AMERICAN ACADEMY *of* ACTUARIES

May 31, 2006

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

Re: File Reference No. 1025-300. Proposed Statement of Financial Accounting Standards – Employers' Accounting for Defined Benefit pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132(R)

Dear Sir or Madam:

The American Academy of Actuaries'[1] Joint Committee on Retiree Health is pleased that the Financial Accounting Standards Board (FASB) is reviewing the accounting rules for postretirement benefits other than pensions (OPEBs) as part of its comprehensive project to improve retirement benefit accounting guidance. Retirement benefits involve long financial horizons and it is appropriate that the promises associated with these benefits be subject to accrual accounting standards. Actuaries design the mathematical models that allow careful analysis of the financial implications, and actuaries also develop supporting documentation for the assumptions. Actuaries have had and will continue to have major responsibility in helping plan sponsors implement accounting guidance. We feel our experience with past standards can provide useful insight for this current project.

Our joint committee, which has responsibility for the actuarial profession's involvement in public policy issues related to health care benefits for retirees, strongly supports changes in FAS 106 to continue to provide meaningful actuarial measurement for OPEB plans. Such changes will enhance the professional value of accounting and actuarial work regarding these benefits, and will improve the understanding of these benefits with both corporate management and the public.

We are hopeful that the ultimate result of this project will be to change the original FAS 106 rules to recognize important differences in OPEB plans. In the 15 years since FAS 106 was promulgated, OPEB values disclosed in financial statements have been perceived differently from OPEB values accepted by sophisticated financial analysts.

Our committee is, therefore, extremely concerned that the FASB exposure draft chronology for the project has given priority to placing on corporate balance sheets the existing measure of accumulated postretirement benefit obligation (APBO) rather than the revision of the measurement process. Given how few assets are associated directly with OPEB benefits and the sensitivity of OPEB calculations to

[1] The American Academy of Actuaries is a national organization formed in 1965 to bring together, in a single entity, actuaries of all specializations within the United States. A major purpose of the Academy is to act as a public information organization for the profession. Academy committees, task forces and work groups regularly prepare testimony and provide information to Congress and senior federal policy-makers, comment on proposed federal and state regulations, and work closely with the National Association of Insurance Commissioners and state officials on issues related to insurance, pensions and other forms of risk financing. The Academy establishes qualification standards for the actuarial profession in the United States and supports two independent boards. The Actuarial Standards Board promulgates standards of practice for the profession, and the Actuarial Board for Counseling and Discipline helps to ensure high standards of professional conduct are met. The Academy also supports the Joint Committee for the Code of Professional Conduct, which develops standards of conduct for the U.S. actuarial profession.

variations in assumptions and methods, we feel the first step should be a review and possible update or revision of the measurement process. To give the current APBO balance sheet status is likely to diminish the credibility of balance sheets and add unwarranted volatility.

Concerns About Current APBO Measurement

Most actuaries who have significant experience working with retiree health plans have encountered plans for which the substantive plan has been reduced in major ways over the course of FAS 106 reporting. While retiree and employee groups protested early changes by plan sponsors, court cases usually did not find a vesting of benefits and cases were decided in favor of plan sponsors. As a result, major reductions continued and recent changes have met with less resistance by retirees, though they rarely receive anything in exchange for the diminished benefits.

Most observers believe that major changes, reducing or even terminating benefits, are inevitable in the future. An employer in today's competitive economy, faced with business pressures to keep expenses low, will not hesitate long in curbing long-term health care promises that cannot be legally enforced. Accordingly, we believe that employers have placed implicit and not-yet-spoken limits on their OPEB benefits. The lower resistance to significant benefit reductions may be evidence that participants recognize the limits within the employer's commitment. The participants may have discounted the future value of any currently provided retiree health benefits.

The current concept of "substantive plan" embedded in the FAS 106 APBO measurement does not account for these limits. On the other hand, the authority derived from FAS 106 to delay recognition of plan changes and actuarial gains/losses has mitigated financial pressures caused by the conceptual shortcoming. We feel that a shift in financial reporting that immediately records the benefit obligation on the balance sheet must be accompanied by an expansion of the current concept of substantive plan to reflect limited employer commitments and discounted participant benefits.

While the FAS 106 concept of a substantive plan, as opposed to a plan with specific dollar-denominated provisions, provides some flexibility, it does not incorporate this ability to make major reductions, including termination, in an OPEB program. The original exposure draft of what became FAS 106, when released in February 1989, stated that the actuarial projection should assume every plan provision as of the measurement date would be in place for the life of the plan. When it was pointed out that deductibles and other dollar-denominated provisions customarily changed with inflation adjustments every few years, the concept of "substantive plan" was incorporated in the final version of FAS 106. In essence, under the substantive plan the actuarial projection could assume future plan changes, if specifically patterned and communicated to participants.

It has become clear in the past 15 years, however, that even this flexible definition of plan will accurately reflect a retiree health plan for only five or 10 years at the most. The reason is that a communication of the substantive plan to the plan participants may include general policy about plan provisions but, for a majority of plans, it also will include statements reserving the sponsor's unilateral right to change any and all of the provisions. When the explicit provisions of the FAS 106 substantive plan are accompanied by the explicit provision reserving the employer's right to change it all, it is implicit that one should not assume any provision is part of a long-term commitment.

