From: Michael McShee [mailto:mmcshee@gitec.ch]
Sent: Monday, July 02, 2012 7:02 AM
To: FASB Comments
Cc: Philip Hood; Natalie L. Watanabe; Michael P. Breen
Subject: Agenda Request - Cash Balance Pension Plans

Dear Sirs,

I am writing to request that the Board place the question of cash balance pension plan accounting (for plans with variable interest credits) on the agenda, and in relation to my request, I attach a background document.

The issue is "important" because it concerns a pension plan type which is almost universal in Switzerland where company pension cost/liability is a very large item, and it is important because there is no authoritative guidance that speaks directly to the proper treatment of such plans.

At the same time, the project is not "large in scope" or one that would be likely to consume large resources. In essence, the subject could be addressed by a relatively simple extension/clarification of EITF-03-04 which relates to pension plans that are "related" to the plan-type discussed in the document. In fact, in 2004, the board developed such guidance, though it was never published.

I will be glad to answer any questions that would help the board decide whether to add this matter to the Agenda, and of course, I would also be glad to help carry out a project if one is defined.

Best Regards,

Mike McShee

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Project Request
Swiss Pension Background
Application of DB Accounting

Summary

It is requested that the board adopt a project in the Agenda to provide guidance on the principles to be applied to Cash Balance pension plans which specify an interest credit that is based on a Base Rate which is guaranteed and a Bonus Rate which depends on the earnings of the fund.

The request is founded on the particular circumstances of the Swiss market. Switzerland is a small country by most measures, but a "huge country" measured by pension fund assets. Every employer has a substantial level of pension cost and practically all plans are CB plans with the Base/Bonus interest structure.

For this reason, the project is considered to be of high importance.

There is no authoritative guidance on the matter other than EITF 03-04 which relates to cash balance plans that have a "fixed" (non contingent) interest rate. The background work of EITF that led to the publication of EITF 03-04 is however, all relevant to the Base/Bonus plans.

Following EITF 03-04, the Board did give further consideration to the Base/Bonus type of plan and had reached a provisional conclusion in 2004 (see Attachment 1.) In the event, the provisional conclusion reached would have provided a consistent logical basis for Base/Bonus plans. The Board did not proceed to issue that guidance, perhaps in contemplation of a new comprehensive pension project.

However, to a very large extent, one may say that the EITF and the Board have already extensively analyzed the issue and arrived at a sound conclusion.

For this reason, the project is considered to be one that would consume relatively modest resources.

This paper provides background on the type of plans in question and explores the consequences from an accounting perspective.

General

The starting point is a universal legal obligation to provide a minimum level of “pension benefit.” The law in question is referred to as “LPP” and we speak of “LPP benefits.” Companies typically provide more than the LPP benefits and then we speak of “LPP benefits” and “Excess benefits.” LPP benefits comprise retirement benefits and benefits payable on death or permanent disability in service.

LPP retirement benefits have a “cash balance configuration” with:

1. Credits at defined percentages of “covered pay” – credit percentage increases with age in 4 10-year “steps.”
2. Covered pay limited to a salary cap
3. Employer must pay at least 50% of the cost
4. Legal specification of a minimum guaranteed rate of interest credit
5. Annuity option at retirement with a minimum annuity rate legally specified.

A “typical plan” provides enhancement of the LPP benefits in some or all of the following ways:

1. Benefit provided on salary above the LPP salary cap
2. Retirement credits provided at higher rates than required in LPP
3. Employer pays more than 50% of the cost
4. Plan provides a superior guaranteed rate of “interest accumulation.” – but see below
5. Plan provides a superior annuity option. – but see below

Historically, larger employers often provided a final pay defined benefit plan, generally with a benefit formula that clearly delivered more than LPP benefits.

The Swiss market has followed the global trend away from final pay DB plans and nowadays, practically all Swiss plans represent the employers "attempt" to convert to a DC plan while conforming to the requirement to deliver the LPP benefits with their Cash Balance guarantee features.

The typical plan of "accounting interest" (operated by a substantial employer for whom US GAAP is relevant) is:

1. A plan with the Cash Balance structure outlined above and,
2. benefits that are substantially superior to the LPP benefits – in other words, the "Excess Benefits" are substantial in comparison to the LPP benefits.

