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Technical Director – File Reference No. 1025-300
Financial Accounting Standards Board
401 Merritt 7
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LETTER OF COMMENT NO. 35

Dear Mr. Herz:

On behalf of The Depository Trust & Clearing Corporation we appreciate this opportunity to provide our comments.

Regarding your Proposed Statement of Financial Accounting Standards – Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans exposure draft we respectfully disagree with the notion that it will improve existing financial reporting.

We suggest that you reconsider this proposal, or at least delay it until further analysis can be completed to more appropriately define "funded status," particularly in terms of the way plan obligations are measured.

It is difficult to understand how you concluded that the benefits resulting from what are being called improvements in financial reporting in the proposed Statement outweigh the costs of implementation, when it is stated in the very same section of the exposure draft that the proposed Statement would not change the basic approach to measuring plan assets, benefit obligations, or annual net periodic benefit cost. The negative impact it will have on shareholders equity represents a huge cost.

Under current accounting standards, forward looking information needed to understand plan economics is already disclosed in the footnotes. We do not agree with the definition of funded status, making it difficult to understand how a reduction in equity would reflect an improvement in financial reporting, especially in our case, which we discuss later in this letter.

The exposure draft states that "insufficient guidance in existing accounting standards may cause incomplete reporting of the employer's financial condition and results of operations, which may lead to the inefficient allocation of resources in the capital markets." It also states that "This proposed Statement is a first step in a comprehensive project to remedy that situation." This may be a step in the wrong direction. The implication is that financial analysts don't understand the numbers, which may not be true. If, on the other hand, these statements are aimed at internal resource allocations, they relate directly to plan funding, which in America most companies use their actuaries

to determine. We doubt that financial analysts or corporate management rely on accounting standards to evaluate plan funding and economics. In fact, many companies, including The Depository Trust & Clearing Corporation, get two separate and distinct valuation reports from their actuaries – one for funding purposes and another one for plan accounting.

We can't agree with the notion that the difference between the fair value of plan assets and the projected benefit obligation of a defined benefit pension plan, referred to in the exposure draft as the over-funded or under-funded status of the plan, truly represents the economic status of the plan. It does not.

This fails to reconsider a pivotal conclusion made 20 years ago that we believe is flawed. Stating that "issues on the measurement of the pension benefit obligation are complex and considering them will require substantial time," doesn't support the expected impact of the proposal. This is a critical and controversial issue. Of course, we are referring to the proposed use of the projected benefit obligation ("PBO"). Because use of the PBO is conceptually incorrect, failing to first reconsider this critical issue is like putting the cart before the horse.

There is probably a general consensus that the fair value of assets in a defined benefit pension plan is relatively easy to measure. Most of the investments held by defined benefit pension plans are stocks and bonds, for which market values are readily available. The difficulty – and again the core issue – is defining an appropriate measure of the obligation. While it depends on a number of assumptions, the most fundamental and problematic is whether the accumulated benefit obligation ("ABO"), the PBO, or perhaps some other measure, is the most appropriate.

As you know, the PBO reflects the present value of future benefit payments for services rendered to-date including future compensation increases, at an assumed rate, that have not yet occurred. Comparing the PBO with the current fair value of the plan assets, which are also assumed to grow in the future, is a mismatch. [Perhaps for consistency, the plan assets should be projected to reflect assumed future returns and then discounted to a present value using the yearend discount rate, similar conceptually to the way the PBO is calculated.] In any event, using the PBO to determine what is referred to as the funded status doesn't make sense.

Our pension plan can be used as a case in point. With $379 million in plan assets at yearend 2005 and a PBO of $505 million, the plan would be considered under-funded by $126 million under the proposed definition. This is the message that would be given to our financial statement readers under the proposed accounting standard. It would be reported as an after-tax reduction in equity of $76 million ($126 million net of a 40% tax benefit). Under current accounting standards, the information for this type of comparison is already in the footnote disclosure, and we reported a $20 million reduction in equity at yearend 2005 using the ABO as the measurement of the plan obligation. While this was somewhat less misleading, neither measure reflects the true economics of our plan. The facts tell a much different story, as explained below.

The plan assets available at yearend 2005 were $379 million. At the same time, projected benefit payments over the next 10 years on a nominal basis were $186 million, as reflected in the footnote disclosure. Given an 8% assumed rate of return on plan assets, there would be a net increase in the plan assets to over $570 million after paying those benefits. In fact, deducting all projected benefit payments based on service-to-date from the current plan assets while assuming an 8% return would produce a surplus in every year for the next 77 years – until our youngest plan participant reaches their assumed mortality. Considering this analysis, it is hard to understand how a $76 million after-tax reduction in equity would send the right message to our financial statement readers. It is more likely to cause inappropriate and misguided concern.

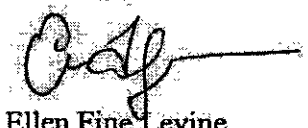
Concerning other postretirement plans (mainly retiree medical coverage), the proposed accounting must address the same, although arguably less controversial, issue concerning an appropriate measurement of the obligation.

Since tax-efficient funding is limited under the tax code, the issue is exacerbated for such plans. Under the circumstances most, if not all, of those obligations will cause reductions in equity.

The overall disparity between the message this accounting would send and the true economics is enormous. Accordingly, we don't view this as an improvement. We also don't see how it would give the financial statement readers a better understanding about the plan economics. On the other hand, it is more likely to mislead them to think there are funding concerns.

We disagree with the proposed accounting standard and we appreciate your consideration of these comments. We hope you will take the requisite time needed to fully address and resolve the significant measurement issues embodied in the proposal before making any changes. We would be happy to discuss this further with you.

Sincerely,



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