

FASB FOCUSES ON DEFINED BENEFIT PLANS THAT PAY LUMP SUMS

The Financial Accounting Standards Board tentatively decided on October 13 to broaden the focus of its cash balance measurement project to include any defined benefit plan that pays lump sums. By a 5 to 2 vote, the Board asked FASB staff to develop an amendment to the accounting standard governing pensions (FAS 87) that would set the obligation equal to the greater of the obligation otherwise determined or the value of the “walk-away” benefit (i.e., the lump sum that would be payable if the participant were to terminate employment on the measurement date). An amendment, if one is ultimately approved by the Board, is unlikely to be adopted before the spring of 2005.

BACKGROUND

FASB, in 2003, had tentatively concluded that cash balance plans that credited a variable rate of interest (e.g., the yield rate on a 10-year government bond) should have an obligation, for each affected individual, equal to at least the account balance. In reaching that conclusion, the Board appears to have been influenced by the similarity of cash balance plans to defined contribution arrangements and by a desire to converge with international standards. The Board had anticipated issuing an exposure draft covering this interpretation in May 2004. However, actuarial practitioners objected to this proposal for several reasons, especially for the inconsistencies in accounting it would create among otherwise similar plans. The Board was influenced by those objections.

THE PROPOSAL

FASB staff has now been directed to work to “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.” Under this new approach, the scope of the project is broadened to include all plans that pay lump sums. The project is also narrowed, in a sense, because the proposal will not affect accounting for the few cash balance plans that only pay annuities.

Staff must still flesh out the details, work with user groups including actuaries, and present the Board with a formal amendment that can be published as an Exposure Draft. Comments from the public on the Exposure Draft would then be considered by the Board in deciding whether to adopt an amendment to FAS 87. There is no timetable for these developments. Thus, a final ruling should not be expected before the spring of 2005.

ANALYSIS

While this proposal is an improvement in some respects over the narrower cash balance proposal, it has some problematical elements.

- A lump sum is generally only payable if the participant leaves service on the measurement date, yet the proposal would disregard experience that suggests that event is far from certain. Thus, it overlays a “liquidation” model onto an ongoing plan model for any plan that pays lump sums.
- It is not clear how to handle plans that pay partial lump sums.
- Because the proposal is entirely new, there may be other problems in application that will be discovered as it is investigated more thoroughly.

Many traditional defined benefit plans that pay lump sums will be affected hardly at all, especially where the lump sum does not include the value of subsidized early retirement benefits. However, other plans, including many cash balance plans, pension equity plans and some traditional plans may be impacted significantly.

Each plan is unique and should be examined to see what the potential impact would be if the proposal should be adopted.

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