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October 27, 2003

Mr. Lawrence W. Smith
Director, Technical Application and Implementation Activities
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

RE: (File Reference No. 1025-200) Exposure Draft of Replacement of Statement 132, *Employers' Disclosures about Pensions and Other Postretirement Benefits*

Dear Mr. Smith:

Milliman USA hereby presents our comments on the FASB's Exposure Draft of a replacement for Statement 132, *Employers' Disclosures about Pensions and Other Postretirement Benefits*.

Milliman's Interest in the Exposure Draft

As actuaries, Milliman prepares and uses organizations' financial statements. We perform the actuarial valuations for the pension plans and other postemployment benefit programs of many companies, both publicly traded and privately held, and assist employers and their accountants in the gathering of relevant information included in the financial statements. Milliman also frequently uses the financial statements on behalf of clients, analyzing, for example, an organization's financial/employee benefits competitiveness. We also review financial statements when we are engaged in clients' due diligence process for possible merger and acquisition situations.

In addition, Milliman is actively involved in policy review and development directly pertinent to the FASB's proposed Statement. For the past three years, we have analyzed the pension data included in the financial statements of the largest U.S. companies. The studies examine many of the key trends that have given rise to the concerns cited by the FASB as a major reason for proposing the Exposure Draft. Through various professional liaison groups, Milliman has been actively involved in reviewing and commenting on the understandability and appropriateness of the accounting standards relating to pensions and other postretirement benefits.

Because we are not accountants, we cannot speak directly to the issue of what should constitute generally accepted accounting practices. However, as actuaries and financial consultants heavily engaged in the preparation, use, and policy appraisal of financial statements, we offer experience and expertise that the FASB might find helpful in developing a revised Statement.

Summary of Milliman's Comments

We concur with the FASB's expressed concerns underlying its proposed Statement – that there is a need for improved pension disclosures. The disclosures provided under the current SFAS 132 can be improved without burdening preparers of financial statements.

We do not agree with demands for more extensive re-engineering of the underlying measurement and attributions methods of SFAS 87, SFAS 88, and SFAS 106. Far to the contrary, our experience with our clients and our studies of benefit disclosures in financial statements have shown that these existing standards have stood up very well to the extreme test through which they have been during the past three years.

Milliman's Specific Comments

Our specific comments are organized according to the "issues" in the preamble to the Exposure Draft.

Issue 1: Additional disclosure of information for each major category of plan assets.

Disclosure of the percentage of the fair value of plan assets invested in each major investment category is a useful item of information. The final Statement should require the disclosure of such information as of the measurement date, as clarified in Q&A 10 of the Frequently Asked Questions for this proposed Statement.

If the existing percentages of investment classes held are disclosed, then information about target allocation percentages would provide useful additional information in limited circumstances. In most instances, the target ranges disclosed would be very broad and would vary little from year to year, even after changes in economic conditions such as that which companies experienced in recent years. Because disclosure of any significant changes in plan assets would be required under paragraph 5.r. of the proposed Statement, any actual significant changes in a plan's investment strategy – for example, significant divestment in equities combined with duration-matching of liabilities using bonds – would be reported, even if the targets are disclosed, then modified according to the revised investment strategy (under 5.d.1.(b)).

The breaking down of the expected long-term rate of return for each individual asset category is not necessary and could produce misleading conclusions. Moreover, when considered in conjunction with other required disclosures, such a breakdown could indicate management's projection of a rate of return on employer stock held by the benefit plan. Although we are not experts in the appropriateness of forward-looking statements, we believe that such a projection would be contrary to the Securities and Exchange Commission's position of guarding against projections that could mislead investors.

In a normal situation, the determination of the long-term rate of return considers a portfolio's current and future characteristics in the aggregate. Such an analysis takes into account average rates expected to be earned on existing fund assets, assets anticipated through reinvestment, and anticipated contributions, as required by paragraph 45 of SFAS 87 and paragraph 32 of SFAS 106.

