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LETTER OF COMMENT NO. //

May 2, 2008

Mr. Russell G. Golden

Director of Technical Application and Implementations Activities File Reference: Proposal FSP FAS 132(R)-a

Financial Accounting Standards Board

401 Merritt 7

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**Subject:** Proposed Financial Accounting Standards Board Staff Position 132(R)-a: Amendments to SFAS #132(R): Employers' Disclosures About Pensions and Other Postretirement Benefits

Dear Mr. Golden:

On behalf of Mercer<sup>1</sup>, we appreciate the opportunity to comment on this proposed FSP.

We applaud the FASB's decision to provide financial statement users with more thorough information about pension and other postretirement (collectively, "retirement") plan assets and their associated risk. The proposed FSP is a good initial step, but we believe certain aspects of the proposed FSP should be adjusted in order to provide the most useful information in a cost-efficient manner.

Our letter consists of a number of general comments followed by responses to the specific questions outlined in the RFC.

#### **General Comments**

We believe the most useful aspect of these disclosures will be providing information necessary to assess financial risk to the plan sponsor. As such, "significance," as used in the FSP, should be qualitatively defined in relation to the plan sponsor's statement of financial position, not the plan's assets. Thus in general, if the retirement plans pose a significant risk to the employer, the footnotes should discuss how that risk is being managed with emphasis on significance to the employer, not to the pension plan. For example, Mercer analyzed the 365 companies in the S&P 500 with reported retirement plan assets in 2007, and determined that the median ratio of pension assets to corporate assets was 8.8%. 2 Segregating retirement assets into extensive categories, many of

Mercer is a leading global provider of consulting, outsourcing and investment services, with more than 25,000 clients worldwide and approximately 10,000 in the United States.

For 75% of the companies total pension assets are less than 20% of total corporate assets.



Page 2
May 2, 2008
Mr. Russell G. Golden
Financial Accounting Standards Board

which are not significant to the employer's operations, may not provide cost-effective, useful information in situations where the plan does not pose significant financial risks to the employer.

- We applaud FASB's goal of principles-based reporting. However, the US environment forces reporting entities and their auditors to create rules so that they can avoid litigation costs. We recommend that the final FSP clearly permit management to exercise judgment over the determination of "significance" and allow auditors to accept those judgments without creating "worst-case" rules that would protect them but cause unnecessarily detailed reporting.
- Similar to the discussion about asset categories, "concentrations of risk" should be clearly focused only on those concentrations of risk that are potentially significant to the employer, and not every narrow concentration of risk within the retirement plans. This issue is described more fully in our response to question 3.
- As noted in our answer to question 6, we are greatly concerned that adding this
  complexity this year will overload employers and trustees that will already be struggling
  with timely gathering of the asset data necessary to comply with new measurement date
  rules.

## **Comments on Specific Questions**

- 1. We believe the principle of disclosing categories by type of plan asset is understandable. However, one must be careful not to require reporting so much information that the bigger picture is indiscernible.
- 2. We are concerned that the asset categories enumerated in the FSP will prove difficult to delineate and do not necessarily describe risk well. As such, we have created an alternative list that may serve as a useful starting point for your continuing discussions:
  - Cash and cash equivalents
  - Publicly traded equities
  - Investment grade debt instruments (whether corporate, government, or asset-backed)
  - Non-investment grade debt instruments (high yield bonds, distressed debt)
  - Commodities
  - Hedge funds
  - Private equity (venture cap, LBO, mezzanine, special situations)



Page 3 May 2, 2008 Mr. Russell G. Golden Financial Accounting Standards Board

- Private real estate and other private real assets (real estate, infrastructure, timber)
- Annuity Contracts held in an insurance company's general fund
- Other

Plan sponsors should be able to combine and/or add categories based on their overall assessment of materiality and significance to the employer's operations as a whole.

