LETTER OF COMMENT NO. 157

AMERICAN FAMILY INSURANCE GROUP

6000 AMERICAN PARKWAY . MADISON WI 53783-0001 . PHONE: (608) 249-2111

May 31, 2006

Technical Director
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Re: File Reference No. 1025-300

Dear Technical Director:

American Family Insurance Group (American Family), based in Madison, Wisconsin, is a group of property and casualty and life insurance companies operating in 18 states with premium volume in excess of $6 billion annually.

American Family appreciates the FASB's attempt to improve the understandability and representational faithfulness of the defined benefit pension and postretirement plan amounts reported on employers' financial statements. However, we respectfully offer our comments below for FASB's consideration while completing the final draft of the accounting standards and in anticipation of the connection with Phase I of the FASB project to Phase II coming in future years.

<u>American Family's General Comments / Recommendations to the FASB</u>
American Family is extremely concerned about the broad impact of the changes in the FASB exposure draft. As written, long-standing accounting provisions to smooth annual expense and surplus volatility will be eliminated causing great distress on American corporation balance sheets as well as distress to the viability of America's pension plans. It is American Family's belief that pension accounting should rely greatly on the actuarial sciences and the inherent estimation within that profession. It is therefore imperative for FASB to avoid mandating an accounting method that attempts to be too refined and overly accurate. American Family believes the pension accounting rules should strongly employ the spirit of broader actuarial estimates, methods and techniques.

While we understand the important benefits of merging to international accounting standards, we see no reason to rush to that merger at the expense of the health of the United States pension plans. Faster implementation and no phase-in result in a tremendous charge to surplus. According to a study by Towers Perrin, Fortune 100 companies sponsoring defined benefit plans would have been required to recognize a *liability of $331 billion on their balance sheets at year end 2004, instead of the $62* billion actually reported. The proposed rules will put even more pressure on U.S. companies to abandon pension plans. At a minimum, we think a later effective date and phase in will accomplish the long term change goals of the international community yet preserve an acceptable transition for some U.S. pensions. However, American Family offers FASB the following specific recommendations that would be more broadly acceptable to American employers:

1 – Merge Implementation of Phase I with Phase II – Phase I, as laid out in the FASB exposure draft, calls for full recognition of the PBO and elimination of any previous and future smoothing of the effect of asset returns different than the assumed rate, plan amendments, and assumption changes. FASB further explains that detailed consideration of pension accounting will be considered in Phase II which will occur years later. American Family believes that FASB has put the cart before the horse.

Making the Phase I changes now before fully reconsidering pension accounting in its entirety is really quite unbelievable. Phase I essentially adopts UK pension accounting, which is probably the most conservative method conceivable. Once adopted in Phase I, employers will continue to argue for reversal of certain aspects of the approach in Phase II. Are we to believe that once adopted, FASB will agree that it overextended itself in Phase I and give something back to corporate America? Or are we to believe that FASB never really cared what corporate America thinks in the very first place by implementing Phase I before a completed study occurred? The Phase I changes are so dramatic and actually catastrophic to many companies and pension plans that it is imperative that all pension accounting issues are reexamined before any substantive changes are made to pension accounting rules.

2 – Phase-in of Cumulative Effect Over Time - At an absolute minimum, FASB should recognize the extreme difficulty the full recognition in the exposure draft places on corporate America and phase in the cumulative effect over a substantial period. Pension accounting rules have been evolving for a very long time. Why should FASB unnecessarily force this huge cliff event now? Spreading the cumulative effect accomplishes the objective of bringing current year reporting under the new FASB rules but at least offers some much needed corporate and pension plan relief and the ability of the employers to have time to adjust their product prices and operations to accommodate the huge balance sheet effects.

3 – Alternatives to Full Recognition of the PBO – Full recognition of the PBO is a very dramatic change for most ongoing plans. American Family believes FASB should further consider several options towards softening the effect of this change. There is an undeniable fact that employers may at any time, and in fact often do, reduce benefits in the future or freeze pension plans. So it is also undeniable that any employer has only committed to paying a future pension based on current salary regardless of present plan language that allows for increases in future considered compensation. Therefore, there is a strong argument that the ABO is the only true liability at any reporting date.