As employers have tried to have plans that are more DC than DB, some approaches to "LPP enhancement" have changed. This includes from the list above:

1. Providing a superior guaranteed rate of interest accumulation has become practically unknown. Employers have understood that if they want to be like DC, then they must avoid interest guarantees.
2. Providing superior annuity options – this has also become practically unknown. Logically employers trying to be like DC should stop offering any annuity option, but in practice, some have just offered lower annuity terms for Excess benefits.

Structural

Swiss law imposes certain organizational and structural rules on employers for the provision of benefits (LPP and Excess.) Swiss law has some parallels to the US legal requirement for "segregation and restriction" of pension assets from employer assets. The "platform" demanded by Swiss law is a legal entity form called a "Foundation". We may probably just say that a Swiss pension Foundation is very similar in effect to a US Pension Trust. Foundation assets must be applied for the exclusive benefit of participants/beneficiaries and (stronger than in the US) there is a total prohibition of any asset reversion to the employer in any circumstances whatsoever.

The role of the Swiss Foundation entity is not limited to retirement benefits; it also includes in-service death and long-term disability benefits. So, if an employer provides, for example, a life insurance benefit of 2 times annual salary, or an LTD benefit of 60% of salary, then these benefits must be provided via the Foundation.

A foundation might buy insurance for the risk, or it might self-insure the risk. If insurance is bought, then the cost of the premium is built into the contributions that the foundation "collects" from the employer (not deducted from the Cash Balance account credits.) If insurance is not bought, then the foundation has an arrangement to collect "risk costs" from the employer (typically by an explicit annual contribution that is separately accumulated by the foundation – employees may also be required to contribute towards "risk costs.")

There is nothing special or exceptional about the nature of the death and disability benefits, they are the kind of benefits that employers routinely provide in the US and elsewhere (and of course, in other countries they are not accounted for as defined benefit retirement benefits under FAS87 but the cost of uninsured losses is recognized at the time when the loss occurs.)

In Switzerland. even when the benefits are fully insured, the premiums and benefit payments have to pass through a foundation. A special case is where an employer purchases a group annuity contract to fully cover retirement, death and disability benefits. In terms of the retirement benefits in such a case, the group annuity contract will stipulate:

1. The insurer assumes the risk of the interest accumulation and annuity option of the LPP benefit

2. The insurer defines in the contract, some other interest and annuity provision applicable to the Excess Benefits, and that insurance provision becomes part of the plan as conveyed to the participants
3. The complete transfer of risk to the insurer is such that the plan actually is a Defined Contribution plan.

There is nothing special or exceptional about the concept of purchasing insurance in Switzerland with one exception. The exception is that many accounting and actuarial practitioners aver that the purchase of insurance is irrelevant and must be ignored and that a fully insured Defined Contribution Plan must be classified as a Defined benefit plan and make an actuarial valuation. The grounds for that are:

1. Risk is not transferred because the insurer might fail and the employer might subsequently feel a "moral obligation"
2. The death benefit (say 2 times salary) or the LTD benefit (say 60% of salary) is clearly a *defined benefit" and everything is "in the same plan."

The fact is that insurers sell a wide range of products and when they are used for pension finance, one has to look at the facts and circumstances to see the right accounting treatment. In this market we have a large number of players that simply do not have a basic knowledge of pension finance or pension accounting principles, and they create a lot of pressure to "assume every case is the same." Unfortunately for employers, the pressure is to assume that every case needs a complex and expensive actuarial valuation followed by a comprehensive "audit review."

Operational

To see how plans operate, let us start to build a numeric illustration. Let us begin considering only the active account accumulation, and for the moment, let's assume that there will be no annuity option. Suppose we have a plan with total savings balances of 500 units, and suppose that we have:

Initial

LPP account	200
Excess account	300
Total Account	500

Currently the "LPP interest rate" is 1.5% and that means that after 1 year the 200 unit LPP account must be at least 203 units – that's a fact, from the law. But the total account development depends on the plan provisions, and we can find a range of possibilities:

End Year

	Case A	Case B	Case C	Case D
LPP account	203	203	203	203
Excess account	300	297	303	304.5
Total Account	503	500	506	507.5

At this stage, we are looking at the development of the "guaranteed account" and we are simplifying it:

1. We are ignoring the new credit for the current year
2. We are ignoring the possibility of additional interest based on earnings.

In case A the plan is providing essentially that the LPP part always gets interest at the LPP rate and the Excess part never falls. This might be the most typical provision.

