MERCER
Human Resource Consulting

1166 Avenue of the Americas
New York, NY 10036-2708
212 345 7000 Fax 212 345 7414
www.mercerHR.com

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

Subject:
Comments on tentative decisions reached on October 13, 2004 regarding the amendment of Statement 87 for pension plans with a lump sum option

As both a user and a preparer of financial statements, as well as a provider of financial statement information to many companies, we support FASB's efforts to strengthen the value and relevance of financial information reported to those who rely on it.

However, we are concerned about the tentative decision reached by the Board at its October 13, 2004 meeting regarding the accounting for defined benefit pension plans with lump sum features. The decision calls for an accounting approach for a subset of defined benefit plans that fundamentally differs from the approach used for all other defined benefit plans (in fact the approach is different from the approach used for other employee benefits and compensation).

Our key concerns are:

- The tentative decision is not consistent with going concern accounting.
- This accounting treatment could overstate liabilities on an organization's balance sheet because additions to pension liabilities due to "walk-away" would not be matched with reductions in the liabilities for other compensation and benefits that would be forfeited when an employee "walks away."
- The tentative decision would reduce the consistency of accounting standards. FAS 87 is an internally consistent model for measuring pension obligations. The tentative Board decision to set a minimum obligation equal to the "walkaway" lump sum would overlay features from a different model on top of Statement 87. The result is a reduction in the overall internal consistency of the model, reduced comparability between employee benefit plans of different types, and less reliable and relevant information for investors and other users of financial statements.

We urge the Board to reconsider its tentative decision, and to not make piecemeal changes to the pension accounting model. Should changes in the model be desired, they should be undertaken as a whole and only in the context of an articulated, consistent set of measurement and recognition principles.

The following elaborates our concerns and provides more detail on these key issues.

Consistency with going-concern accounting

In the basis for conclusions to Statement 87, the FASB outlined some of the basic features of the pension accounting model, including:

- *"...in the absence of evidence to the contrary, accounting should be based on a going-concern assumption that, as applied to pensions, assumes that the plan will continue in operation and the benefits defined in the plan will be provided."* [para. 149]
- *"... in concept, the employer's obligation to the existing employee group is the sum of its obligations to individual employees, adjusted to reflect the present value of the amount and **probability of payment**."*[Emphasis Added] [para. 115]

Setting a minimum liability to an amount that reflects an assumption that part of the obligation is to be measured "as if" all employees terminate employment on the measurement date is inconsistent with both the going-concern concept and with the requirement that future benefit payments be adjusted for "probability of payment."

Potentially overstated liabilities

The Board's focus on the "walkaway" benefit for only some plans in only one part of the employee compensation and benefits picture will overstate total company balance sheet liabilities.

For example, consider a company that offers both pension and post-retirement medical benefits. The pension plan offers terminating participants the right to take the lump sum value of their benefits on a subsidized basis. In the pension plan, an individual (not yet eligible for retirement) might have a projected benefit obligation of $32,000 and an accumulated benefit obligation of $30,000, assuming probabilities of termination of employment at various ages and election of the lump sum form of payment. The accumulated post-retirement benefit obligation might be $8,000. Assuming no unrecognized items, the company's balance sheet would thus reflect a total obligation of $40,000 ($32,000 plus $8,000).

In this example, if the participant terminated today, he would receive a current lump sum of $35,000. However, he would not be eligible for retiree medical coverage. Under the Board's proposal, the balance sheet would reflect a total of $43,000, ($35,000 for the pension lump sum, plus $8,000 for the accumulated post-retirement benefit obligation). This liability is overstated because the employee's forfeiture of the other post-retirement benefits is a necessary condition for him to receive the immediate pension lump sum. Following is a summary of this illustration:

	Current accounting	**Full "walkaway" accounting**	**"Walkaway" for pension only**
Pension ABO	20,000	35,000	35,000
Pension PBO	32,000	35,000	35,000
Other post-ret. APBO	8,000	0	8,000
Total balance sheet (assuming no gains and losses)	**40,000**	**35,000**	**43,000**

Although it is tempting to focus on the "walkaway" amount as a measure of the employer's obligation, we note that an employee does not have a free, unrestricted right to an immediate lump sum. In order to receive the lump sum, he must give other items of value from the employment relationship: post-retirement medical benefits (as in our example here), seniority, accrued incentive pay, future compensation, medical coverage, etc. To be consistent, any reductions in liability from other factors should be recognized by the organization if the value of pension benefits is increased to reflect immediate termination benefits.

