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Cost Accounting Standards Board
c/o Mr. Raymond Wong
Office of Federal Procurement Policy
725 17th Street NW -- Room 9013
Washington, DC 20503

September 6, 2013

**Subject:** Comments on CAS 413 Pension Adjustments for Extraordinary Events

Dear Mr. Wong:

We would like to thank the Cost Accounting Standards Board and its staff for the opportunity to comment during the public meetings in July and August on the potential changes being considered for the CAS 413 pension adjustments for extraordinary events. The comments expressed in this letter reiterate many of our verbal comments during the meetings, and raise a few additional items for the CAS Board's consideration. The comments expressed in this letter represent the views of the undersigned actuaries who work frequently with clients that are subject to the CAS pension accounting rules. It is important to note that our views are not necessarily the same as those of our clients or our firm.

Following is a summary of those issues that we feel would warrant further review and consideration related to this topic:

Curtailments

We believe that the curtailment of benefits should be excluded from the list of events that give rise to a segment closing adjustment. A plan freeze is a different type of event than the sale of a segment or the termination of a pension plan. In particular, when a plan is frozen, assuming there is no change in the relationship between the contractor and the government, there is simply a reduction of the amount of future benefits that are accruing under the DB pension formula. As such, we believe that it would be more appropriate to treat benefit curtailments like plan amendments, which would be amortized into future cost accounting periods, and for the contractor to continue calculating assignable pension costs under CAS 412/413.

It should be noted that there are a number of plan freezes that either have, or will have occurred prior to any potential changes to CAS 413, and will still be subject to the existing CAS 413 rules.

Merging or Eliminating Segments and Use of Inactive Segments
We recommend that CAS 413 be amended to give contractors more flexibility to combine or eliminate segments due to corporate restructuring actions where legacy pension segments no longer make sense. This could help alleviate the problem that some contractors are beginning to face of "orphaned" segments, where a soft freeze occurred some years ago, and the number of active participants in a given segment is diminishing, and costs for that segment are being allocated over a smaller base.

Related to this, we feel that the inactive segment concept which is allowed under CAS 413 is an excellent solution to the "orphaned" segment problem, however, in practice it is difficult to implement. Allowing more flexibility for contractors to set up and maintain an inactive segment would be a positive change to the CAS.

Pension Plan Mergers and Spin-Offs
When a pension plan is merged or a plan is spun into multiple plans, the ERISA rules and/or the purchase and sale agreement usually dictate the amount of assets to be transferred. These assets are often not equal to the CAS assets associated with the affected liabilities being transferred. When this is the case, a balancing item must be created to maintain the CAS balance equation. In these cases, we would suggest that any excess transfer amount be considered a prepayment credit, and in the case of a shortfall, such amount be treated as an unallowable expense.

Example 1: Assume Plan A has three segments: A1, A2 and A3, and is transferring assets and liabilities for Segment A1 to Plan B. Prior to the transfer, the assets of Plan A equal $1,000,000, consisting of $400,000 for Segment A1, $400,000 for Segment A2, $100,000 for Segment A3 and $100,000 in prepayment credits. Based on the required transfer amounts which are predicated by the purchase and sale agreement, Plan A must transfer $475,000 related to the liabilities of Segment A1 to Plan B. In order for the CAS balance equation to be maintained, Plan A should transfer $400,000 of CAS assets and $75,000 of the existing prepayment credit to Plan B.

Example 2: The facts are the same as Example 1, however the required transfer amount predicated by the purchase and sale agreement is $525,000 related to the liabilities of Segment A1 that are spinning off to Plan B. In order for the CAS balance equation to be maintained, Plan A should transfer $400,000 of CAS assets, and $125,000 the remaining plan assets to Plan B. Since the excess of the transfer amount is greater than the existing prepayment credit, then Plan A should set up an unallowable amount of $25,000 which should be allocated to the remaining segments in proportion to the CAS assets for the remaining segments. As such, $20,000 of the unallowable amount should be allocated to Segment A2 (so the sum of the remaining assets, plus the unallowable amount remains $400,000) and $5,000 of the unallowable amount is allocated to Segment A3 (so the sum of the remaining assets, plus the unallowable amount remains $100,000).

Participant Transfers Between Segments

When participants transfer among segments, we believe that the appropriate liability basis for determining the amount of required asset transfer should be based on the harmonized liabilities. That is, the liability should be equal to the MAL as of the actuarial valuation date first occurring on/after the participant transfers between segments. While a strong supporting argument can be made for using the same spot basis (for those plans that employ a smoothing bases for the MAL discount rate) as we recommend below related to segment closing adjustments, we don't believe that the incremental precision warrants the additional calculations in the case of transfers among segments.

Assignable Cost Limit – Adding a Buffer

It is well understood that any mark to market accounting basis will be inherently more volatile than a smoothed basis. The CAS Board recognized that dilemma in developing the harmonization rules, choosing to employ longer amortization periods that permitted for ERISA minimum funding purposes. Given the CAS Board's desire to have CAS expense be more stable across multiple years, we believe it makes sense to provide for a buffer on the Assignable Cost Limit calculation.