Looking at current and future investments in the aggregate will frequently involve consideration of investment class correlation coefficients that may increase combined expected returns for certain aggregations while decreasing the combined expected returns for other aggregations, as would commonly be expected of hedging, a balance fund, or other investment strategies. Because the long-term rate of return assumption also considers the future investment of assets, the selection of the rate must take into account factors that would not be immediately evident from the disclosure of investment class returns in an isolated context that only considers the current allocations. This reflection of investment class correlations and future expectations, considered in the context of other factors relevant for the aggregated investment, would rarely and only coincidentally produce the same results or lead to the same conclusions as the building-block approach that the proposed Statement would imply. Quite simply, the proper mixture and diversification of asset classes that have appropriate characteristics when integrated produces a different expected long-term rate of return in the aggregate than that which is obtained by adding together a weighted average of the expected return of individual asset classes. Disclosing individual rates for the separate classes would, therefore, produce more confusion and potentially misleading information.

Additionally, as previously noted, we are concerned about the signals to the market that would be produced if one of the asset classes is primarily the plan sponsor's own stock, since the amount of the employer stock itself must be disclosed. The more component parts disclosed under the expected rate of return, the more likely that information about the company stock could be extracted. We do not believe that pension and other postretirement benefits disclosure is the appropriate venue for a corporation's management to publicly speculate on the expected long-term rate of return on the company's financial results.

Milliman does not believe that the disclosure of the range and weighted average of the contractual maturities of debt securities would be useful under general circumstances. Nearly all pension fund assets are actively traded and have a mixture of both debt and equity instruments. The fact that the debt securities have a particular weighted average maturity today does not mean the pension fund will hold those securities and realize the cash flow as described. Much of the cash flow required for the payment of benefits comes from ongoing contributions and the trading of equities, although a limited number of pension funds have debt securities that match the needed cash flows for benefit payments.

For the few cases where the investment philosophy is to match durations of the obligations and debt securities, disclosing maturity information might be appropriate. However, the weighted-average maturity is not the appropriate metric to determine if the assets and liabilities are properly matched. Instead, the duration of the assets, along with the duration of the matched liabilities, would be much more meaningful. Without the information on the duration of the matched liabilities, the information of the duration of debt securities is not useful. Note that "duration," as used here, is the derivative (change in value) with respect to a change in the discount rate. We recommend that any new disclosures along these lines apply only to those plans that attempt to match durations between assets and liabilities. For plans that actively trade their invested assets, these disclosures add no value and are potentially extremely misleading.

Finally, the final Statement should include the clarification of references to "a weighted average basis," as was done in Q&A14 of this project's Frequently Asked Questions issued by FASB in September 2003.

Issue 2: Disclosure of accumulated benefit obligation.

Milliman wholeheartedly agrees that the accumulated benefit obligation should be disclosed. Its removal in the last changes to disclosure information took away a significant piece of important information.

We also believe that there should be a reinstatement of the original provision in Statement 87 that required disaggregation showing the disclosures for plans with assets that are less than the accumulated benefit obligation separately from those with greater than the accumulated benefit obligation. To analyze whether an individual plan is possibly subject to an additional minimum liability in the future, this information must be presented in a disaggregated manner. Indeed, in our review of pension and other postemployment benefit disclosures, we have found that one area most inaccessible to analyses involves the determination of minimum liability, an element that has become of major significance during the past couple of years and that will probably remain an important issue in many companies' reports over the next few years.

Issue 3(a): Disclosure of cash flow information.

The Exposure Draft proposes the disclosure of estimated future benefit payments for the next five years and an aggregate amount thereafter. We are concerned that users of financial statements may misinterpret the information. The Exposure Draft seeks disclosure of the benefit stream being valued (e.g., benefits accrued to date adjusted for future contingencies other than service) rather than the expected actual, total benefits payable. If financial statement users project a distribution of probable future cash flow from this information, they will be misapplying the information. The Exposure Draft's erroneous description of this as the "expected benefit payments" adds to the confusion.

