



AMERICAN ACADEMY *of* ACTUARIES

June 22, 2000

Ms. Wendalyn Frederick
Technical Manager
Professional Standards & Services, File Q511
AICPA
1455 Pennsylvania Avenue NW
Washington, DC 20004-1081

Dear Ms. Frederick:

The Pension Accounting Committee of the American Academy of Actuaries appreciates the opportunity to comment on the proposed amendments to SOP 92-6.

Major Issues

We agree that the use of net vs. gross obligations is an important issue that needs to be settled. We believe the “net” postretirement benefit obligation is far more important than the gross obligation. (Unless otherwise noted, references in this letter to postretirement benefit obligation applies to both postretirement and postemployment benefit obligations.) Our belief is based on the following:

1. The plan is, by definition, an obligation to participants. To indicate that a plan’s obligations include amounts that the obligatees will pay seems to contradict the entire nature of the plan. We understand that in many cases, the participants are paying their contribution to the plan, rather than directly to the health care providers. However, under the common actuarial methodology, amounts paid to the health care providers are assumed to be coincident with the date of employee contributions, and in many cases may never be deposited into the trust.
2. The cost of postretirement benefits is typically shared by employers, employees, and Medicare. The employee contributes his/her share of the cost in three ways:
 - copayments
 - deductibles
 - employee contributions

Because two employers may provide identical total benefits, but allocate the employees’ cost sharing differently among the three choices, showing different gross amounts could be considered misleading.

3. The gross liability does not seem to recognize the true nature of the employer/employee transaction. The obligation only exists if an employee makes the contributions. A comparable example would be an agreement (for whatever reason) by Company A to pay \$1,000 to Company B on July 1, 2001 if on that date, Company B pays Company A \$600. Company A then has a liability of \$400 (ignoring discounting). In this case, a

footnote display showing the \$1,000 and \$600 figures is not erroneous, but adds limited value.

4. In general, while we are not convinced that disclosing the gross liability, in addition to the net, provides significant additional benefit to the user of the statement (who, in a practical sense, is probably the Department of Labor,) we do not object to its inclusion in those instances where the figure is readily available. However, the advantages of showing gross liabilities would not seem to justify the significant additional costs that may be necessary to obtain the required disclosures in certain circumstances. For example, two common situations that would require onerous reprogramming are:
 - a. In some cases, an actuary may not calculate the present value of employee contributions. For example, two streams of annual cash flows (benefits paid and employee contributions received) are netted against each other on a person by person basis. The netted amounts are then summed over all participants, and discounted to the present. Computer systems which use this approach would have to be reprogrammed.
 - b. Many plans currently use an approach under which the substantive plan benefit is a defined dollar amount (e.g. \$100/month) and the employee contribution is defined as the excess of monthly gross claims over a defined dollar amount (e.g. \$100/month). Net liabilities under this approach are the present value of defined dollar payments; gross liabilities are not determined and would require significant additional costs to calculate.

Some companies define the dollar amount to be zero, i.e., the employee must pay for the entire coverage, although the company provides an insurance vehicle. In this case, the net liability is by definition zero, so no calculation need be performed under FAS 106. The proposed changes would require a valuation in this case.

In the case of multiemployer plans, the additional cost of calculating gross liability is likely to be “paid” in the form of reduced employee benefits. As such, we question whether the users of the financial statements would believe that the cost of the calculation of the gross liability is worth the benefit.

In a number of places, as part of the rationale for the changes, the amendments indicate that employee cost sharing was not prevalent in 1992 when SOP 92-6 was issued. While we have not attempted to perform a comprehensive survey, the experiences of the members of this committee is that some form of cost sharing was virtually universal in 1992, and that employee contributions were required more often than not. We believe that minimizing actuarial and audit costs, as described in paragraph A-3, is still an important objective. We note that 92-6, as originally issued, did not create additional administrative costs (beyond the FAS 106 requirements) for funded employer plans, but these amendments would create costs in some circumstances.

The amendments indicate that financial statements for prior plan years would be required to be restated. This seems to imply that prior year amounts, presented in this year’s financial statements for comparative purposes, must show gross and net amounts. If so, in many cases, this will require the plan sponsor to pay an actuary to re-do prior years’ valuations. If the prior year valuation must be redone to determine gross amounts, that revised valuation will probably cost more than the original valuation.

Minor Issues

- ▶ Paragraph 6 indicates that FAS 112 does not apply to health and welfare plans. Technically, FAS 112 applies to employer accounting for certain health and welfare plans. It does not apply to the accounting of the plan's statements. You may wish to clarify this point.
- ▶ Our version of paragraph 8 ends in mid sentence.
- ▶ The last paragraph of paragraph 13 indicates that "changes in the amount of postretirement benefits expected to be funded by participants' future contributions should be identified . . ." Actuarial valuations for the Postretirement Benefit Obligation typically include an assumption as to future contribution increases. Increase in contributions higher or lower than assumed are part of actuarial gains and losses. This paragraph could be interpreted to require showing the effect of any change in contributions (an onerous calculation), the effect of contribution changes different than expected (thus segregating one type of actuarial gain/loss from the others) or the effect of changes in the employee contribution assumption (thus segregating one type of assumption change from the others). We believe the amendments should eliminate, or at least clarify, this requirement.
 - ▶ Paragraph 27a includes a description of the employee contribution formula. In many cases, no one standard formula exists, because
 - plans have been aggregated,
 - plans have been modified over time, grandfathering current retirees, or
 - contributions for each individual were determined one person at a time.

You may wish to clarify the level of detail expected in this aspect of the disclosure.

- ▶ Paragraph A.8. states "The event that gives rise to benefits is participant service." We believe this is misleading. The events that give rise to benefits are typically the payment of employee contributions and retirement after meeting eligibility requirements. These eligibility requirements do frequently include a service period, but the service period is generally much shorter than the number of years actually worked by the participant. FAS 106, and by extension SOP 92-6, frequently require attribution over an employee's entire period of service, but attribution is much different than defining the event which allows benefits to be paid. Indeed, even after retirement, benefits are still conditional on payment of employee contributions.

The next to last sentence of paragraph A.8. states in part " the fact that the participant must make future contributions to maintain coverage does not mean that future benefit payments should be expected and that the plan has no obligation." We agree but are unsure who would make that claim. It is the amount of obligation, not the existence, that is affected by employee contributions, and that is why the net obligation is the most appropriate figure to disclose.

- ▶ Paragraph A.10. claims that the net approach is more consistent with FAS 35. We believe this is an invalid comparison, since these amendments are primarily dealing with

postretirement contributions that frequently never become trust assets, while pension plans might have pre-retirement contributions that become plan assets, but do not have postretirement contributions. FAS 35 figures would be the same under net or gross calculations, so there is no way to conclude that the net approach is more comparable.

- ▶ We believe the schedule at the top of page 40 would be improved if the line “benefits earned” were changed to “benefits earned, including actuarial gains and losses.”
- ▶ We note that the required disclosures are more akin to the old FAS 106 requirements rather than the new FAS 132 requirements. Was any thought given to adopting FAS 132 rules?

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We appreciate the opportunity to comment. If you have questions regarding these comments, please call David Rivera, assistant director of public policy, at (202) 785-7869, or Jim Verlautz, committee chair, at (612) 397-4031.

Sincerely,

James F. Verlautz
Chair
Pension Accounting Committee

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