The strength of the employer's right to change the plan is a much more prominent feature of the OPEB environment now than it was when FAS 106 was released. The information that FAS 106 brought to the attention of the business community has played a part in this, but most employer benefit reductions have been a response to the economic climate and the changing health care circumstances of the past 15 years. Court cases in this period have also sided with plan sponsors' unilateral right to make significant changes. We see the implication that the actuarial measurement and the accounting treatment need to distinguish between long-term benefits that are legally binding and those that are not. Measurement under FAS 106 uses payment projections for five decades or more with increasing health rates; the resulting expense and APBO is heavily weighted for future periods when the substantive plan will, in all probability, not be operative.

We believe the goals set out by the March 31 exposure draft, (transparency and completeness) are important ones. We feel the consequences of the two-step implementation, however, are likely to be seriously counterproductive unless revised measurement has higher priority. Implementing the posting to the balance sheet of the current APBO will result in a misrepresentation of the financial liabilities of the reporting corporation in all too many cases. Such misrepresentation will have the opposite effect of the announced intention of the comprehensive project, which is to increase the credibility of financial reports.

Actuarial Measurement

At the time the actuarial community first began to discuss OPEBs with FASB in the 1980s, there had been increasing requests from clients of actuarial consulting firms and health insurers to quantify the long-term implications of OPEB promises, particularly those associated with retiree health care. This was a time of developing actuarial methods, usually using the annuity model as the framework and making major accommodations for the complexities of health care insurance. It was presumed these benefits were vested and, where there was no age limit on eligibility, that they would be paid throughout the retiree’s lifetime. No consensus of court cases had then indicated otherwise. As a result, no attempt was made to distinguish between plans with long-term guarantees and those without.

With hindsight, it is clear that many actuarial valuations under FAS 106 projected benefit levels for the future that were more generous than what actually occurred or will occur. Actuarial models more suitable to plans without long-term guarantees might have avoided that. With this in mind, our Academy committee believes it is very likely phase 2 of the announced FASB project will conclude that the obligations associated with a vast majority of retiree health benefit programs would be better served if the FAS 106 methodology were revised. We therefore urge the Board to reverse the order of its priorities and first begin the review of methodologies.

Many aspects of FAS 106 have served the financial community well. We recognize that, given the volatility inherent in the current APBO, the amortization of transition, prior service costs, and gains and losses have served to moderate unwarranted balance sheet volatility. Our committee is not advocating that the APBO be marked to zero in those cases where the plan sponsor has reserved the right to significantly alter or terminate OPEB plans. We do, however, strongly recommend that the Board commence the reevaluation of the FAS 106 measurement process before assigning the current APBO more prominence than it now has in financial statements. We in the actuarial community are available to work with you to establish an OPEB measurement process that would meet the accounting goals of transparency and accuracy. This discussion has begun, as indicated by deliberations within our committee and a recent paper published in the *North American Actuarial Journal*.

Beyond the Actuarial World

This committee recognizes that there are pressures to make retirement accounting more transparent by moving footnote disclosures to balance sheets. Nevertheless, some pressing for change may not be aware that knowledgeable analysts do not consider most OPEB obligations to be debt. This gap between analysts with an understanding of the true nature of the OPEB obligation and the rest of the investing public may create an arbitrage opportunity rather than the level playing field associated with complete and transparent financials. If the Board's goal is for financial reports to be more meaningful, the disclosure of the APBO is secondary to a review of the measurement process. Such a review would have the concomitant benefit of informing interested parties.

We recommend the FASB consider the value that the financial community actually places on the current disclosures before deciding these disclosures should go on the balance sheet. An obvious question is whether major changes in APBO cause analysts to change their opinions of creditworthiness. It is our view that the recent implementation of the Medicare Part D prescription drug plan had a much smaller impact on the valuation of stocks and bonds of affected OPEB sponsors than was reflected in the APBO decrease disclosed after the passage of the law. A valid conclusion is that APBO does not, in the case of many OPEB sponsors, reflect real economic value.

In the years since the release of FAS 106, accommodations may have been made that hide the bad outcomes mentioned above. Financial analysts create their own OPEB adjustments, employers implement caps, sponsors select optimistic health care trends, etc. Such moves, however, should not be seen as an endorsement of current APBO measurement. Even plans that have capped their liabilities retain the right to change the plans more drastically, including termination.

Placing the APBO as currently measured under FAS 106 on balance sheets threatens to distort financials rather than make them more transparent. As final evidence in that regard, we reference the United States Congress's inclusion of a retiree drug subsidy (RDS) for OPEB plan sponsors when it passed the Medicare Modernization Act (MMA). This highly unusual move by the federal government, to simply give money to the private sector if they would maintain a program that was already in place, recognized that the plan sponsors could alter or terminate OPEB plans at their own discretion. Employees, retirees, and the government have no remedy to major reductions in OPEB plans by the sponsors because such plans are rarely recognized as legal liabilities. The RDS is a federal subsidy that recognizes there often was no economic exchange entitling retirees to OPEBs. In contrast, the principle economic basis for FAS 106, as stated in paragraphs 3 and 7 of FAS 106, is exchange of employee service for the OPEB benefit. That economic basis is no longer valid in the eyes of many observers, which may be recognized in the revision of accounting standards in Phase 2.

We appreciate the opportunity to provide these comments and would be pleased to work with you to address the problems of measuring an appropriate value for the OPEB promise. If you have any questions or would like to discuss this matter further, please contact Heather Jerbi, the Academy's senior pension policy analyst (202.785.7869; Jerbi@actuary.org).

Sincerely,

Jeffrey P. Petertil, MAAA, ASA, FCA
Co-Chairperson, Joint Committee on Retiree Health
American Academy of Actuaries

Adam J. Reese, MAAA, FSA, FCA, EA
Co-Chairperson, Joint Committee on Retiree Health
American Academy of Actuaries