

September 16, 2005

Mr. Lawrence Smith
Director of Technical Application and Important Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Letter of Comment No: 4
File Reference: FSPAAGINVA
Date Received:

Re: File Reference FSP AAG INV-a, Reporting of Fully Benefit-Responsive Investment Contracts Held by Certain Investment Companies Subject to the AICPA Investment Company Guide

Dear Mr. Smith:

The Stable Value Investment Association (SVIA) is pleased to respond to the FASB on proposed FSP AAG INV-a. We have observed the FASB's process in developing the proposed FSP, and commend the Staff for obtaining in-depth knowledge of the issues underlying stable value investments, and reflecting that understanding in developing a relevant document. We also recognize the effort of the Board and its thoughtful deliberations in considering the principles in the document as it worked its way through issues raised in the development process.

SVIA supports issuance of the FSP. We believe it is conceptually sound, and will promote relevant and meaningful financial reporting to the investment community. Its issuance will enable investors to continue to receive the important benefits of investing in stable value funds.

SVIA is a non-profit organization dedicated to educating public policymakers and the public about the importance of saving for retirement and the contribution stable value funds can make toward achieving a financially secure retirement. SVIA members manage \$355 billion invested in stable value funds by more than 25 million defined contribution retirement investors. SVIA's 90-plus members represent every segment of the stable value investment community, including public and private retirement plan sponsors, insurance companies, banks, investment managers and consultants.

We have several comments on the draft FSP, where we believe refinement of the document would promote effective application of the principles set forth therein. We believe the suggested modifications are important to ensuring that the FSP's principles can be carried out without unintended adverse consequences. These comments are included in the attachment to this letter.



We appreciate the opportunity to comment. If you have any questions regarding our comments or would like to discuss them please contact me at 202-261-6530.

Sincerely,

Gina Mitchell President, Stable Value Investment Association



Attachment

Applicability to Relevant Stable Value Structures

The proposed FSP, in paragraph 3, describes the nature of stable value investments. While the paragraph captures the essence of these investments, wording refinements are needed to promote technical accuracy. Also, the suggested refinements would help avoid uncertainty as to which types of investments are within the scope of the FSP and are eligible for contract value. Further, the descriptions should be enhanced to help ensure that the FSP continues to be relevant, so as to accommodate evolving stable value investments so long as they meet the basic criteria for full benefit responsiveness as prescribed by the FSP. As an additional benefit, enhanced verbiage would promote harmonizing the accounting treatment utilized by investment companies with that used by employee benefit plans.

<u>Recommendation</u>: We suggest the language in paragraph 3 be revised, as discussed above. The following is provided for your consideration.

Some employer-sponsored defined-contribution plans offer an investment alternative often referred to as a stable value fund. These funds primarily invest in a variety of investment contracts such as guaranteed investment contracts (GICs) issued by insurance companies and other financial services institutions, bank investment contracts (BICs), and other investment products with similar characteristics. issued by banks or insurance companies, referred to as "traditional GICs" and "synthetic GICs." The issuer of a traditional GIC takes a deposit from the fund and purchases investments that are held in the issuer's general account. GICs and BICs are supported by the contract issuer's general assets or by one or more designated assets. The contract issuer is obligated to repay the principal and specified interest to the fund. In a synthetic GIC structure, the fund itself-owns the underlying assets are owned by the fund or otherwise maintained separate from the contract issuer's general assets (which avoids the assets being subject to creditor claims). The fund and-purchases a wrapper contract, typically from a bank, or-insurance company or other financial services institution, where Tthe issuer of the wrapper contract is obligated to provides an guarantee that the crediting interest rate not less than zero. (which is the rate earned by participants in the fund for the wrapped portfolio) will never be negative (that is, that there will be no loss of principal or accrued interest). In most synthetic GIC structures, Investment contracts typically provide that realized and unrealized gains and losses on the securities in the wrapped portfolio underlying assets are not reflected immediately in the net assets of the fund, but rather are amortized, over a multiyear period, usually over either the time to maturity or the duration of the underlying investments-being wrapped, through adjustments to the future interest crediting rate. For purposes of this FSP, the term



investment contract refers to a GIC or BIC contract or a wrapper contract together with the underlying wrapped portfolio of individual investments.

Contract Value as the Appropriate Measurement for Stable Value

The FSP, in paragraph 6, states that all investments should be reported at fair value, and then adds that contract value is a relevant measure for specified stable value investments. This structure and wording introduces ambiguity into a judgment of what is the more appropriate measure of a stable value fund. Lack of a clear statement that contract value is the appropriate measure of stable value investments could subject employee benefit plans with investment in stable value to allegations that participant or beneficiary transactions at contract value might not be valid.

