



## AMERICAN BENEFITS COUNCIL

November 13, 2012

The Honorable Mary Schapiro  
Chairman  
U.S. Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549-0190

Dear Chairman Schapiro:

On behalf of the American Benefits Council (the "Council"), I am writing today with respect to a very serious problem regarding the measurement of pension obligations under Accounting Standards Codification ("ASC") Topic 715, Compensation -- Retirement Benefits, specifically section 715-30 ("Standards").

The Council is a public policy organization representing principally Fortune 500 companies and other organizations that assist employers of all sizes in providing benefits to employees. Collectively, the Council's members either sponsor directly or provide services to retirement and health plans that cover more than 100 million Americans.

***Current economic events have further revealed a fundamental flaw in the Standards regarding the applicable discount rates used to measure pension obligations. This flaw is causing the Standards to fail to produce an accurate measurement of pension obligations reflected on companies' balance sheets.***

The erroneous measurement has resulted in the Standards creating economic conditions, rather than accurately reflecting those conditions. By erroneously causing pension obligations to be significantly overstated, the Standards are triggering artificial reductions in equity on company balance sheets. These reductions are, in turn, making it much harder for many companies to obtain the credit needed to make business investments and retain or create jobs.

As discussed in more detail below, it is critical that this flaw in the Standards be promptly corrected. The Standards are intended to properly measure retirement obligations, not overstate them and thus impede our economic recovery.

## FUNDAMENTAL FLAW IN STANDARDS

ASC 715-30 paragraph 35-42 very appropriately states that in measuring obligations attributable to pension plans, the assumptions shall be based on the presumption that the plan will continue in effect (absence evidence to the contrary). However, in paragraphs 35-43 through 35-46, Section 715-30 goes on to require that the discount rates used to measure the pension obligations reflect the discount rates that could be used in effectively settling the pension obligations as of the measurement date. In general, this hypothetical settlement would be “implemented” by determining the cost of buying high-quality corporate bonds that could be used to cover the plan’s projected obligations.

In effect, ASC section 715-30 bases the applicable discount rate on a hypothetical purchase of high-quality corporate bonds on a given date by an ongoing plan. The problem with this approach is that given today’s artificially low interest rates, such settlement of all plan obligations on one day is a transaction that almost no fully ongoing plan – a plan that is not terminating or taking steps to shrink its existing liability – would enter into. *In other words, the Standards base the most important assumption – the discount rates – on a hypothetical transaction that generally does not happen with respect to a fully ongoing plan in today’s unusual interest rate environment.*

Here is another way to view this issue. Assume that the Standards did not exist and Company A is selling a Division to Company B. The Division sponsors a pension plan that is fully ongoing. The question arises as to the value of the pension plan’s assets and liabilities. Would market participants value the pension plan based on a hypothetical purchase of bonds in today’s unusual interest rate environment? The answer is generally no. If interest rates fluctuate wildly as they did in late 2008, or as they could due to Federal Reserve Board actions, would market participants truly believe the value of pension plan obligations really fluctuates by 30% or 40% over the course of two or three months? Of course not.

In short, an important point has been driven home by the efforts of the Federal Reserve Board to stimulate the economy by reducing interest rates: non-market forces can create interest rates that do not reflect the natural workings of the market. If these non-market interest rates are used to value ongoing pension obligations, the valuation will not be accurate, but rather will be distorted by non-market forces. This is wrong and needs to be corrected.

## EFFECTS OF THE FUNDAMENTAL FLAW

There are many adverse effects that can flow from the potential overstating of pension plan obligations. One critical effect is a reduction of equity on a company's balance sheet. This can have numerous repercussions, including making it more difficult for the company to obtain credit. This difficulty in obtaining credit can in turn mean that companies are less able to make business investments and retain and create jobs. Companies are facing enough challenges today. There is no need for the Standards to create additional challenges by distorting the value of pension obligations.

## THE SOLUTION

The solution to this problem is also straightforward conceptually. We understand that liabilities should be valued based on the cost of settling those liabilities. But it makes little sense to assume that all fully ongoing plans will settle those liabilities on a given day without regard to the advisability of the timing of such a settlement.

A far better approach would be to assume that the plan does not attempt to "time" the bond market by settling all liabilities at the same time. Instead, just as modern portfolio theory would support a dollar cost averaging approach to investing, the same principles would support a similar approach to the settlement of long-term liabilities over an extended period. For example, pension plan obligations, which can extend over 60 or 70 years, could be settled over 25 or 30 years by ratably purchasing bonds over that period. That would be a prudent and sound means of settling a liability for a fully ongoing plan.

The question then becomes: how do we best approximate the value of bonds purchased over, for example, a 25-year period? Again, the answer is straightforward: by constructing an average of bond prices and interest rates over the past 25 years, as historical data is the best available predictor of the future. Certainly, no one would argue that current rates are the best predictor, especially in light of the explicit efforts by the Federal Reserve Board to reduce interest rates.

Congress recently adopted a similar approach with respect to valuing liabilities for purposes of determining pension funding obligations. We recognize that the funding rules do not control accounting standards and that there may be different considerations that are relevant to the two areas. However, it is instructive that Congressional action reflected a recognition that current interest rates are not an accurate means of measuring pension obligations. So we are not suggesting that the accounting rules should in all cases follow every aspect of the funding rules. Instead, we are saying that Congress recognized the same current inaccuracy that we are urging you to correct.

In short, under our proposed solution, pension liabilities would be valued by using the 25-year average of bond interest rates to simulate a settlement of such liabilities over a 25-year period. Of course, because some plans have effectively settled their liabilities – or intend to do so – it would be appropriate to preserve the ability of companies to elect to continue to use the current rule, provided that the current rule is used consistently over time. By permitting both approaches – which is what has been permitted by Congress in the funding area for the same reasons – the Standards would be making the assumptions more realistic and accurate. A hypothetical transaction should not be assumed unless such a hypothetical transaction has occurred or there are indications that it will occur, either of which would be evidenced by an election to use the current rule.

We very much appreciate your consideration of our request.

Sincerely,



Lynn D. Dudley  
Senior Vice President, Policy

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