For plans (e.g., a nonqualified supplemental executive plan in the U.S.) with large liabilities attributable to a small group, the estimation of near-term cash flows could create problems. For example, assume an executive at a plan's normal retirement age has fully accrued a benefit and may, under the terms of the plan, take the total value of the benefit in a single lump sum upon employment termination. If there has been no public announcement about the executive's expected retirement date and if the benefit is being valued under Statement 87 as though it is payable at any time (because the benefit is fully accrued), it is not clear what should or must be shown in the benefit payment disclosure for this person.

Many valuation systems have been programmed with iterative steps that sum together many paths of possible outcomes. Commutation functions and present value factors that value level streams of payments are often embedded in these routines. As a result, they have not been programmed to capture and isolate the total expected payments for each individual year of the future, which the Exposure Draft erroneously assumes is an available piece of information. Although the resulting measure of the total projected benefit obligation has the same concluding result as a point-by-point segregation of contingent benefits in the style suggested by the FASB proposal, current systems are not designed to provide the seriatim information. To capture this will require varying degrees of modifications to software systems, some of which could be significant. If the FASB retains this (or any similar) disclosure requirement in the final Statement, we suggest delaying the effective date for one year.

Finally, according to the explanation in Paragraph A22, the reason for the disclosure of cash flow information is to "assess...how well asset maturities align with benefit payments." Again, we are concerned that the proposed disclosure will be misinterpreted in this context. The asset disclosure information is not sufficient to make an appropriate comparison because a variety of cash flows are not represented. These include future contributions, dividends on equities, and other normal changes in investment holdings through active asset management that produce cash flow on an ongoing basis. Please refer to our comments above under Issue 1 for disclosure using duration rather than actual cash flows.

Issue 4: Tabular format for assumptions.

Milliman supports the additional clarity the Exposure Draft would produce in the layout of the major assumptions. We suggest that two other assumptions be added to the disclosure of assumptions:

- the expected long-term rate of return for the period following the financial statement; and
- the assumed crediting rate on account balances in a cash balance plan.

Issue 5: Reduced disclosure for nonpublic entities.

Milliman agrees that if users of financial statements do not need certain items of disclosure for nonpublic entities, that the FASB should create exemptions for these items.

Issue 6: Sensitivity to changes in major assumptions.

We believe that sensitivity information is extremely useful. We do not agree with the FASB's concerns that sensitivity information on individual assumptions (while holding the others constant) is "not useful information, misleading, or open to misinterpretation." In fact, determined and disclosed properly, sensitivity information can itself provide important background for much of the information that is being sought under some of the issues we previously commented on for this proposed Statement, such as the benefit cash flows.

The sensitivity information concerning the expected long-term rate of return on assets is not necessary because it can be determined from the existing disclosed information. That means this discussion of appropriate disclosures of sensitivity information is only relevant in relation to assumptions that affect the determination of the obligations.

For active populations, the sensitivity to a change in the discount rate is really measuring the change in the spread between the rate of salary increase and the discount rate. Thus, although they both may change according to economic conditions, the sensitivity to the spread changing is a very relevant and useful piece of information. Note that if the sensitivity to a discount rate change is disclosed in the aggregate (rather than just on actives), the disclosure of information on the sensitivity to a change in the salary scale assumption also is needed. However, if the sensitivity to a discount rate change is provided separately with respect to actives and nonactives, then the sensitivity to the salary scale assumption is not necessary.

Note that sensitivity information can be expressed either as a change relative to a 1% change in a rate, or it can be expressed as a duration. Disclosure as a duration is preferable if similar information is provided for the debt securities, as we discussed in Issue 1. But because the duration for debt securities is irrelevant for most funds due to active trading, a disclosure of the sensitivity to a 1% change in the discount rate is the more relevant piece of information to the financial statement user.

Milliman does not believe that disclosing the effects of both an increase and a decrease of 1% in the assumed health care cost trend rates is useful. Such a requirement results in additional costs to produce the information without adding any relevance. Only a 1% increase in the rate needs to be disclosed.