In case B the plan is providing a capital guarantee on the total account, but no interest at all. The increase in the LPP account is balanced by a decrease in the B account. This illustrates the "minimum guarantee option."

In case C, the credit is 1.5% (LPP rate) on the LPP money and 1% on the Excess money. That is very typical of what a group annuity contract would provide.

In case D, the same 1.5% LPP rate is being applied to both the LPP and Excess money. This used to be very typical as it made for a simpler plan that communicates easier, but employer risk/guarantee aversion has reduced incidence of this method.

In a sense, all cases start out "trying to be a DC plan" but then the law introduces an "element of guarantee" and, after that the plan itself adds some further guarantees.

The smaller the guarantee, then the more the plan is like a DC plan, and, as the guarantee increases the plan becomes increasingly "dominated" by the guarantee and the related DB characteristics.

Now, "absence of guarantee" is only one part of being DC or DC-like. The other part is the question of what happens to the actual investment earnings on the plan assets. And to illustrate this, we have to provide our example plan with some assets. Let us suppose that our plan happens to operate under Case A – that it to say the guarantee is to credit 1.5% on the LPP money and to keep the excess unreduced.

Let us suppose that our plan began the year:

Total Account	500
Assets	500

In the course of the year, we might have:

Result 1 earned 10%	550 closing assets
Result 2 earned 0.6%	503 closing assets
Result 3 lost 5%	475 closing assets

Then we will have this position after the year:

End Year

	Result 1	Result 2	Result 3
Total account	503	503	503
Assets	550	503	475
Status	47	0	(28)

Result 1 is what is supposed to happen. The plan is to earn more than the guaranteed interest. And actually the intent is to provide the excess to the employee accounts – that, after all, is what a DC plan does.

One might just credit the 47 excess of Result 1 to the account which would become 550. Before exploring that, let us just pass over the "uninteresting" Result 2 and consider "Result 3." Result 3 is reporting a deficit of 28 units. In legal terms, there is a range of possibilities what to do about a deficit, but there is a legal requirement that "something" has to be done. In reality, a very substantial part of such a deficit could be and often is "met" by the plan participants. But for the moment, let us consider that the proposition is an employer funded guarantee (of the 503 unit account balance.)

In that context, the employer would have to set up a schedule of contributions to cover the shortfall over a reasonably short time horizon (say, 5 years.)

That “risk” actually points to a fairly good reason for not crediting or “distributing” the 47 unit gain from Result 1. In other words, a year with result 1 is likely to be followed by a year with result 3.

Partly for this reason, one typically finds plan provisions that stipulate that a part of “Result 1” is not distributed but retained unallocated in an account called “investment fluctuation reserve” or IFR.

The operation of an IFR account may be considered as a means of protecting the employer against the risk of being called to pay an additional amount over the base defined contribution in order to fund guarantees.

The concept of the IFR is also established in the pension regulatory system. The law and related regulations are actually very unclear as to the purpose of IFR, or how it should be calculated, or where the money should come from to fund it. In a broad sense, however, the law says:

1. Each pension fund should set a target for the IFR
2. When the IFR is not covered, then the pension fund does not have "free assets" available for supplemental distribution.

The regulator probably considers that this provides plan participants with valuable protection against pension fund insolvency. Though, in fact, it actually reduces benefit delivery to plan participants.

Let us revert to our Result 1 situation and recall that it is supposed to correspond to a Case A pension fund (recall, a Case A fund guarantees LPP interest on the LPP balance and zero interest on the Excess balance.) And, let us suppose that this pension fund established a target of 6% (of the account balance) as the IFR target. So the target IFR will be 30 Units.

In that context, we can present the closing position of that fund as:

LPP Savings	203
Excess Savings	300
Target IFR	30
Total "Liability"	533
Plan Assets	550
"Free Assets"	17

The 17 units represent the "distributable" resources which can be credited as "bonus interest" to the savings accounts. The first "charge" would be to provide the same 1.5% on the excess savings that was already credited on the LPP savings – using 1.5% of 300 or 4.5 units and leaving 12.5 units.

