
(1) Projected Account Balances (rounded):	\$119,000	\$61,000	\$119,000
(2) Projected Future Contributions (rounded):	\$759,000	\$759,000	\$759,000
(3) Total Estimated Accumulated Contributions	\$878,000	\$820,000	\$878,000
(4) Annuity factor at NRD:	10.039		
(5) Estimated Projected Annuity =(3)/(4)	\$88,000 pa	\$82,000 pa	\$88,000 pa
(6) Estimated Projected Pensionable Salary	\$770,000		
(7) Estimated Replacement Ratio = (5)/(6)	11.4%	10.6%	11.4%
(8) Total Estimated Replacement Ratio	33.4%		