However, if the FASB decides to require disclosure of sensitivity to certain measurement assumptions, then there should be delayed effective dates with respect to those portions of the new standard, since many computer systems do not currently provide that metric and in the short term additional valuations will have to be run to produce this sensitivity information.

Issue 7: Disclosure of measurement dates.

We believe the measurement date is a useful disclosure item and should be required for all. The Exposure Draft's approach of only disclosing the measurement date when there is a change in events prior to the financial statement date will cause undue confusion as to what constitutes sufficient change to require the disclosure. One preparer of financial statements may consider a 0.5% change in discount rates to be irrelevant, whereas another may consider a 0.1% change to be relevant and require disclosure. We believe it is better to leave it to the user of the financial statements to determine relevancy of economic changes. For financial statement users to assess relevancy on their own, knowledge is required of the measurement date without having to rely on the preparer to decide whether a relevant change has occurred.

Issue 8: Deletion of the reconciliation of assets and obligations.

Milliman recommends that the reconciliation of the assets and obligations from statement to statement be retained. This is a useful presentation for understanding the iterative nature of the calculations and how the numbers progress from year to year. Although in many instances all of the numbers for the reconciliation could in fact be derived from the information that would be retained by the proposed Statement, there have been financial statements presented in recent years for which that derivation would have been extremely difficult or impossible to accomplish. The proposed simplification of the reconciliation is not truly a simplification, since the user of the financial statement must still perform the calculations necessary to recreate the reconciliation. The calculations to produce this reconciliation will have been conducted by the company (and are usual presentations by actuaries that provide the valuations) even if full disclosure in the footnotes is not required, so the savings in preparing a financial statement are negligible or nonexistent.

In the case of the merger or spinoff of a material portion of a business involving a material change in the pension plan or other postemployment benefits, the reconciliation should include sufficient information to be able to properly gauge the effect of the transaction, including different pre- and post-transaction measurement assumptions, remeasurements made in connection with the transaction, and other relevant information.

Issue 9: Disclosures considered but not included in the Exposure Draft.

Of the numerous items listed in the Exposure Draft that the FASB did not pursue, we found some that would be useful and suggest that they be considered:

- Item (g), the disclosure of PBO and ABO, grouped by active versus nonactives – This breakdown would be useful when combined with Milliman's previous discussion in Issue 1 of durations of each grouping.
- Item (h), the duration of the obligations, as we previously commented on in Item 1 – Alternatively, the sensitivity to changes in the major assumptions would suffice to meet this requirement (also as we previously discussed in Item 6).

Issue 10: Interim disclosures.

Milliman believes that disclosing the proposed limited information in the quarterly interim statements would be useful to financial statement users. We agree with the FASB's conclusion in item (i) in Issue 9, that disclosing updated information on obligations and assets would not be useful.

Issue 11: Timing of effective date.

We recommend that the FASB delay the effective date of the entire Statement to a date in 2004. The amount of time available to pull together the information proposed for disclosure on multiple plans (particularly those with international subsidiaries) during the last few weeks of 2003 is too limited and will create burdens that are in disproportion to the value the additional information will provide.

In particular, if the disclosure of information on projected benefit payments is retained, this specific segment of the Statement should have a delayed effective date because the information is not currently available. Most actuarial valuation systems will need to be modified to produce this. Additionally, the valuations themselves would then have to be rerun once the programming is complete, at considerable expense to plan sponsors. More of our reasons for delaying the effective date are discussed above under Issue 3. Similarly, if sensitivity analysis is required as proposed under Issue 6, a delayed effective is warranted.

Conclusion

Thank you for allowing us to present our views on this important matter. Milliman USA remains committed to appropriate disclosure requirements for pension and other postretirement benefit plans. Please do not hesitate to contact Mark Beilke, Director of Employee Benefits Research, in our Washington, D.C. office at (703) 917-0143, if we can provide additional background material or insights as you craft the final Statement.

Sincerely,

Thomas K. Custis, F.S.A.
National Director of Pensions
Milliman USA

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