Consistency of accounting standards

The following details several instances where we believe the tentative decision is inconsistent with existing accounting standards. We believe that investor understanding and comprehension would be better served if all of the material in a company's financial statements were presented within a consistent framework.

Examples of other standards

In many other accounting standards, liabilities are measured at "best estimate," not "worst case" values. The tentative decision would impose a "worst case" model on certain defined benefit plans, making them inconsistent with both other plans and liabilities determined under other accounting standards.

For example, under Statement 106 liabilities are determined assuming that participants will retire at expected retirement ages rather than earliest retirement age or full eligibility retirement age. (And, for participants not eligible to retire, Statement 106 requires that the employer book a liability, even though the "walkaway" amount is $0.) Similarly, for pension plans that offer an early retirement subsidy, benefits are valued assuming participants retire at an expected retirement age, not at the earliest possible retirement age when the subsidy is generally the most valuable.

As another example, consider the general case of Statement 5. Certainly employee termination is probable, and an amount of liability, while not certain, can reasonably be estimated. Thus Statement 87 is, in a sense, a special application of Statement 5. Statement 5 does not require accrual of the worst cases liability unless that is the most likely estimate.

Comparability among defined benefit plans

As we noted in our comment letter of April 14 (concerning the accounting treatment for certain cash balance plans), we agree with the Statement 87 *Basis for Conclusions* that a "standardized method would improve comparability" [para. 127] and feel that applying different accounting models to different subsets of the defined benefit universe degrades comparability. In this case, pension plans that offer participants a lump sum option would be treated differently than other pension plans, reducing comparability across companies.

We note however, that plans that offer participants a lump sum option would properly be expected to make appropriate assumptions about the usage of the option and the discount rate used to convert between lump sums and annuities. For example, the lump sum option in a final average pay plan will often be calculated at a discount rate that is reasonably expected to be less than the FAS-87 discount rate, resulting in a higher value of benefits for participants who are assumed to take a lump sum in the future. Typically, the actuarial assumptions anticipate this additional value and include it in the measurement of the obligation.

Consistency with recent FASB decisions

On several occasions in the past two years, the Board has discussed, and rejected, ideas similar to making the lump sum the minimum obligation. Although we recognize that accounting theory and practice evolves over time, we have seen no facts different than those previously evaluated in developing existing theory.

For example, in the discussion of EITF 03-4, the Board specifically endorsed traditional defined benefit accounting for most types of cash balance plans, and thus specifically rejected (for those plans) setting the obligation equal to the account balance (or lump sum payable on termination of employment).

In the discussion of the revisions to Statement 132, the Board discussed and specifically rejected the addition of any new liability measurements or disclosures, including plan termination and "walkaway" values.

And, most recently, we believe that the Board's change of direction on the interpretation / amendment of FAS 87 is at least a tacit acknowledgement that the theoretical, implementation and practical difficulties of setting an account balance minimum for cash balance plans outweighed the perceived benefits of making the change.

Conclusion

In summary, we do not believe that the proposed change will enhance financial accounting or reporting. The proposed model is internally inconsistent, and will therefore result in less reliable and comparable measurements and reporting. We strongly encourage the Board to reconsider its tentative decision. If it is determined that changes in the pension and post-retirement benefit accounting model are needed, we urge that those changes be made to the model as a whole, and only with reference to a cohesive set of underlying principles.

Sincerely,

Ethan E. Kra, F.S.A., Ph.D.
Chief Actuary – U.S. Retirement Practice

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