These 12.5 units allow a bonus interest credit of 2.5% on the prior year 500 unit total balance. After the credit, the plan position would be:

LPP Savings	208
Excess Savings	312
Actual IFR	30
Total "Liability"	550
Plan Assets	550
"Free Assets"	0

FAS87 Accounting

So, let us suppose that we have, as above, defined how the plan operates, including how it presents its own position under local Swiss pension fund accounting rules. Now let us consider how FAS87 would treat such a plan. And let's suppose that it is plain that the plan should be classified as a Defined Benefit plan.

For a moment, let us suppose that we only had the guarantee. So, it is a plan with 1.5% interest on 200 units and zero on 300 units. Let us suppose that the Discount Rate is 2.5% and that all employees are 10 years from retirement and that all will certainly survive to that time.

We can make the following calculations based on the interest guarantees found in the plan:

	Current Account	Projected benefit	Present Value
LPP Savings	203	236	184
Excess Savings	300	300	234
		Pension Obligation	418

This is a defined benefit calculation that is based on projecting benefits at a guaranteed rate explicitly provided in the plan/law and discounted at a rate as required under the accounting standard. If this plan only provided for the guaranteed interest (1.5% and 0%) then it would be a plan of the kind described in EITF 03-04 and the above calculation is the one specified in EITF 03-04.

But the plan is not exactly as described in EITF 03-04 because it is obliged to credit additional interest on top of the guaranteed interest based on the investment earnings and subject to the operation of the IFR procedure as described.

One may say that, under the terms of the plan, it currently "owes" 503 units to the participants (520 units after the "bonus distribution) and, in a sense, the plan also owes a further 30 units (contained presently in IFR) to participants for future distribution.

In fact, this principle underlies the discussion in the 2004 FASB board minutes which spoke of the obligation being equal to the account value.

One may think of a plan like this having a "calculated PBO" (in line with EITF 03-04 based on the defined benefit guarantees) and an additional PBO component which "pushes-up" the calculated PBO to a higher level that reflects the facts of the plan.

The logic of the 2004 FASB board minutes is exactly in line with this – the board minutes envisage a push-up to the amount of the account balance. And, with a plan like this, there would be similar logic in a further push-up to the asset value if greater.

Pushing up or direct to value?

We showed above how the combination of the explicit guarantee interest credits and a Discount Rate generates a calculated obligation that will certainly need pushing up. In such a case, there is really no need for the calculation; we may go direct to the greater of account value and assets. But there are likely factors we need to consider that were "discarded" in my construction of the stripped down example. Some of these are discussed below.

Annuity Conversion

We have been considering plans that will always deliver all benefit in lump sum form. But in reality practically all plans deliver a considerable proportion of benefit in annuity form.

In fact, a given plan will most likely contain a substantial volume of current pensions. The existence of these pensions and the prospect of additional future pensions is, of course, one of the core factors that makes it necessary to classify these plans as defined benefit plans.

There is no difficulty in measuring the obligation in respect of current pensioners. Pensioners in such a plan are no different from pensioners in any other plan. But, we still have the question of how an annuity option in a plan impacts on the active pension obligation.

We discussed above the active pension obligation that arises from the accumulation of the active participant accounts with the presumption that the benefit payment resulting from retirement will be a lump sum.

Now let us consider a retirement event, where an individual arrives at retirement with an account balance of 1,000 units. The plan will contain specification of the terms for the annuity option calculation. As discussed above, the account balance is composed of LPP savings and Excess savings, for example 400 units of LPP savings and 600 units of Excess savings.

The law specifies a minimum conversion rate for the LPP savings and plans may define their own conversion rate for excess savings (plans may also offer no annuity option on the excess savings, but most plans do.)

The conversion rate is usually expressed as a percentage – such as 6.8% which means that the annuity option is 6.8% of the lump sum. So a lump sum of 1,000 would produce an annuity option of 68 units per year.

A fairly common current structure would be 6.8% conversion rate for LPP savings and 5.8% on Excess savings. This would produce an annuity option in our example of 62 units per year (6.8% of 400 plus 5.8% of 600.)

The annuity rates are not really "guaranteed" in the plan:

1. The LPP rate (6.8%) is set by "the government" from time to time, though political considerations tend to keep this rate "too high."
2. The 5.8% rate is changeable by the plan at short notice and the recent tendency has been to reduce it, or even eliminate the option.

For the purposes of applying the defined benefit accounting rules, one should probably just assume that annuity rates currently expressed in the plan are actually guaranteed on an indefinite basis.

