



LETTER OF COMMENT NO. 38



Moody's Investors Service

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Via Electronic Mail: director@fasb.org

File Reference: *Proposed FSP FAS 132(R)-a*

Dear Mr. Golden:

Moody's Investors Service (Moody's) appreciates the opportunity to provide the Financial Accounting Standards Board (FASB) our views on proposed FASB Staff Position (FSP) FAS 132-a ("proposed FSP"). Moody's is among the world's most widely utilized sources for credit ratings, research and risk analysis. Moody's ratings and analysis track debt covering more than 12,000 corporate issuers globally, including approximately 900 U.S. companies that sponsor defined benefit pension plans. The financial statements and related footnote disclosures prepared by the companies we maintain ratings on are a critical element of our analysis. Accordingly, the views presented in this letter are from the perspective of a user of financial statements.

We agree that existing standards governing disclosures of postretirement benefit assets fail to accurately and transparently reveal employers' exposure to pension asset risk. Some of the disclosures suggested by the proposed FSP could provide important new information for financial statement users. We also have some suggestions for additional disclosures, not discussed in the proposed FSP, which we believe could further assist financial statement users in assessing the risks inherent in a company's investment strategy for its pension assets.

The importance of improved disclosures about pension assets has been very evident in our recent interaction with both investors and companies. On many occasions investors who subscribe to our research have asked about our views on how pension funding will be impacted by the current market turmoil and which companies' pensions are exposed to

subprime related risks. And, several companies have approached Moody's analysts to discuss how "de-risking" pension investments would impact our view on a company's overall risk profile.¹ Current disclosures about pension assets are generally not particularly helpful in addressing either set of questions.

Our experience supports the Board's research findings and other financial statement users' concerns that many, if not most, companies solely provide the percentage of the fair value of total plan assets represented by the broad categories of equity, debt, real estate and other investments. It is virtually impossible to assess the possibility of sudden underfunding due to poor asset performance or how pension investment strategies impact a company's overall risk profile without incremental granularity in disclosures about the types of assets held and concentrations of risk. We believe the Board's proposal will improve financial statement users' ability to make these assessments.

In our opinion the biggest risk to companies sponsoring defined benefit pension plans is sudden, unexpected underfunding due to changes in interest rates (obligation risk) or poor asset performance. Understanding this risk is critically important for companies with significant defined benefit plans and financial covenants in debt instruments (or other obligations) that are tied to equity or net worth. We believe current disclosure requirements are sufficient to allow users to assess how changes in interest rates could impact pension obligations. However, additional disclosure is needed to help users to assess risks inherent in pension assets.

Asset categories

The proposed FSP, as currently drafted, states that companies disclose "each major category of plan assets as of each annual reporting date for which a statement of financial position is presented." The proposed FSP further lists out categories of assets which should, at a minimum, be disclosed. It would appear that the proposed FSP is recommending a principle for asset disclosure, while at the same time prescribing rules on how to apply that principle. We strongly support more detail in the disclosures about the different types of investment vehicles pension assets are allocated to. However, we are concerned the compliance mindset of many companies could actually lead them to try to fit all of their investments into the list included in the proposed FSP. With the dearth of complex securities in the marketplace, many may not fit neatly into a prescribed list asset classes. Confusion over which securities should be classified into what category could lead to issues of non-comparability. If the proposed FSP were issued as currently drafted

¹ See Harvard Business Review article: "*You Have More Capital Than You Think*" (November 2005) by Robert C. Merton for further discussion of one theory about how the investment of pension assets can impact a company's risk profile.

we envision many companies would be more concerned with mechanically complying with the standard rather than giving useful, transparent information to the user.

We believe that a principle of disclosing plan assets based on how management organizes, deploys and manages assets would be more useful to users of financial statements. We believe such a management approach will: a) be easier for companies to implement as the majority of the required data is currently available; b) will give insight into how management views and manages plan assets and; c) may give more insight into concentrations of risk than using a purely prescriptive approach. Again, internal plan reports are likely tailored to enable management to assess concentrations of risk. Criteria for the aggregation and disclosure of plan assets could be similar to the management approach used in FAS 131 *“Disclosures about segments of an Enterprise and Related information.”*

We do recognize that using a management approach to identifying and disclosing plan assets will lead to comparability issues. However, we believe the insight into how management assesses plan assets and risks will be more useful than requiring companies to fit square pegs into round holes.

Measurement and disclosure of asset performance risk

We acknowledge that any additional information regarding asset categories and concentrations of risk will be of benefit to users. However, we believe that disclosing asset classes and concentration of risk is only half the story in illuminating asset performance risk. The risk in each asset class must be quantified to allow the user to fully assess overall asset performance risk. Just disclosing asset class may mislead the user and result in incorrect conclusions. For example, consider two hypothetical portfolios comprised entirely of corporate debt securities. The first portfolio is comprised of Aaa-rated securities while the second is comprised of high-yield securities. Under the proposed disclosure requirements, both portfolios would be disclosed as corporate debt securities, but the user would be unaware of the additional default risk inherent in the second portfolio.

We suggest that the final standard require companies to disclose what risks the asset class is exposed to and how the company quantifies those risks for its internal purposes. Such quantification is relatively easy for fixed-income securities, which carry two main risks: interest rate risk and default risk. Both these risks can be quantified using measures such as duration and credit rating.

We do recognize that it will be more difficult to quantify risks in other asset categories. Equity securities, for instance, have many different and distinct risks which would be hard to succinctly disclose in financial statements. We therefore suggest that companies be required to disclose the internal quantitative measures they use to assess and manage asset performance risk in the different asset categories. In the case of equities, many companies measure and track asset performance risk using a benchmark index factoring with an allowance for tracking error (tracking error describes an acceptable percentage by which the plan's performance may deviate from the benchmark index). For example, consider two plans funded entirely with equity securities. Assume that one plan's investment manager measures asset performance and risk against the S&P Smallcap 600 index with a tracking error of 10%, while the other uses the Dow Jones Industrial Average as a benchmark with a tracking error of 2%. Under the proposed FSP both portfolios may look identical but the first plan is clearly exposed to a larger degree of performance risk. Obviously this information would be extremely useful and relevant information to the user when assessing asset performance risk.

We accept that it will be impossible to arrive at standard quantitative measures to allow pension asset risk to be directly comparable between companies. We once again believe that some form of management approach be used when assessing which risk measures should be disclosed. We believe that requiring disclosure of quantitative measures of asset performance risk will not entail much, if any, additional effort or expense by plan sponsors as pension plan managers will already be collecting and using this data for internal purposes.

Fair value measures

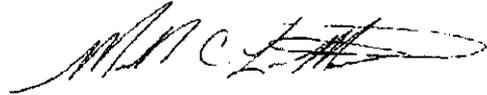
We agree that requiring companies to disclose information that enables users of financial statements to assess the valuation techniques and inputs used to develop fair value measurements of plan assets would be useful in assessing the subjectivity of those valuations. However, we categorize Statement 157 disclosures related to pension assets as a "nice to have", rather than a "need to have", for purposes of evaluating company's pension asset risk. If companies demonstrate that the cost of providing these disclosures is considerable, we recommend this requirement be eliminated from the final FSP.

Mr. Russell G. Golden
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We would be pleased to address any questions you may have regarding our comments or discuss our position at your convenience.

Sincerely,



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