

College Of Pension Actuaries C O P A

Via E-mail to: director@fasb.org,

Re: File Reference No. 1025-300.

These comments are made on behalf of the College of Pension Actuaries (COPA). Membership in COPA is restricted to Enrolled Actuaries and is open to any Enrolled Actuary who is either actively enrolled or retired in good standing. These comments are made by a subcommittee whose purpose is to work with the accounting profession and other interested parties to develop better financial standards and reporting for retirement plans.

Sometime ago, the FASB announced tentative plans to establish the Projected Benefit Obligation (PBO) as the basic standard for measuring the liability of a firm maintaining a defined benefit pension plan. The American Academy of Actuaries (the Academy) commented on these tentative plans by letter dated February 10, 2006. This letter offered cogent reasons why the PBO should not be established as the basic standard for measuring liability. The letter stated that the Accrued Benefit Obligation (ABO) was a far more appropriate standard. On March 9, 2006, COPA commented on the same tentative plans. The COPA letter strongly endorsed the Academy position and offered additional reasons why the PBO is an inappropriate standard and the ABO is far more appropriate.

COPA believes the strongest arguments favoring use of the ABO rather than the PBO were set forth in these letters. We are concerned that the FASB, apparently, was not persuaded by these arguments. We feel very strongly that adopting the PBO as the basic standard for determining an employer's pension liability would be a serious mistake. It would make financial statements less transparent and thus less helpful to the various users of these statements. Just incidentally, it could have a devastating effect on the future of defined benefit pension plans. For these reasons, we offer this further discussion.

Reality and Appropriateness of PBO as a measure of Liabilities

1. We vigorously urge that the FASB review the February 10 and March 9 letters of the Academy and COPA. Everything we say, here, is in the way of supplementing, not replacing these earlier comments. For the record, we wish to incorporate by reference our March 9, 2006 letter.
2. We take exception to the notion that an employer has even an implicit obligation to provide inflation related pay increases. In a vast majority of cases, the employer has neither an explicit

PO Box 5262
Oak Brook IL 60523-2108
Telephone: 630/242-5679
info@pensionactuaries.org
www.CollegeOfPensionActuaries.org

*the only
national society
consisting exclusively of
pension actuaries who are enrolled*

nor an implicit obligation. Most employers do have an implicit commitment to remain competitive in their employment practices. However, any relationship between remaining competitive and recognizing inflation is entirely coincidental. We have all seen many situations where, for a series of years, there was a very weak correlation between pay rates and inflation.

We doubt that any observer would maintain that the cost of increasing pay in order to remain competitive is a cost that should be recognized before the pay increase occurs. Future pay increases simply should not be anticipated. We believe the same rule should apply to future pension accruals. The cost of an increased accrued benefit brought about not by inflation but by a discretionary pay increase is a future accrual, not a current one. It should not be recognized before the pay increase occurs. It is not a liability unless and until the employer decides to provide the pay increase.

3. We take exception to the assertion at Subparagraph B17.d. of the exposure draft that the ABO, for pension accounting is not analogous to the Accumulated Postretirement Benefit Obligation (APBO) for other post retirement benefit accounting. We see a very close analogy.

In many health care plans, the employer has promised to provide stated benefits as they may be impacted by inflation. In these plans, it is entirely appropriate for the APBO to reflect health care cost trend rates.

With rare exceptions, there is no comparable promise respecting pension benefits. Indeed, if there were such a promise, the ABO should reflect it. This would occur, for example, if the pension plan provided for automatic post-retirement cost of living increases.

There is no inconsistency between using the ABO for pension purposes and the APBO for purposes of other postretirement benefits.

4. We were somewhat bemused by the assertion that

Among those respondents who argued that obligations dependent on future compensation increases are excluded by the definition of a liability, very few were prepared to accept a measure of net periodic pension cost that was based only on compensation to date.

This assertion, made at Paragraph 139. of Statement 87 and quoted at Subparagraph B17.e. of the current exposure draft certainly does not reflect the attitude of COPA. Indeed, based on our observations, the assertion reflects the attitudes of very few practitioners.

We agree with the Board that the use of ABO in the position statement should go hand-in-hand with a similarly based value in the income statement. However, reexamination of the components of Net Periodic Pension Cost appears to have been established as an issue for phase 2. We believe that the question of defining the components of the balance sheet liability for pension costs should also be an issue for phase 2 rather than phase 1.