While in most cases the CAS expense for a plan or segment hitting the assignable cost limit will be fairly low (or even zero) prior to the application of the assignable cost limit, timing differences could result in situations where the expense is limited by the assignable cost limit well before all existing amortization bases are extinguished. In that case, any subsequent actuarial loss will be amortized over 10 years, which may be a shorter time period than the weighted average period for the existing amortization bases. Should this occur, the CAS expense may be even more volatile than the market performance should suggest.

To alleviate this concern, we would suggest that the liability for the assignable cost measure be increased to 115% of the otherwise applicable liability. In our opinion, this 15% buffer provides a reasonable cushion to absorb future volatility. Also, settling plan liabilities through the purchase of annuities often results in costs that are 10-20% above the mark-to-market liabilities.

It is important to note that absent any new gains/losses occurring, the excess above the 100% amount will be amortized as a gain over a 10-year period starting on the next valuation date, since the ongoing CAS expense calculations will remain calibrated to achieve 100% funding. So while the current year CAS expense will be higher than if no buffer were utilized, the expense will be far smoother and any "excess CAS expense" due to the buffer will serve to reduce future years' CAS expense over a 10-year period.

Actuarial Basis for the segment closing liability

When a segment closing adjustment occurs, there is a comparison between the actuarial liability and the market value of assets. Just as the assets are valued at market value for purposes of this calculation, we also believe that the liabilities should reflect a fair market value. As such, we would suggest that the segment closing adjustment calculations be modified to reflect spot interest rates as of the date of the segment closing. The basis for these calculations could be the same basis as used by the contractor to determine their Minimum Accrued Liability/Minimum Normal Cost (MAL/MNC) calculations, but without reflecting any interest rate averaging or smoothing that is permitted for purposes of determining the ongoing CAS expense (i.e., calculated on a "spot" interest rate basis). If the CAS Board would prefer to use a single set of interest rates for all contractors, we would suggest that the Board consider using the PPA spot segment interest rates that are published monthly by the Treasury (the spot rates for each segment are published each month along with the 24-month average segment rates that are used for minimum funding calculations).

We also believe that the segment closing liabilities should reflect the present value of future administrative expenses. This is important as the MNC calculation for an ongoing plan includes a provision for the current year administrative expenses, so including a provision for the present value of future administrative expenses seems appropriate when performing the segment closing calculations due to the final nature of these calculations.

We note that the current language in CAS 413 allows the cost of purchasing annuities and/or paying lump sums to be used in cases where the liabilities are settled in this fashion in connection with a segment closing. We believe that this provision should be retained so that contractors experiencing a segment closing can effectively settle their pension liabilities without incurring additional costs.

Lastly, in considering changes to the definition of the segment closing liability, we would request that the CAS Board clarify that the remaining actuarial assumptions to be used be appropriate for the closed segment. In particular, the reference to "current and prior" actuarial assumptions has led to discussions with DCAA in some circumstances, often in situations where the prior assumptions were changed well in advance of the segment closing taking place since they no longer represented the contractor's best assumptions as to future events. We believe that a more refined definition of the actuarial assumptions to be used would be "current and reasonable assumptions that are appropriate to the closed segment".

Asset allocation issues / lack of historical allocation data

The current CAS rules set forth what appears to be a relatively straight-forward methodology for determining segment closing adjustments. In principle, the rules endeavor to base the segment closing adjustments on the full historical cost basis for the affected segment. In practice, however, this principles are difficult to apply.

In many situations in which segment closings occur, it is not possible to obtain or recreate the historical information for the segments. While the CAS regulations allow the contractor and the contracting officer to agree on a mutually agreeable method for estimating the history, our experience is that has led to disagreements in the past.

In particular, the asset allocations for plans using composite accounting should be allowed to be performed using the accrued liability proration method defined in CAS 412-50(c)(5)(ii) as a safe harbor. This makes logical sense since the plan is being accounted for on a composite basis, and thus CAS pension costs are being allocated on a uniform basis across multiple segments. In light of the CAS Harmonization rules, we believe that the language covering the allocation of assets to the segment should be clarified to reflect the ongoing CAS liability at the time of the segment closing on a harmonized basis (i.e., the greater of the MAL or long-term basis).

Phase-in of plan amendments

The current 60-month phase-in for plan amendments parallels the PBGC's phase-in methodology for plan terminations. We believe that this phase-in makes sense where there are material, voluntary plan amendments shortly before segment closing. That said, we don't believe that the phase-in should apply to more "routine" plan amendments, such as reflecting legislative increases that automatically occur under the existing terms of the plan, or in the cases where routine plan amendments don't increase plan costs by a set percentage (e.g., 5%).

We welcome the opportunity to submit our comments for the CAS Board's consideration and would be happy to answer any follow-up questions that you may have.

Sincerely,

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