For illustration purposes, let us assume that our sample plan simply provides a guaranteed conversion option based on a rate of 6.8% applied to all savings. So, in our example, on retirement with a 1,000 unit savings balance, there would be an annuity option of 68 units of annual pension.

At the moment of retirement, that annuity will generate a pension obligation which will be measured as the actuarial present value of the 68 unit pension. The value will be computed based on best estimate mortality assumptions and the Discount Rate selected based on the usual procedure (the FAS87 basis.)

It is unlikely that the FAS87 basis will produce a present value for the 68 unit pension that is equal to the 1,000 unit savings balance particularly at this time when Discount Rates are so low. For the sake of illustration, let us suppose that the FAS87 basis would give a present value of 18.50 units for each annual pension unit. (If we express that as a "Swiss Conversion Rate then we would have a 5.405% conversion rate – 5.405 units of pension per 100 units of capital.)

The retirement event would then develop the following:

Account Balance	1,000
Annuity (plan 6.8% rate)	68
Obligation (68 x 18.5)	1,258

The day after the retirement (if the pension option is selected,) the pension obligation is certainly 1,258.

The day before the retirement, the obligation is also 1,258 if we know the pension option will be selected, and the obligation is 1,000 if we know the lump sum option will be selected.

If we assume (on a best estimate basis) that the average retiree takes 50% in capital and 50% in pension, then the obligation is 1,129.

The average active participant is a lot more than a day before retirement, but the example is illustrating the fact that in this example plan with these parameters and assumptions, the active obligation is actually more than the account balance. We can summarize the possible "outcomes" for a "young active" as follows:

1. On leaving service the pay-out is the account balance
2. On retiring with a lump sum, the pay-out is the account balance
3. On retiring with an annuity, the "pay-out" (or cost of benefit provision) is more than the account balance
4. On death in service, the pay-out is the account balance (plus the additional death benefit of the plan)
5. On permanent disability pay-out is the account balance (plus the additional LTD benefit of the plan)

The result is that, due to line 3 above, it is possible (though not certain) that there is obligation in excess of the active savings balance.

We say "not certain" because the plan conversion rates are not really "absolutely guaranteed" – especially in relation to the Excess savings. If a plan cannot "sustain" its conversion rates, then the law requires that something be done and when a plan has "unsustainable" conversion rates, then the first line of action is reduction (or partial elimination) of the conversion rates. But we think that as long as a plan expresses stated conversion rates, then one really must assume that they will continue.

Another "standard procedure" is that plans build up provisions in order to provide "future support" for a conversion rate. Such provisions may be built in the same way as IFR – that is to say, by retaining unallocated a portion of the investment returns that are earned.

Fitting a procedure to the plans

These plans are built on the base of a defined contribution objective. But through a combination of legal (LPP) provisions and plan provisions certain interest, capital and annuity guarantees have been added to the DC base, and the result is plans that are a variant of Cash Balance plans which require Defined Benefit reporting.

The operation of the plans during active service is based on the operation of the savings accounts (the LPP and Excess parts.) The accounts operate based on a combination of non contingent fixed interest credits and additional "bonus interest" credits.

At the point of retirement, the annuity option (which is part guaranteed and part not guaranteed) operates to produce a "retired lives pool" which then constitutes a straightforward defined benefit obligation.

The active pension obligation is generated by the active account balance which is, in a sense "payable on demand" (on leaving service or under the in-service withdrawal provisions.) So, it seems clear that the active account balance is "an obligation."

But, the "true obligation" may be higher than the account balance for a number of reasons:

1. There might be "additional liability" because the guaranteed interest rate is higher than the Discount Rate (extremely rare/unlikely but possible.)
2. There might be "additional liability" because the "guaranteed conversion rate" is "too generous" based on the FAS87 "pension valuation."
3. Plan assets in excess of the account balances which may be classified as IFR, provision for conversion or simply "unallocated." The fact is, that all plan assets are ultimately "owed" to employees.

To deal with these issues, the first and fundamental point is that the treatment of any particular plan has to be based on the facts and circumstances of the case. A plan that provides no additional (legal or substantive) guarantees should have no additional liability, and one that provides substantial additional guarantees should envisage substantial additional liabilities. Points 1 and 2 may be categorized as "liability oriented" and point 3 as "asset oriented."

