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Watson Wyatt & Company

Suite 2000 1600 Market Street, Philadelphia, PA 19103-7240

Telephone 215-282-3300 Fax 215-282-3315

Letter of Comment No. 8

File Reference: FSPFAS106A

Mr. Lawrence W. Smith Director, TA&L—FSP Financial Accounting Standards Board 401 Merritt 7 P.O. Box 5116 Norwalk, CT 06856-5116 Email: director@fasb.org

Subject:

Comments on Proposed FSP, File Reference FAS106-a

Dear Mr. Smith:

Watson Wyatt Worldwide is taking this opportunity to comment on the Proposed FASB Staff Position on Statement 106 (FSP FAS 106-a), "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003" (hereafter referred to as "the Act").

As a large employee benefits consulting firm with approximately 6,000 associates worldwide, Watson Wyatt assists many companies with the preparation of information related to FAS 106 and FAS 132. It is from this perspective that we are providing comments on the proposed FSP. As the firm's FAS 106 Resource Actuary. I have prepared our comments with input from others in the firm.

In summary, we appreciate that careful consideration will be given to the appropriate accounting recognition for the impact of the Act on employer-sponsored plans. The Act makes fundamental, sweeping changes to Medicare, and certain provisions may not have been adequately addressed by the existing accounting statements. In particular, the tax-exempt subsidy to be provided to employers who sponsor "qualified" drug plans appears to be fundamentally different from the Medicare benefits provided under Parts A, B, and C today, and accordingly, different accounting treatment may be warranted.

At the same time, we are concerned about

- The lack of true guidance in the FSP (other than "Do nothing at this time");
- Uncertainty over possible differences in accounting for various types of employer response to the
- Uncertainty over the timing of guidance from FASB, and whether such guidance will provide for retroactive accounting recognition; and
- The possibility that delayed FASB guidance will cause some employers to make short-term financial decisions that may undermine the long-term benefit security of employees and run counter to the underlying public policy objectives of the Act.

Therefore, we have the following questions and comments:

- Does the phrase "requires additional disclosures" in the introduction to the FSP refer to a) requested comments on the FSP, b) the "additional disclosure of any information" that sponsors are encourage to provide, or c) something else?
- The FSP describes the qualified plan subsidy as "...28% of the plan's share of an individual
 beneficiary's annual prescription drug costs between \$250 and \$5,000..." We believe most
 observers interpret the subsidy as related to the costs covered by the plan, not the plan's share of
 those costs (i.e., the benefits paid).

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• In the first sentence under the "Federal Subsidy" section, the word "as" should be removed.

- In two places, the FSP emphasizes the voluntary nature of PDP (prescription drug plan) enrollment and how that might affect the subsidy available to employers. We feel that this "uncertainty" is no different from the uncertainty over other common aspects of retiree medical programs—for example, participation (enrollment) in the program at retirement, percentage of retirees covering dependents, or percentage of retirees selecting various options in a multi-option program. In some cases, enrollment may be expected to be near 100% (e.g., the employer pays the Part D premium), and in other cases, enrollment may have no effect on the employer's obligation (e.g., a fixed-dollar reimbursement account). Therefore, we feel that estimates of PDP enrollment will be employer-specific, in accordance with existing FAS 106 guidelines and practice; we do not expect they will be part of any forthcoming FASB guidance, and therefore are superfluous to the FSP.
- Similarly, the FSP points out that the effect that Medicare Part D will have on employer-sponsored retiree drug plans will depend on "...the Act's macro socioeconomic effects on health care cost trends and consumers' behavior." While this is certainly a true statement, we do not expect FASB to provide guidance in assessing these effects, nor do we anticipate that plan sponsors will be better able to predict these effects until they have an opportunity to see the Part D program in actual operation. Accordingly, we feel this statement also should not be part of the FSP.
- The phrase "reflect enactment of the Act" needs to be more precisely defined so that it is clear which types of accounting and disclosures are "premature." For example, the accounting for the direct subsidy to an employer-sponsored qualified plan will require careful consideration, and to proceed with an arbitrary method at this time would probably be premature. On the other hand, terminating all post-65 drug coverage effective 1/1/2006 is a plain-vanilla plan amendment, the accounting for which is quite clear. Both of these are potential employer responses that could be interpreted to "reflect enactment of the Act."
- There are many "in-between" approaches that we would also view as plan amendments—e.g., providing a \$500 "fill-in" account for benefits not paid by other plans. Employers who choose such approaches may argue (successfully, we believe) that these amendments are being made independently of the Act, so there is no need to wait for FASB guidance. The FSP should not simply suggest that any response to the Act is "new territory" that will require employers to wait for guidance.
- We would also like clarification of the types of disclosures that are being encouraged. It seems
 clear that no APBO reduction should appear in the FAS 132 disclosure; nor should future net
 periodic costs reflect a lower service cost and APBO until (and if) such guidance is provided.
 What then would be an appropriate disclosure? Could a plan sponsor cite an expected present
 value of subsidies or PDP benefits?
- Once determined, the accounting should be made retroactive to the later of a) the date the Act was
 signed and b) the date by which any plan amendment made in response to the Act has been
 adopted by the employer and communicated to plan participants. Requiring employers to delay
 recognition until the FASB has made its decision would, we feel, produce an unfair and
 unacceptable variation between accounting periods that is inconsistent with the underlying
 financial fundamentals.
- In the case of employers who a) intend to sponsor a "qualified" drug plan and b) currently operate
 a plan that satisfies the requirements for qualification, it would be appropriate for the accounting
 to be retroactive to the date the Act was signed, since no plan amendment would be required for
 the financial benefits to be realized, and no change in the substantive plan (from the participants'
 perspective) has occurred.



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- If the FASB agrees that retroactive accounting is appropriate, it should advise employers of this as
 soon as possible (ideally, in the final FSP), even if the details of the accounting are still being
 developed. This will permit many employers to make benefit decisions based on long-term
 business and human resource goals rather than on the maximum obtainable accounting benefit in
 the upcoming year.
- Although different responses to the Act (e.g., qualified plan versus PDP) may deserve different
 accounting treatment, we ask that FASB closely examine the long-term underlying economic
 value of the Act's provisions and ensure that if two different responses have similar fundamental
 value, the accounting impact for those two responses will be similar as well.
- And finally, we ask that FASB deliberate these matters quickly, so that employers can proceed
 with a higher degree of confidence.

Thank for your consideration of our comments. If you have any questions, please feel free to contact us.

Sincerely,

Stuart H. Alden, FSA, MAAA, FCA FAS 106 Resource Actuary Watson Wyatt & Company

Stu.Alden@WatsonWyatt.com