5. We take exception to the assertion at Subparagraph B17.c. that measuring obligations using the ABO rather than the PBO would necessitate changing how the discount rate is determined. Here, there is a reference to Paragraphs 140-142 of Statement 87.

We certainly agree that there is a distinction between real interest rates and rates that reflect inflation. However, we submit that this distinction is not relevant to the current issue. The only function of the discount rate is to translate an obligation expressed in terms of future payments to an obligation expressed as a current value. This function is performed appropriately by using a notional portfolio that satisfies proposed Paragraph 44A. of Standard 87.

The notional portfolio should be a diversified portfolio of high quality bonds cash-matched to obligations under the plan. The process of selecting this portfolio has nothing to do with real interest rates.

Impact of a PBO-Based Liability

Several consulting actuarial firms have estimated the impact of the proposed use of PBO. Towers Perrin, estimates that, if adopted for 2004, the proposal would have added pension liabilities totaling \$331 Billion to the balance sheets of those Fortune 100 employers sponsoring defined benefit plans. Shareholder equity, assuming a 35% tax rate, would have decreased by \$180 Billion. Watson Wyatt studied the top Fortune 1,000 for the same year, examining the combined impact on liabilities for pension and other post retirement benefits. By their calculations, the reduction in shareholder equity was \$312 Billion, an average of 9.54%.

It is not correct to say that there was no change – that footnote information was merely shifted to the position statement proper. The FASB was convinced that the proposed change would have an

impact on readers of financial reports. This conviction was sufficient to prompt the FASB to move forward with the proposal. Employers will undoubtedly share this conviction.

The impact of the proposed change will be especially troublesome among the clients of COPA members. These clients are typically smaller employers vitally concerned with the impact of their financial statements on their lenders. These lenders often lack the sophistication of the financial analysts who typically help evaluate the worth of larger employers. Lenders to small plans may have difficulty understanding that the proposed change essentially moves information from footnotes to the position statement proper. These lenders may resist the voluntary amendment of existing loan covenants, thus causing great difficulty for our members' clients.

We are going through a period in which employers are either terminating their defined benefit plans or freezing benefit accruals. The reasons for some of these curtailments are rational. In other cases, the reasons are not entirely rational, but merely reflect the notion that "if everyone else is doing it we should think about doing it, too." In the long run, we believe it will come to be recognized that much of this curtailment activity was a mistake. It will be recognized that, simply for its use as a workforce management tool, a pension plan is a worthwhile expenditure of shareholder resources.

We cannot predict how this spate of curtailments will play out. However, we do know that the rush to curtail will certainly be pushed along by an accounting change that appears to reduce shareholder equity by an average of almost 10%. An outcome of Phase 2 could be a decision to use the ABO as the basic measurement tool. If this is the case, the temporary use of PBO to measure liabilities could have unfortunate consequences – pointlessly causing the nearly complete demise of defined benefit pension plans.

* * *

Summary

1. We vigorously urge that PBO as a measure of liabilities not be adopted in phase 1.
2. To go further, we urge that there be serious consideration in phase 2 of an approach to Net Periodic Pension Cost that reflects ABO accruals as accurate measures of Service Cost.
3. If, notwithstanding our position, the FASB decides to adopt PBO as a measure of liabilities in phase 1, we urge that the effective date for smaller non-public employers be postponed by two years. This will help provide time to educate users of these employers' financial reports. In

File Reference No. 1025-300

May 18, 2006

Page 5

many cases, this two-year delay will permit existing loans to be closed out automatically, without the need to negotiate revised covenants.

* * *

The principal author of this letter is Edward E. Burrows, although other members of the subcommittee made significant contributions. In addition to being a member of the subcommittee, Mr. Burrows is the current President of COPA. Your files will show that he has requested permission to participate in your public roundtable meeting scheduled for June 27, 2006.

We stand ready to respond by phone, by letter, or in person to any comments or questions the Board or its staff might have.

Sincerely,

THE ACCOUNTING AND STANDARDS SUBCOMMITTEE
OF THE REGULATIONS AND LEGISLATION COMMITTEE



By _____

Annie Brown Voldman
Member, College of Pension Actuaries
Subcommittee Chair