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LETTER OF COMMENT NO. 13

September 26, 2006

Mr. Robert H. Herz
Chairman, Financial Accounting Standards Board
401 Merritt 7
P.O. Box 06856-5116
Norwalk, CT 06856-5116

Re: Financial Reporting of Postretirement Benefit Obligations

Dear Mr. Chairman:

AARP is a nonprofit, nonpartisan membership organization that helps people 50+ have independence, choice and control in ways that are beneficial and affordable to them and society as a whole. AARP advocates for policies that enhance and protect the economic security of individuals as they move from work to retirement. Nearly half of our more than 37 million members are still working.

The relatively low savings rate in the United States makes safeguarding the private pension system a critical public policy issue. Over the past two decades, Congress has enacted significant tax and employee benefit legislation. Most of these changes have made pension coverage broader, fairer and more secure.

In recent years, however, support for the private, voluntary defined benefit pension system has declined as plan sponsors have faced adverse economic conditions, a volatile stock market, new competitive pressures, legal challenges to certain hybrid plan arrangements and an aging workforce. The number of firms, particularly financially strong firms, announcing or contemplating freezing their pension plans has steadily increased over this period of time.

The recently enacted Pension Protection Act of 2006 will substantially change the way pension plan sponsors measure and fund their pension plans. With these new changes in pension funding rules, the defined benefit system is at a crossroads. Proposed new financial accounting standards should be considered within this context. Plan transparency is an important public policy goal, and one which AARP supports. However, the retirement income security of those currently covered by defined benefit plans is also a critical public policy goal.

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In short, accounting standards for the current defined benefit system under consideration by the Board will have a major impact on the very future of the defined benefit plan system. In this critical time period, it is important to ask whether new accounting rules will strengthen the defined benefit pension system or encourage employers to terminate or freeze existing plans.

Defined benefit pension plan freezes and terminations can be very harmful to the retirement security of millions of workers, particularly longer service older workers. Defined benefit pension plan designs typically provide only small benefits early in a worker's career and larger benefits later in the career for those who devote much or all of their working lives to the company. As a result, the negative impact on an older worker's retirement benefit can be substantial, with an older worker facing a reduction in future benefits of up to one half. Even if new defined contribution replacement plans are put in place, an older worker can not make up the lost benefits, and will be subject to a dramatic increase in risk over that shorter time period prior to retirement. It is therefore critical that FASB understand the potential impact of the implementation of new accounting rules on retirement security, with appropriate consideration and understanding of the needs of older workers and a viable plan to protect their hard-earned benefits.

Our review of the documents and other statements issued by the Board does not indicate significant consideration of the impact of the proposed new standard on the defined benefit system, and the possibility that this proposed new standard could substantially reduce defined benefit pension plan coverage of the American workforce and harm older workers.

We believe that the Board should strongly consider the impact of new final reporting standards, and whether such a standard will exacerbate prevailing trends and substantially reduce the number of employers sponsoring a defined benefit pension plan. Because of the critical nature of this rule at this time, we believe it is appropriate for the Board to delay imposing a new reporting standard until the impact of the proposal is fully measured and evaluated.

In the event that the Board decides to move forward with a new reporting standard despite these reservations, we recommend that the Board take all due care to limit the negative impact on plan sponsors, and ultimately plan participants. For example, the Board should limit the negative impact of such standards where it can, such as temporarily permitting the use of the accumulated benefit obligation (ABO) in calculating pension liabilities. The ABO represents a widely-recognized and understood measure of pension liabilities consistent with the concept of a balance sheet liability. In contrast, the projected benefit obligation (PBO), based on estimates of future salary levels, may overstate pension liabilities for many plan sponsors, thereby encouraging plan sponsors to freeze or terminate a plan.

We urge you and the other Board members to conduct a more thorough review and analysis of the potential impact of the proposed new rules on the millions of American workers, particularly older workers, depending on a defined benefit pension plan to provide financial security in retirement. While accounting transparency is an important goal, it must be weighed against the at least equal, if not greater, public policy goal of providing financial security to millions of workers.

AARP appreciates this opportunity to provide its views on the work of the Board related to pension accounting. If you have any further questions, please feel free to contact me, or please call Frank Toohey of our Federal Affairs staff at 202/434-3760.

Sincerely,

David Certner
Legislative Counsel and
Legislative Policy Director
Government Relations and Advocacy