

Pension Schemes

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This issue is one of the most important ones among the 44 or more issues discussed in the process of the revision of the SNA. Indeed, the aging of the population will create major problems of financing of pension benefits, and the system of national accounts will be partially judged on its capacity to inform users correctly on this phenomenon.

The problem lies in the fact that the current SNA only recognizes pension obligations (meaning records a financial liability) for *funded* employer pension schemes. No such obligations are recognised for *unfunded* pension schemes. An Electronic Discussion Group (EDG, organized by the IMF) was set to propose recommendations. The main recommendations, which will be presented at the February 2006 meeting of the AEG (the committee which leads the SNA 93 revision process), are the following:

- Abandon the different treatment for funded and unfunded schemes, and recognize a pension liability for all employer schemes, including for general government as an employer of civil servants,
- Use actuarial valuations for the calculations of stocks and flows,
- Allocate the funds net assets (if any) to the employer.

There are several reasons for changing the current recommendations. First, it is not correct to treat differently a liability because of differences in the mode of financing (funded or unfunded). Thus recognizing all liabilities for employer schemes removes an unequal treatment. Second, it meets households' perceptions, because they feel they have an asset whatever the mode of financing. The use of an actuarial method of calculation of contributions improves the quality of the estimate of the cost of labor expressed in accrual terms.

Why are actuarial valuations? Under this word, the idea is to estimate a pension liability based on the present value of expected future pension benefits. Actuarial valuation implies using projected demographic series (sometimes over 100 years) and, more importantly, using a discount rate to calculate the present value of these future flows. The recommendation for discount rate is to use the interest rate on high quality securities relevant to the sponsor of the pension scheme and with terms of maturity consistent with the time horizon of the pension liability. Actuarial valuation allows showing the present value of the future promises made in today's balance sheet. It implies imputing an interest to the employees corresponding to this debt. With actuarial valuation the contributions of the employers will be compiled as equal to the change in the net present value of the promises made during the period, and not to the effective payments made by the employer to the pension scheme. Thus it represents better the actual cost for the employer of the pension promises. Actuarial valuations are already used by large enterprises to estimate their pension liability under business accounting standards.

The change in the treatment will allow treating in a similar way all funded, unfunded, under-funded or over-funded schemes, all situations that occur in the real world. At present, not only the treatment differed in the SNA depending on the financing of the schemes, but the borderline between under-funded and unfunded was unclear.

The change in the treatment comes with the recommendation to allocate the pension schemes' net assets (negative and equal to the pension liability for a totally unfunded scheme) to the employer. This conforms to

generally accepted accounting principles. This implies that all pension schemes in the SNA, whether really funded or not, whether defined contribution or not, will have a zero net worth by construction (their “asset” will be equal to their “liability”). Changes in the insurance technical reserves due to changes in discount rates will be recorded as reevaluations.

The report of the EDG includes also recommendations to record output for non-autonomous pension funds and unfunded schemes, excluding holding gains and losses from the measurement of output.

There is a significant debate in Europe on these recommendations, in particular regarding the schemes set by government for their own employees. Several large European countries deny that the liability on these schemes should be treated as normal liabilities in the SNA. Their arguments are two fold: (1) the value of the pension promise to government employees is revisable by the government, (2) the status of government schemes is similar to social security schemes, and there is no plan to recognize the liability of social security schemes.

The AEG will make its final decision in February 2006.