For the liability oriented points 1 and 2, I believe we must turn to the principles expressed in EITF 03-04. As long as we are considering only the defined benefit guarantees incorporated in a plan, we are essentially dealing with the plan envisaged in EITF 03-04.

We may begin by projecting separately the LPP and Excess accounts to retirement based on the interest guarantees actually incorporated in the law and the particular plan. Then we convert the resulting retirement age account balances to annuity at the conversion rates actually incorporated in the law/plan.

Then we calculate the liability at the retirement age for that pension based on the FAS87 assumptions, and then we discount the resulting value to the present time.

We have prepared some examples based on a range of parameters.

The first example incorporates "minimal" extra-legal guarantees. We assume zero interest guarantee on Excess Savings and "considerably lower" annuity conversion guarantee on the Excess.

Parameters			Annuity Rates		
LPP Gtee. Interest	1.50%		LPP	6.80%	
XS Gtee. Interest	0.00%		Excess	5.80%	
Yrs. to Retirement	10		FAS87	5.25%	
Discount Rate	2.50%				
	Current Account	Projected Account	Annuity	Ann. PV at Retirement	Ann. PV Current
LPP Savings	400	464	31.57	601	470
Excess Savings	600	600	34.80	663	518
Total	1,000	1,064	66.37	1,264	988

This example results in a calculated value of 988 based on the current account balance of 1,000. The second example adds a 1% interest guarantee on the Excess savings:

Parameters			Annuity Rates		
LPP Gtee. Interest	1.50%		LPP	6.80%	
XS Gtee. Interest	1.00%		Excess	5.80%	
Yrs. to Retirement	10		FAS87	5.25%	
Discount Rate	2.50%				
	Current Account	Projected Account	Annuity	Ann. PV at Retirement	Ann. PV Current
LPP Savings	400	464	31.57	601	470
Excess Savings	600	663	38.44	732	572
Total	1,000	1,127	70.01	1,333	1,042

Now the result is a calculated value of 1,042 compared to the 1,000 unit account balance. So, we can see that the addition of some supplemental guarantee to the plan has produced an increase in the pension obligation – and that, of course, makes sense.

Now we need to consider the asset position of the plan. For illustration, let us suppose that the plan in question is as represented in the second example above. From an operational (local plan accounting standards) point of view, such a plan would generally "hope" to present (in the pension fund balance sheet under Swiss-GAAP) a position something like the following:

Case 1 Plan Fully Funded

Plan assets		**1,200**
Plan "Base Liability"		
LPP Savings	400	
Excess Savings	600	
Total Base Liability		1,000
Plan "Provisions"		
IFR	60	
Conversion *	50	
Total Provisions		110
Liability & Provisions		**1,110**
Plan "Excess"		90
Total Liability		**1,200**

* A provision to support a "high" annuity option

We say the plan "hopes" to show such a position, because the plan is established with the objective of accumulating assets to cover what it "owes," maintaining a "safety margin" and distributing investment gains.

The "bottom line" or "action item" arising from the year of operation is the 90 units of "plan excess" that is reported. If it is assumed that the two plan provisions shown (IFR and the support for the annuity conversion rate) are at the target levels, then the 90 units would be applied as additional or bonus interest credits to the employee accounts.

The FAS87 position will reflect the same 1,200 unit asset value and the FAS87 measurement of the pension obligation (corresponding to the Swiss-GAAP pension fund balance sheet's 1,100 "liability and provisions" figure.)

If we make a "FAS87 statement of position" that shows the 1,200 unit asset value together with the 1,042 unit calculated obligation then we have:

Assets at market	1,200
Pension Obligation	1,042
Funded Status	158

But this position needs some further adjustment. The 158 unit funded status has not taken into account the facts that:

1. Based on the result of the year, 90 units are about to be credited to the accounts, increasing the pension obligation
2. The balance of the 158 units (68 units) will be distributed in future (or otherwise used to finance existing plan benefits.)

So, the facts and circumstances of this plan are such that would support the proposition that the calculated pension obligation (based on the EITF 03-04 principles as above) should be "pushed up" not only to the account values, but further to the asset value of 1,200 units.

Now we consider how the situation is impacted by investment losses that result in a lower asset value. The following table compares the position we have just discussed with the same result but with 900 units of assets instead of 1,200 units.

