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Mr. Russell G. Golden
Director of Technical Application and Implementation Activities
Financial Accounting Standards Board
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LETTER OF COMMENT NO. 18

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

Dear Mr. Golden:

We are pleased to comment on the FASB's March 18, 2008 Proposed FSP FAS 132(R)-a, *Employers' Disclosures about Postretirement Benefit Plan Assets*. Watson Wyatt & Company fully supports the FASB and its standard-setting process, and appreciates the ability to participate in the process by submitting comments on the proposed changes.

Watson Wyatt & Company is a multinational benefits, actuarial, and investment consulting firm. We provide actuarial and investment consulting services to sponsors of over 2,000 defined benefit pension plans or other postretirement benefit plans. As a result, we are keenly interested in all proposed changes regarding postretirement benefits accounting. We have prepared our response with input from others in the firm, both from the U.S. and internationally.

We fully support the FASB's desire to require additional disclosure information about the assets held in postretirement benefit plans and their related risks. We also support the concepts and structure that the FASB has defined in the Proposed FSP.

Our main concerns with the Proposed FSP are related to: 1) how much time and work will be required to implement the proposed changes, and 2) the short amount of time plan sponsors will have to gather and prepare this information on an ongoing basis. We believe these concerns are both real and significant and that the FASB will need to consider alternatives in order to achieve their overarching objective in a manner that does not put undue burden on plan sponsors.

Our responses to the specific questions posed in the Proposed FSP and certain other comments are discussed in the Appendix to this letter. If you have any questions concerning our comments, please contact Alan Glickstein at (214) 530-4538 or John Steele at (203) 977-6256. Thank you for considering our comments.

Sincerely,

Alan R. Glickstein
National Practice Leader for Policies and Processes

John D. Steele
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APPENDIX

Question 1

Is the principle of disclosing categories by type of plan assets understandable?

Yes, we believe the principle of disclosing major asset categories is understandable when one carefully reads paragraph 6 and paragraph A4 of the FSP. In addition, we would like to make the following observation: since the Proposed FSP does not provide any thresholds or guidance about what constitutes a major asset category, we expect that considerable scrutiny will be given to the example provided in paragraph B1e.

Based on this example, one might note the following:

- 1) There is no longer an “other” category, which implies that all plan assets need to be allocated to one of the major asset categories. Determining which asset category a particular investment belongs to is not always easy, given the wide array of investment products that are available in today’s marketplace.
- 2) The smallest asset category “Diversified corporate bonds” consists of only 2.3% of the total assets. This is a fairly low allocation to be considered a major asset category. Does this suggest a potential threshold or is this merely the amount associated with a required category?
- 3) The asset category “Diversified U.S. equity securities” has a footnote that says a portion of these assets are invested in REITS (about 4.9% of the total portfolio), yet this was not identified as a major asset category. Does this suggest a potential threshold?
- 4) The asset category “Common stock of U.S. public utilities” has assets that include about 14.7% of the total portfolio and is not a required major asset category. Does this suggest a potential threshold?
- 5) Footnote (c) states that “This category includes interest rate derivatives in an asset position”. This footnote does not appear to be required under the Proposed FSP. Presumably, this statement implies that all of the interest rate derivatives are in an asset position and not just the total net position is in an asset position.

Question 2

Are the asset categories that must be disclosed, if significant, representative of the types of assets held in postretirement benefit plans? Should any other categories be added?

We generally believe that these asset categories are representative of the types of assets held in postretirement benefit plans. We were somewhat surprised that the FASB identified multiple debt categories as required, yet only one equity/stock category. As a result, we do believe that



much discussion will occur about whether or not a particular equity category (like emerging markets or small caps) should be separately identified as a major asset category. We believe some statement or guidance about the FASB's intent on this topic would be helpful.

We also believe that assets held in "insurance contracts" should be required as a separate asset category. Certain countries outside the U.S. (like The Netherlands) often invest a significant portion of their assets in insurance contracts that are deemed to be owned by the plan. We think it would be worthwhile to explicitly require this as a separate asset category.

We also think that the asset categories identified in the FSP presume that the assets have been invested in separate or segregated accounts. However, many postretirement benefit assets (particularly those outside the U.S.) are invested in pooled or commingled accounts. When assets are invested in these types of accounts, the investment information that is required to be provided to investors is largely regulated by local authorities (like the SEC in the U.S.) and is not aligned with the proposed asset disclosure requirements. Furthermore, these funds usually hire their own custodian to value the assets that they hold. Thus, a request from a plan sponsor to provide additional detailed asset information as of their fiscal year-end will be viewed as a special request that must be addressed to the fund's custodian, who has no direct connection to the plan sponsor. Therefore, responding to such a request will be considered a special accommodation and is unlikely to be handled quickly or may even be ignored. As a result, the FASB should consider requiring a separate asset category for pooled/commingled funds with a footnote that provides a general description of the asset allocation for these funds.

Question 3

Is the requirement to disclose concentrations of risk arising within or across categories of plan assets from a lack of diversification understandable, and is this information useful? Would another disclosure principle be better?

