AMERICAN ACADEMY of ACTUARIES

September 21, 2021

Hillary H. Salo
Technical Director
File Reference No. 2021-004
Financial Accounting Standards Board (FASB)
401 Merritt 7, P.O. Box 5116
Norwalk, CT 06856-5116

RE: File Reference No. 2021-004

Dear Ms. Salo:

I am writing on behalf of the Pension Committee of the American Academy of Actuaries,[1] in response to the Invitation to Comment (ITC) published by FASB staff on June 24, 2021. Prior to the issuance of the ITC, we had recently formed a work group to discuss various provisions of Accounting Standards Codification (ASC) Topic 715 and how these provisions might be updated to improve comparability of expense and disclosure of liabilities across different organizations for defined benefit pension plans. We believe this is particularly important in light of the significant changes in pension plan design and utilization since the current rules were last reviewed in a substantive way.

The current pension accounting standards codified in ASC Topic 715 were first released in more or less their present form in FASB Statements No. 87 and 88 in December 1985. At the time, the FASB noted that it had stated upon the release of the prior pension accounting standard, Opinion #8, in 1966 that "accounting for pension cost is in a transitional stage." The FASB then went on to say that it believed this "is still true in 1985." Nevertheless, since that time, there have been only minor changes to the standard. Over the same time period, very significant changes that have occurred in the pension landscape. In the mid-1980s most major corporations offered defined benefit plans, often of the final average salary type, and plan freezes and terminations (without a replacement defined benefit plan) were relatively rare. Now, many plans have been closed to new entrants or frozen entirely, and many of those that continue to provide accruals

[1] The American Academy of Actuaries is an 19,500-member professional association whose mission is to serve the public and the U.S. actuarial profession. For more than 50 years, the Academy has assisted public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

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have “hybrid” benefit formulas (e.g., cash balance or variable annuity plans) that were not contemplated when the accounting standards were developed. The application of the current standard to these designs limits the ability of financial statement users to make meaningful comparisons. Further, the pension accounting standard itself may be contributing to a phenomenon of discouraging companies from sponsoring pension plans for their employees because it rewards sponsors who freeze plans with reductions in liabilities and expense that are disproportionate to the actual amount saved.

The major items that we deem as potentially in need of improvement include:

- **Measurement of Liability—**When the current pension accounting standard was adopted, a requirement to use of the Projected Benefit Obligation (PBO) actuarial method to allocate costs to time periods appeared to make sense, thereby incorporating assumed future salary increases to measure a plan’s liabilities. The PBO measure is intended to incorporate these future salary increases with respect to benefit service provided in the past to allocate the ultimate expected benefit to each year of service with the expectation that final pay pension formulas would continue to be offered indefinitely, and that employers would find it difficult to modify these promises without risking a significant backlash from employees. Thus, it made sense to recognize these promises evenly over the course of the employees’ careers, rather than delaying recognition until the benefits were actually credited by the benefit formula. In practice, it has not turned out this way. Many, if not most, plans have been frozen or converted to hybrid formulas and sponsors have been easily able to modify pension formulas without significant negative employee reaction. Nevertheless, a significant portion of the PBO for an ongoing pension plan comprises benefits that have not yet been earned, and that can be easily modified or eliminated by the plan sponsor, providing a strong incentive for sponsors to freeze pension plans to unlock this illusory “savings.” Further, the PBO appears inconsistent with current practices that call for measurement of the most accurate actual liability at any point in time, without projections of future changes in various factors.
- **Inconsistency of Measure for Different Types of Plans—**Until recent years, the PBO measure was generally applied to all types of defined benefit plans, regardless of formula type. This included not only plans that provided benefits based on a final average salary period of some length, but career average plans that provided benefits based on a year-to-year accumulation of benefit credits. This, however, is no longer being applied consistently to cash balance plans, which conceptually are no different than a career average type plan in that both determine benefits by accumulating accruals earned throughout a career, rather than by reference to final average earnings. In many cases, an Accumulated Benefit Obligation (ABO) measure is being used for cash balance and other hybrid plans. This would appear to provide more favorable treatment for one type of plan than another without a logical basis for doing so. If one type of plan is entitled to use an ABO-type measure, we believe that all plans should be treated the same way.

- **Amortization of Gains and Losses for Frozen vs. Active Plans—**Plans that cover a substantially inactive population base or that have been frozen are entitled to amortize gains or losses over the life expectancy of the covered population, while those that cover active employees are required to amortize the same amounts over the expected future working lifetime of the active employees, which is substantially shorter in all cases, resulting in significantly larger amortizations. This discrepancy creates a further unintended and undesirable incentive for plan sponsors to freeze plans to reduce expense by deferring recognition of existing losses.
- **Accounting for Plans That Provide Benefits That Are Investment-Based—**To the extent that new defined benefit plans are being established or old plans modified with new formulas, many plans are adopting designs that base benefits on the actual return on plan assets, possibly subject to certain guarantees or limitations. The existing standard did not anticipate these designs and is ambiguous in its application. As a result, PBO measurements for these plans tend to vary by plan and by auditor. This inconsistency could be readily addressed by extending the rationale behind bond-based discount rates to the characteristics of these plans.

The Academy's Pension Committee hopes the issuance of the ITC at this point in time provides you with the opportunity to consider the defined benefit pension plan issues that we have raised. We believe the issues identified above fall within your stated goals of selecting projects where there is an identifiable and necessary need to improve U.S. generally accepted accounting principles (GAAP), where the improvements would be technically feasible and appropriate taking expected costs into account.

Thank you for your consideration.

Respectfully submitted,

Bruce Cadenhead, MAAA, FSA, FCA, EA
Chairperson, Pension Committee
American Academy of Actuaries