		Case 1	Case 2
Plan assets		**1,200**	**900**
Plan "Base Liability"			
LPP Savings	400		
Excess Savings	600		
Total Base Liability		1,000	1,000
Plan "Provisions"			
IFR	60		-
Conversion *	50		-
Total Provisions		110	-
Liability & Provisions		1,110	1,000
Plan "Excess"		90	(100)
Total Liability		**1,200**	**900**
FAS87 Calculated Liability		1,042	1,042
FAS87 Supplemental Liability		158	-
FAS87 Pension Obligation		1,200	1,042
FAS87 Funded Status		-	(142)

In case 2, under local pension accounting, in case of an asset shortfall, the provisions are eliminated. But for FAS87 purposes, that doesn't matter, the important thing is the new asset value. The FAS87 calculated pension obligation is unchanged.

We do not have any "excess assets" that generate supplemental pension obligation, so the FAS87 pension obligation is the calculated figure of 1,042. With the asset value of 900 units, this results in a negative funded status of 142 units.

Swiss pension Overview

From a Swiss Legal perspective, this pension plan is bound to "take some action" in relation to its reported deficit of 100 units. Now, these actions may involve employee contributions (in some circumstances, even pensioner contributions) and they can involve reduction and/or limitation of benefits. As a point of interest, the latest revision to IAS19 speaks of making explicit allowance for the "employee share" of measures to be taken. The idea is that the employer would not make recognition of the whole of the 142 unit deficit, but only the part remaining after allowance for the employee share.

FAS87 does not presently contain any provisions corresponding to the "deficit sharing" provisions that are being introduced to IAS19. As a result it would seem that if we arrive at a result as above, then the negative funded status of 142 units should fall to be recognized by the employer (presumably in AOCI.)

Michael McShee
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2-July-12

Attachment 1 Extracts From Board Meetings

March 3, 2004 Board Meeting

Interpretation of Statement 87. The Board considered the following three alternatives for measuring a cash balance pension plan obligation: (1) current methodology approach, (2) hybrid approach, and (3) separation approach.

The Board decided that alternative 2, the hybrid approach, is the appropriate methodology for measuring a cash balance pension plan obligation. Under that approach, entities would apply the following measurement guidance:

1. For cash balance pension plans with a fixed interest crediting rate, the obligation would be measured by projecting forward the plan participants' notional account balances at the fixed crediting rate as stipulated in the plan's provisions and discounting the resulting amount using a discount rate determined in accordance with paragraph 44 of FASB Statement No. 87, *Employers' Accounting for Pensions.*
2. For cash balance pension plans with a market or market-related (variable) interest crediting rate, the obligation would be measured by reference to the plan participants' notional account balances. Entities would not project and discount plan participants' notional account balances.

May 12, 2004 Board Meeting

Interpretation of Statement 87. The Board discussed issues related to scope, effective date and transition, and implementation issues.

The Board decided to expand the scope of the project to amend FASB Statement No. 35, *Accounting and Reporting by Defined Benefit Pension Plans,* to apply the Board's March 3, 2004 decision—that the obligation for cash balance pension plans with a market or market-related (variable) interest crediting rate should be measured by reference to the notional account balance, that is, to the measurement of accumulated plan benefits under Statement 35. The Board also asked the staff to research the implications of further expanding the scope of the project to amend the guidance on the selection of discount rates in Statement 35 to make that guidance consistent with the discount rate guidance in FASB Statement No. 87, *Employers' Accounting for Pensions.* The Board deferred discussion of the transition and effective date of the amendment to Statement 35 until a decision is reached regarding the discount rate issue.

The Board decided the following with respect to the implementation issues considered:

1. Service cost should be determined by the pay/principal credits allocated to employees' notional account balances; similarly, interest cost should be determined by the interest credits allocated to employees' notional account balances.
2. The interest cost component of net periodic pension cost should be based on the actual interest credited to plan participants' notional account balances for the period.
3. For plans that contain a cash balance formula with a variable interest crediting rate, the assumed discount rate that should be disclosed is the discount rate used to measure the portion of the projected benefit obligation (PBO) that is not attributable to the variable cash balance formula. The PBO amount measured at that rate also should be disclosed.
4. For mixed formula plans in which a cash balance pension plan formula has been integrated into traditional defined benefit pension plans (or vice versa) and an employee is entitled to the greater benefit of the two formulas, the PBO should be based on the formula that results in the greater of the two benefits to the participant at the plan's measurement date.