We believe that these categories more explicitly describe riskiness of investments, rather than mere classifications. A few notes on the above list:

- We do not distinguish between government and non-government debt instruments. While some government bonds, for example, US Treasuries, are considered very low risk, the same is not true of all government bonds. Lumping all government securities of widely varying risk into one pool camouflages the riskiness of the portfolio.
- Our classification provides no information as to the currency in which the asset is denominated, a potentially key element of risk. However, we do not believe the value of this information would be worth the cost of greatly multiplying the number of potential categories.
- With respect to derivatives, we believe useful information includes a qualitative explanation of the types of derivative contracts used, the objectives, context, and strategy for their use, and the effects they are expected to have on the portfolio and funded status risks. Plan sponsors could say "we use a series of LIBOR swap contracts to hedge 80% of the dollar duration in our liabilities," but they shouldn't have to list out the notional value of every swap. This would provide investors with more useful information than merely providing boilerplate information on derivative contracts.
- Guidance may be needed as to the classification of hybrid assets such as preferred stock, and it should be acknowledged that ultimately plan sponsors may need to use some discretion in the categorization of some asset classes.
- 3. The requirement to disclose concentrations of risk would be understandable and the information may be useful if it were presented within the proper context of risk to the employer. However, we believe it is important to differentiate "concentration of risk" from concentration of plan investments in an asset category or sub-category. The proposed FSP includes examples of investments in a single entity, industry or commodity, which probably do pose a concentration of risk; and investments in a single country or investment fund, which in many cases do not. The latter can either increase or decrease overall riskiness. For example, fully investing in a fund of US Treasury securities could be



Page 4
May 2, 2008
Mr. Russell G. Golden
Financial Accounting Standards Board

viewed as lessening of risk. More importantly, an investment strategy under which the sponsor invests entirely in fixed income securities that match the duration of plan liabilities is not concentrating employer risk, but minimizing it. Again, risk needs to be considered in the context of the entire company, not just the retirement plan(s).

- 4. Fair market value of assets is already disclosed. However, disclosing asset categories and position within the fair value hierarchy will provide useful information in assessing risk levels and the reasonableness of the expected rate of return assumption as long as the assets are categorized by risk. Significance is defined in terms of the sponsor's balance sheet and there is a significance threshold for splitting out each level in the fair value hierarchy.
- 5. The required disclosures will create additional costs in at least the following three areas:
  - A. Adjusting the trustees' computer systems to track the necessary information. In general, this is out of the scope of our expertise, but we would note:
    - Large, sophisticated trustees can probably make the necessary changes in a more cost-effective manner than small trustees, particularly those outside the US who have little dealings with US GAAP.
    - ii. The breakdown of information shown in paragraph 9(b) may be problematic, depending on how the paragraph is interpreted. We do not see the value associated with separating actual returns between assets sold and assets held, and the software changes necessary to get that information could be significant.
  - B. While most of this information would be prepared on a plan-by-plan basis by trustees, many clients hire us to aggregate the individual plan information and draft the footnote. The process of aggregating, particularly across countries, when various trustees may categorize assets differently, will be onerous, and the development of systems to handle all of the various permutations will be time-consuming and expensive.
  - C. Where assets are held by multiple trustees in pooled asset accounts, the process of "looking through" those pools on an aggregate level to assess concentrations of risk cannot be done by a trustee with partial information, and the employer may not have the skills or information to do so. In these cases, an employer would have to spend money to either aggregate the information themselves, or to have an outside expert do it for them.



Page 5
May 2, 2008
Mr. Russell G. Golden
Financial Accounting Standards Board

6. In general, we believe the effective date is a year too early. Plan sponsors with one plan may well have little difficulty complying by December 31, 2008, but sponsors with multiple plans, particularly those with differing geographies will struggle. In those instances where we might play a role, making sure that computer systems are reprogrammed and thoroughly tested that quickly may be challenging.

In addition we would point out the significant frustration experienced last year by plan sponsors trying to get asset information (and by actuaries trying to finish net liability calculations and footnote disclosures) on a timely basis. The burden will be more difficult this year when essentially all companies will be required to use an end-of-year measurement date, and adding another layer of complexity at this point will add to the frustration and potentially decrease timeliness and accuracy of the financial statements. This will be of particular concern for those companies with level 2 and level 3 assets.

Lastly, the paragraph 9(b) of the proposed FSP requires a beginning to end-of-year reconciliation. This will require keeping track of transactions during the year. It seems to us that to gather the information necessary to prepare such a reconciliation, the necessary computer systems will need to be in place before the beginning of the year this requirement becomes effective. That would imply that this aspect of the proposed FSP should not be effective until years ending at least a year after the date of issuance, plus some time to allow trustees to complete the systems work.

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We appreciate your consideration of these comments. If we can provide any additional clarification or assistance, please call Jim Verlautz at 612 642 8819 or Steve Alpert at 212 345 8566.

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