Relying on the PBO employs substantial prediction of future corporate promises that may or may not happen. In actuality, there is a certain probability that they will occur or won't occur – but certainly not 100% that the PBO is the right measure. Certainly that is the case in today's fast-moving world away from pension plans. And whatever the probability, the costs of future salary increases need to be matched with the accounting periods in which the company incurred the higher salary and agreed to extend the provisions of the pension plan one more year. In light of the substantial questions about whether PBO is the real weighted-average liability of a plan and whether the ABO is the better measure, American Family recommends several alternatives to full PBO recognition:

3A – Adopt the ABO (Our Preferred Alternative) – The ABO is the only liability that is promised as of any reporting date and recognizes that a pension plan is only an annually renewable promise. There is no long term promise or obligation whatsoever.

3B – A Percent of the Current PBO – In recognition of the substantial probability of a liability less than the PBO, the current PBO could be factored down.

3C – Maintain Some Asset/Liability Smoothing – Another alternative that would substantially help one-time and annual volatility would be to tighten, but not eliminate, the current asset/liability smoothing rules. Currently, asset performance different than assumed, plan assumption changes and plan modifications are put into deferral buckets. Some amortization of these items are required if they are greater or less than the 10% corridor of the PBO or of the value of assets. FASB should consider continuing this methodology but to shrink the corridor and perhaps shorten the amortization period.

4 – Relief for the Discount Rate – American Family strongly believes that the current discount rate methodology used by FASB is not appropriate. First, it assumes that the entity must go to the securities markets and obtain high-rated corporate bonds at the current reporting date to fund its future obligations. This is an unnecessarily conservative approach because few employers are ever forced to, or elect to, securitize their obligations in this fashion. The exercise to use the present discounting method lends itself to much volatility from year to year as the current interest rate environment for corporate bonds shifts. And the volatility can go both ways. Recently current rates at reporting dates have been relatively low. But the reverse could be true and has been true in past years.

It's important to emphasize that since very few plans ever securitize, the current discount rate only serves as a measuring device to ensure uniformity among companies – it does NOT more accurately reflect the actuarial long term liability of the plan.

It seems entirely inconsistent to require the actuarial assumption of future salary increases and an ongoing pension plan on the one hand, and yet require a discount rate that basically assumes the plan is either terminated or frozen and therefore securitized. Also, the current discount rate basically ignores the assets in the trust or assumes that the trust assets will only yield the high-rated corporate bond yield. This is just unnecessarily conservative based on long term established investment history of equities. Alternatives for discount rate relief:

4A – Utilize the Investment Rate of Return Assumption as the Discount Rate (Our Preferred Option) – American Family understands FASB's reluctance to use the investment rate of return as the discount rate because it is a rate of return only expected and not actually able to be guaranteed at the reporting date. But the entire pension plan valuation exercise is a series of actuarial estimates of many non-guaranteed factors over a very long term. Booking a liability today based on future non-guaranteed salary growth is a great example of this. American Family believes that if FASB decides to use the PBO to value liabilities, it is then emphasizing the very long term existence of the plan and its present plan language. To be consistent, FASB should also emphasize the very long term returns of pension plan assets that can reasonably be assumed to occur in the future and use that expected yield as the discount rate. However, should the plan reach a high level of probability that it will need to be securitized, using the current corporate bond discount rates as the discount rate would then be appropriate.

The reporting of the PBO clearly requires the current recognition of future salary increases which are controllable by the company and don't clearly represent a current obligation. So it is American Family's sincere belief that using the pension trust asset assumed rate of return as the discount rate is a good balance against the very conservative policy of requiring PBO recognition and results in a fair and transparent reflection of the pension liability.

Conversely, if FASB decides the ABO is the correct measure of plan liabilities, then the present discounting method is a much better match. The ABO is the current liability closely akin to a plan termination or a plan freeze concept. Securitizing this fixed liability with current market bond yields would be a good measure and match.

Reporting the highest potential pension liability, the PBO, and using a very volatile discount rate is causing an intolerable reporting environment for employers and causing much movement away from pension plans. The social result of this could be catastrophic over the long term. Companies continuing pension plans in this reporting environment (Great Britain) have tended to migrate their trust investments to bonds to reduce the reporting volatility. Yes, they are even willing to sacrifice the long term yield advantage of equities in favor of the expense stability. That alone could cost companies and employees a lot over time. However, utilizing a long term average trust asset rate of return for the discount rate will bring stability to the discount rate and will help ensure some much needed stability to the annual pension expense. It should also help companies to maintain a healthy amount of equities in their pension trusts.

