MINUTES

Financial Accounting Standards Board

To: Board Members

From: Interpretation of Statement 87 Team
(Quiring, ext. 326)

Subject: Minutes of the October 13, 2004 Board Meeting **Date:** October 19, 2004

cc: Leisenring, Bielstein, Petrone, L. Smith, Golden, O'Callaghan, Mahoney, Cassel, Sutay, Swift, Polley, Getz, Thompson, Gabriele, Lapolla, Intranet

The Board meeting minutes are provided for the information and convenience of constituents who want to follow the Board's deliberations. All of the conclusions reported are tentative and may be changed at future Board meetings. Decisions become final only after a formal written ballot to issue a final Statement or Interpretation.

Topic: Project Direction

Basis for Discussion: Memorandum dated October 8, 2004

Length of Discussion: 11:15 a.m. to 11:45 a.m.

Attendance:

Board members present:	Batavick (by phone), Crooch, Herz, Schieneman, Schipper, Seidman, Trott
Board members absent:	None
Staff in charge of topic:	O'Callaghan
Other staff at Board table:	Cassel, L. Smith, Quiring
Outside participants:	Leisenring (IASB)

Summary of Decisions Reached:

The Board met to provide the staff with direction on how it should proceed with this project in light of the concerns raised by constituents (via unsolicited comment letters and in small group meetings with Board members) on the Board's tentative decisions reached to date.

The Board directed the staff to develop an amendment of FASB Statement No. 87, *Employers' Accounting for Pensions,* for all defined benefit plans with lump sum features (that is, plans that allow employees to receive an immediate walk away amount upon separation of employment) so that the pension obligation recorded would be the greater of the undiscounted walk away amount that employees would be entitled to if they separated employment at the measurement date or the actuarial present value of the pension obligation at the measurement date.

Objective of Meeting:

The objective of the meeting was for the Board to provide the staff with direction on how it should proceed with this project. The objective of the meeting was met.

Matters Discussed and Decisions Reached:

Mr. O'Callaghan noted that constituents have expressed concern about the operationality of the measurement model for cash balance pension obligations that tentatively had been agreed to by the Board. He asked the Board for direction on how to proceed with the project. Major concerns expressed by constituents and alternatives considered by the Board are outlined in the attached audience handout.

Ms. Schipper and Messrs. Crooch, Trott, and Schieneman supported Alternative 2. Ms. Schipper stated that Alternative 2 would not provide a full solution for all employee benefit problems, but would address the initial question that gave rise to this project. She noted that a comprehensive pension project may be undertaken by the Board (possibly as a joint project with the IASB) that would address other employee benefit issues.

Mr. Trott stated that Alternative 2 is more representative of the Board's intent in Statement 87 and the view of the FASB staff in EITF Issue No. 88-1, "Determination of Vested Benefit Obligation for a Defined Benefit Pension Plan," and improves financial reporting for all pension plans with lump sum features, not only cash balance plans. He also noted that Alternative 2 eliminates the controversy surrounding the definition of a cash balance plan and the uneven application of the decisions reached in this project for different types of pension plans. He stated that the fair value of the pension obligation (that is, the amount that a third party would require to assume the obligation) is the walk away amount when that amount is higher than the actuarial present value of the obligation.

Mr. Herz did not object to Alternative 2, but noted that he is skeptical about the proposed model. He identified with the concerns expressed by constituents and noted that the model may result in a measure for pension obligations that is not fair value.

Ms. Seidman and Mr. Batavick objected to Alternative 2. Ms. Seidman does not support the proposed measurement model. She stated that the pension liability should reflect the amount that a third party would require to take over the obligation (present value). She does not believe that the walk away amount represents the present value of the pension obligation because present value would incorporate assumptions about the expected timing of the payment of the benefit. She does not believe that a third party would assume that all employees would terminate immediately. In addition, the walk away amount would not reflect certain contractual terms such as caps, floors, and spreads above or below a market rate. Ms. Seidman also noted that there could be implications for other literature that involves determining the present value of obligations where assumptions are required to be made about the timing of payment on an obligation.