The general principle is conceptually understandable, but presents difficulties for companies to implement on a global basis. First of all, there is no threshold or guidance to help plan sponsors determine what constitutes a concentration of risk. Considerable time and effort will be required by multinational companies to try to identify concentrations of risk. Secondly, by only identifying a few examples of risk concentrations, you put a tremendous onus on the company to try to identify them. Similar to the asset categories originally identified under FAS 132(R), it seems unlikely to us that companies will look for concentrations of risk beyond the few examples that have been provided in the FSP.

In addition, asset risks are generally considered only on a plan by plan or country by country basis. The company representatives responsible for making investment decisions (for example, independent trustees make investment decisions on matters such as asset allocation and manager selection in the U.K.) are often required to work for the local legal entity and must make decisions on behalf of their plan participants. Therefore, there is often limited knowledge of the specific investment strategies used by other plans and other countries within the global entity. As a result, we believe that identifying concentrations of risk will be quite



difficult on a global basis, largely because they have not been considered in the past. While this may be why the FASB believes it is important to mandate such a disclosure requirement, it is important for the FASB to understand that this will be very difficult to implement with only a vague principle to guide companies.

Again, we would like to make the following observation: since the Proposed FSP does not provide any thresholds or guidance about what constitutes a concentration of risk, we expect that considerable scrutiny will be given to the example provided in paragraph B1e.

Based on this example, one might note the following:

- 1) Real estate and real estate related holdings were identified as a concentration of risk. We do not believe this was obvious from paragraph 7 in the FSP, although this was discussed in paragraph A5. In the example, real estate represented about 27% of the plan's total assets. Clearly this provides a threshold benchmark.

Furthermore, we cannot tell from the example how a plan sponsor should differentiate between assets that have significantly different capital allocations from risk allocations. For example, should a dollar invested directly in a fully funded piece of real estate be treated the same way as a dollar invested in a piece of real estate that is leveraged with an 80% mortgage?

- 2) The asset category "Common stock of U.S. public utilities" would appear to be a concentration of risk category defined under paragraph 7 of the FSP. This category represents about 14.7% of the total assets. Does this suggest a threshold of at least 15%? Or is this not needed to be disclosed as a concentration of risk because it has already been identified as a separate asset category? What if Company A discovered a few of their corporate bonds were issued by utility companies?
- 3) Paragraph 7 identifies one example of a concentration of risk as a significant investment in a single country. However, the example does not identify the assets invested in U.S. equities and U.S. treasury securities as a concentration of risk. This tells us that not all countries represent a significant concentration of risk. Presumably, it depends on the relative size of the specific security market in that country.

Question 4

Would the disclosures about fair value measurements of plan assets provide decision- useful information?

We believe this information would help investors identify those companies that utilize especially aggressive or especially conservative investment policies. It would also enable investors to make direct comparisons between companies, and it would provide more information about the risks to which these assets are exposed. However, we would be surprised if this information played a significant role in the decision to invest in a particular company. As a result, we do not think it is necessary to ask plan sponsors to use lots of time



and resources to gather information that is not readily available on a timely basis to complete these new asset disclosures.

Question 5

Would any of the required disclosures impose excessive incremental cost? If so, please describe the nature and extent of the additional costs.

Yes, these new disclosure requirements will result in significant incremental costs both to implement and to maintain on an ongoing basis.

Many of our clients are very concerned about the amount of time and expense that will be required to implement these proposals. The tasks include the following:

- 1) Contacting the custodian and investment managers used for each of their plans to obtain a detailed categorization of the assets held and how they are valued.
- 2) Reviewing all of the various securities held and mapping out a detailed categorization of them by asset categories and subcategories to analyze and decide which asset categories should be disclosed, to identify possible concentrations of risk, and to identify which level within the fair value hierarchy the security should be assigned. Once this is completed, the company will need to work with their custodians and investment managers to create reports that provide this detailed information.

Since there are literally hundreds of possible categories that will need to be reviewed and analyzed, this will be a very tedious and time consuming process. In addition, it will require information to be analyzed not only on a plan by plan basis but also in the aggregate for potentially dozens of plans located across multiple countries.

- 3) Creating, maintaining, and updating this asset reporting information from period to period on an ongoing basis. Once the securities have been mapped out, the plan sponsor will need to work with their custodians and investment managers to perform these tasks on an ongoing basis.
- 4) Identifying all of the asset valuation techniques used for each security or category of assets, documenting those valuation techniques, and identifying any changes to those valuation techniques from period to period.
- 5) Setting up processes to reconcile the level 3 assets as required by the FSP. There are significant concerns about the level of detail required to properly perform such reconciliation.
- 6) Identifying any derivative contracts that have a negative fair value. This will require a process to be created, maintained, and updated to identify and monitor all derivative contracts by contract type. This could be a significant task as there are often lots of derivative contracts used by fixed income investment managers.



In our experience, even the most plain vanilla fixed income portfolios actively manage interest rate risk and the duration of the portfolio using multiple derivative contracts. Plan sponsors focus on the entire portfolio and not the individual securities selected by an investment manager. Requiring each derivative contract that is in a liability position to be disclosed by type forces plan sponsors to gather and review investment information at a completely different level of detail than they do currently.