4B – Utilize a Discount Rate Reflective of the Long Term Average of Corporate Bonds – Rather than subjecting corporate America to the needless annual fluctuations of the current reporting date yields of corporate bonds, allow companies to determine the discount rate using long-term averages for all durations of liability. FASB or another entity could even publish the rates by liability duration to be used. Needed consistency between entities would be assured and another variable of volatility would be largely eliminated. Without this change, the discount rate could be the greatest source of annual pension plan liability volatility.

FASB commented on using an averaging technique to smooth potential year-to-year changes in the discount rate in paragraph 201 of FAS 87. FASB rejected the idea that material changes in long-term rates should be ignored solely to avoid adjusting assumed discount rates. We believe using an averaging technique does not ignore material changes in long-term rates. Rather, the averaging technique merely smoothes the material changes, allowing companies the opportunity to deal with the material changes in a more reasonable manner, and more importantly, consistently between entities.

FASB also commented on the use of a common discount rate in paragraph 196 of FAS 87. At the time, FASB considered a common discount rate inappropriate because no readily available rates seemed fully suitable. We feel in today's world, normalized averages of long term rates by duration could be published by FASB or some other regulatory body. This would ensure consistency and accuracy across all employers.

5 – Maintain 5-Year Asset Performance Amortization – Both FAS87 and IAS19 contain provisions to spread pension plan trust performance different than assumed over several years. We support a continuation of this actuarial long term way of viewing the plan. Smoothing the year to year variability in asset performance is an effective way of saying that the average performance in any 5-year cycle will tend to be close to the long term rate of return assumption.

Responses to Specifically Requested Issues

American Family's comments on the specific issues raised by FASB are as follow:

Issue #1: Do you agree that implementation of the proposed rules do not require information that is not already available, which would make the costs of implementation not significant?

We agree the information needed to implement the proposed rules is largely available, and this makes the costs related to gathering or computing the information tolerable. However, we feel there are other costs that should be considered. FASB acknowledges in the exposure draft that there would be one-time costs associated with the proposed rules, which are as follows:

- costs to implement changes in systems and processes used to gather data for measurement assumptions
- fees paid to external consultants involved in the measurement of benefit obligations or the valuation of plan assets
- fees paid to external auditors to audit the results of the proposed rules
- the costs of training Executive-level management and accounting management and staff on the proposed rules

FASB believes the ongoing benefit resulting from the proposed rules will exceed these one-time costs. However, we feel that at a minimum, extending the effective date of December 15, 2006 would help companies manage these one-time costs while still allowing for FASB's desired benefit of the proposed rules.

We also believe the proposed rules will trigger companies into reevaluating and changing their current pension plans. This extensive work will involve the use of external consultants, and has the potential for significant costs. These costs should be included with the cost of implementing the proposed rules. In addition, we feel there are social costs that should be considered. A survey by Pricewaterhouse Coopers shows 38% of companies with a defined benefit plan have made a change over the past three years. Of these companies, 67% have frozen their plan to new hires. The proposed rules have the potential to continue this trend at a higher rate. While these social costs can not be easily measured, we feel they still need to be considered.

Issue #2: Are there specific implementation issues associated with the requirement to align the plan's measurement date with the financial statement date?

American Family already aligns the plan's measurement date with the financial statement date and therefore offers no comment on this issue at this time except to say that if certain less marketable assets were in our pension trust, a 12/31 measurement date may be intolerable.

Issue #3a: Should the Board provide an impracticability exemption related to the assessment of the realizability of deferred tax assets?

American Family believes it is reasonable to include this exemption.

Issue #3b: How would this standard impact contractual arrangements other than debt covenants?

American Family has Executive and employee bonus plans which are calculated, in part, on return on equity (ROE). The proposed rules would affect these bonus plans. The current required pension and postretirement benefit disclosures are not considered in the calculation of these bonuses. The current required recognition of a minimum pension liability is considered in the calculation of the bonuses as it is recognized.

Issue #4: Are there specific impediments to implementation that would make the proposed effective date impracticable for public companies?

American Family is a nonpublic company and therefore offers no comment on this issue at this time.

Issue #5: Do paragraphs 7-13 of the proposed Statement provide appropriate guidance for entities that do not report Other Comprehensive Income?

This issue does not apply to American Family and we offer not comment at this time.

Thank you for the opportunity to provide our comments, concerns, and recommendations on this exposure draft. Please contact me if you have any questions or would like to discuss our concerns in more detail. My email is dharris@amfam.com and my phone is 608-242-4100, extension 30011.

Respectfully,

Dan Harris, CPA
Tax Director
American Family Insurance
6000 American Pkwy
Madison, WI 53783-0001