Ms. Seidman expressed support for Alternative 4 and Alternative 5. She stated that the staff should consider the comment letters received by the International

Financial Reporting Interpretations Committee (IFRIC) on its Draft Interpretation D9, *Employee Benefit Plans with a Promised Return on Contributions or Notional Contributions,* and the projected timeline for a comprehensive project on pensions to determine if the interim change is meaningful enough to be made now.

Mr. Batavick objected to Alternative 2. He identified with the concerns expressed by constituents. Mr. Batavick supported Alternative 5.

Mr. Leisenring suggested that the FASB and IASB staffs prepare a document outlining the similarities and differences between the model proposed in Alternative 2 and the model proposed in Draft Interpretation D9.

Follow-up Items:

The FASB staff will consider the comment letters received by IFRIC on Draft Interpretation D9. The FASB and IASB staffs will consider preparing an analysis of the similarities and differences between the model proposed in Alternative 2 and the model proposed in Draft Interpretation D9.

General Announcements:

None.

Financial Accounting Standards Board

Board Meeting Handout
October 13, 2004
Interpretation of Statement 87 for "Cash Balance" Pension Plans

PURPOSE OF TODAY'S MEETING

The Board will be asked to provide the staff with direction on how it should proceed with this project in light of the concerns raised by constituents (via unsolicited comment letters and in small group meetings with Board members) on the Board's tentative decisions reached to date.

CONSTITUENTS' CONCERNS

While constituents have expressed several concerns with the Board's decisions in this project, the following are the ones that are the most prevalent:

1. If cash balance pension plans are defined benefit plans, as the Board has decided, then projecting benefits forward at assumed crediting rates and discounting the resulting amounts using a rate based upon the yield of a portfolio of high quality fixed-income investments should be acceptable as it is for all other defined benefit plans.
2. The measurement model equates to a liquidation model for variable interest crediting rate cash balance plans.
3. There are very few "pure" cash balance pension plans, and the majority of cash balance pension formulas have been integrated with traditional defined benefit formulas (or vice versa) and employees can be provided the greater of the two benefit formulas which can create complexities and anomalies in measuring the pension obligation. For example:
    a. Variable rate plans with different economics will have similar projected benefit obligations (PBOs); for example, a pension plan that credits a T-bill rate versus one that credits two multiplied by the T-bill rate versus one that credits a T-bill rate plus two percent. Economically these three plans are different but initially would have similar PBOs under the proposed measurement model. The PBOs eventually would diverge as the formulas produced different account balances.
    b. A plan with an interest crediting rate of a one-year T-bill rate with a cap of four percent is not economically equivalent or greater to a plan with

a fixed interest crediting rate of four percent, but under the proposed measurement model would have a greater PBO.

4. Why subject cash balance pension plan sponsors to change now only to have plan sponsors change again when a convergence pension project is undertaken?

STAFF ALTERNATIVES FOR THE BOARD TO CONSIDER

The Board will consider the following alternatives:

1. Direct the staff to proceed with the project and continue to explore alternative measurement models for cash balance plans with variable interest crediting rates.
2. Amend FASB Statement No. 87, *Employers' Accounting for Pensions,* for all defined benefit plans with lump sum features so that the minimum pension liability recorded would be no less than the walk away amount that employees would be entitled to if they separated employment at the measurement date.
3. Reconsider enhanced disclosures for cash balance plans beyond those required by FASB Statement No. 132(R), *Employers' Disclosures about Pensions and other Postretirement Benefits*.
4. Postpone making decisions on issues and in the interim the FASB staff would analyze the comment letters received on the International Financial Reporting Interpretations Committee's (IFRIC) project. The staff would monitor IFRIC's pension project and provide the Board with periodic updates on IFRIC's decisions, if any. The staff would expect to return to the Board early in 2005 for project reconsideration.
5. Postpone the project and readdress cash balance pension plans as part of a broader pension project at some later, yet to be determined, date.