Currently, much of this data is not provided to plan sponsors. Plan sponsors are (typically) not investment experts. They will need to be reliant on their investment managers to provide this information and may have little recourse if an investment manager does not make the effort to work with the plan sponsors to provide the information needed. Plan sponsors are concerned that considerable reporting customization will be required for each plan sponsor an investment manager works with, and the information that will ultimately be available will be limited. This is a particular concern when working with non-U.S. investment managers who might have a limited number of investors that need to provide this information under U.S. GAAP.

There is also considerable concern about the availability of detailed information from hedge funds, pooled funds, and any other investment that has less frequent valuations (such as private real estate or private equity), and how quickly this information is available from these types of funds. Many hedge funds do not provide detailed information about the items they invest in and how those investments are structured or hedged. Also, many pooled funds do not provide detailed asset information more frequently than once a year and well after the year has ended. How will a plan sponsor obtain this information shortly after the close of their fiscal year-end?

It is our understanding that the proposed disclosure requirements are conceptually possible to attain for assets held in separate/segregated accounts where the physical securities are held by the plan's custodian. In most cases, the custodian values these securities and provides detailed information about these holdings to the plan sponsor. However, this information is significantly more difficult to obtain for pooled funds, hedge funds, alternative investments, and venture capital where the custodian is simply provided with a net asset value (NAV) and the number of shares owned from the investment manager. The situation is even more difficult for plans with assets held in custody in certain jurisdictions outside of the U.S., such as developing countries. In all of these situations, the custodian does not value the assets and cannot provide detailed asset information. As a result, the plan sponsor will need to get this information directly from the investment manager. These investment managers may hold assets that fall into several asset categories which will need to be identified and allocated for the plan sponsor. Many of these investment managers are not set up to provide this type of information shortly after the plan sponsor's fiscal year-end. The time required to set up these administrative processes and procedures will be extensive and will need to be done by each of these investment managers, who are outside the control of the plan sponsor.

As a result, we believe there will be a significant gap in the asset information that would be available in time to meet financial reporting deadlines on an ongoing basis, if the proposed asset disclosures are implemented. We recommend that the FASB focus on information that is



readily available to plan sponsors before year-end and is not dependent on detailed point in time information as of the end of the fiscal year. Some possible alternatives include the following:

- 1) Allow the use of asset disclosure information collected three months prior to the company's fiscal year-end.
- 2) Have different disclosure requirements for assets held in separate accounts and pooled accounts.
- 3) Allow the disclosure of a typical asset allocation to a specific asset category or asset level during the past year rather than an exact dollar amount as of year-end. For example, "During the past year, the company held pension assets that typically included allocations as follows: x% in U.S. equities which are entirely made up of level 1 assets, y% in corporate bonds which are entirely made up of level 2 assets, etc."
- 4) Allow information to be provided by investment manager or investment fund and simply require the percentage of the total assets controlled by each. Then the reader could look up publicly available information about that investment manager or investment fund to gather more detailed information.
- 5) Only require asset disclosure information for U.S. plans, until the IASB implements a similar asset disclosure requirement for non-U.S. companies.
- 6) A combination of the above alternatives.

Companies hire investment managers because they want to delegate the specific investment selection decisions and strategies to professionals. Plan sponsors simply want to select investment managers, provide investment guidelines, monitor their performance, and decide whether to keep them or fire them. They do not want to get involved with the details of security selection, hedging strategies and timing decisions – investment decisions which are defined as the responsibility of the investment manager with oversight by the plan sponsor. As a result, the information that will be disclosed will need to be gathered and provided to the plan sponsor by their investment managers or custodian. The plan sponsor has typically delegated all of the reporting and asset valuation responsibilities to these professional institutions, and the FASB needs to focus on information that is already provided by these institutions in a timely manner when it creates asset disclosure requirements.

Question 6

Is the time needed to compile the information required to support annual reporting disclosures sufficient given the proposed effective date for fiscal years ending after December 15, 2008? If not, please describe the nature and extent of the effort required and the time needed.

No it is not. More time will be required for companies to successfully implement the proposed asset disclosures. Many of the tasks required to be completed to implement these changes are



highlighted in our response to question 5 above. In particular, additional time will be required when non-U.S. investment managers are being used, as well as when pooled funds and hedge funds are being used.

In addition to the time needed to implement these changes, the proposed effective date also coincides with the effective date when many plan sponsors will be implementing a fiscal year-end measurement date. The measurement date change alone will put significant pressure on plan sponsors to meet the financial statement reporting deadlines by forcing companies to establish new procedures and processes for gathering and documenting year-end disclosure information for their postretirement benefit plans. Making changes to the asset disclosure requirements, which will also require significant planning and work to implement, will result in an unfair burden on plan sponsors.

Since it seems unlikely to us that a final statement of asset disclosure changes will be issued prior to the third quarter of 2008, we suggest a one year delay in the proposed effective date for implementing any changes. This would result in an effective date that applies for fiscal years ending after December 15, 2009.