Recommendation: To promote uniform application and interpretation, we believe the wording should be enhanced to clarify that for stable value contracts meeting the definition of full benefit responsiveness, contract value is the appropriate and relevant measure. We believe that doing so would not detract from the requirement that the fair value must be presented as indicated on the face of the financial statements.

Criteria for Determining Full Benefit-Responsiveness

We believe that paragraph 7(b), which sets forth requirements for investment contracts to be deemed fully benefit-responsive, requires refinement in several respects:

• This paragraph states that if an event has occurred that may affect the realization of full contract value for a particular investment contract, the investment contract shall no longer be considered fully benefit responsive. While we agree with this concept, use of the phrase "may affect" without qualification is problematic and would result in unnecessary diversity in application. Similarly, the example "a decline in creditworthiness of the contract issuer or wrapper provider" is open ended, and is likely to contribute to further unnecessary disparity in application. It should not be necessary, for instance, to consider a decline in a contract issuer's credit rating from AA to AA- as causing a contract to no longer be deemed fully benefit-responsive.

Recommendation: We suggest appropriate modifiers be added, such that circumstances causing an investment contract to no longer be considered fully benefit responsive are linked to events having a material effect on the likelihood of potential realization. Applying the concept of materiality to realization of full contract value permits fiduciaries to make appropriate judgments and execute these judgments as circumstances dictate.

Minor wording modifications are needed to ensure technical accuracy, in two
respects. Pooled stable value funds have agreements with the participating plans,
rather than with the individual plan participants, and second, agreement terms that
the interest crediting rate cannot be less than zero are found in the wrapper



contracts, which are between the fund and the financially responsible contract issuer, rather than in the agreement with the participating plans.

<u>Recommendation</u>: The appropriate wording refinements should be made to the document.

The following recommended wording reflecting these comments is provided for your consideration:

Either (1) the repayment of principal and interest credited to participants in the fund is a financial obligation of guaranteed by the issuer of the investment contract or (2) the fund holds investment contracts, generally referred to as wrappers, issued by financially responsible third parties covering a designated pool of investments held by the fund and provides for prospective interest crediting rate adjustments to participants in the fund that cannot be less than zero. on a designated pool of investments held by the fund, provided that the terms of the agreement with participants in the fund specify that the crediting interest rate cannot be less than zero. Any potential for a decline in the interest crediting rate below-zero must be transferred to a financially responsible third party through a contract-generally referred to as a wrapper. If an event has occurred that may materially affects the potential realization of full contract value for a particular investment contract (for example, a material decline in creditworthiness of the contract issuer or wrapper provider), the investment contract shall no longer be considered fully benefit-responsive. [Note: some of the material identified as deleted actually has been retained but moved.]

Recognizing Prohibitions against Arbitrage Transactions

Paragraph 7(c) appropriately speaks to the matter of participant-initiated transactions with the fund at contract value without conditions, limits or restrictions. It is important, however, that paragraph 7(c) explicitly references the long-standing industry practice to minimize arbitrage opportunities that may harm stable value investors as has been footnoted in Paragraph 7(e). These "equity wash" provisions in fully benefit-responsive contracts prevent one fund participant from engaging in a risk-free arbitrage against other participants by transferring directly from the stable value fund to another fund.

<u>Recommendation</u>: We suggest the FSP make clear that equity wash provisions are allowable in the context of the requirements of paragraph 7(c). This could be accomplished by reference to paragraph 11 of SOP 94-4.

Ability to Transact at Contract Value

We believe that paragraph 7(d), which deals with events that limit transactions at contract value, requires refinement in two respects:



• For an investment contract to be considered fully benefit responsive, paragraph 7(d) requires that an event of the type described must not be probable of occurring. Such potential limitation on the ability to transact at contract value appears to have been taken from SOP 94-4. We believe, however, that this part of SOP 94-4 is not directly applicable. The SOP applies in the context of financial reporting by one employee benefit plan, where such events might have a more significant effect than would be the case with a fund holding investments of a number of plans.

Recommendation: While disclosure of such contract limitations may be appropriate, we suggest that even if there is more than a remote probability in the case of one or more of the plans that these events will occur, this should not automatically preclude the contract from being considered fully benefit responsive. A judgment should be made in each instance as to whether there is more than a remote probability of an event that will materially limit transactions at contract value.

• The examples include reference to premature termination of the contracts by the plan. In the context of this paragraph, such termination would be made by the fund, rather than the plan.

Recommendation: The example should refer to premature termination by the fund.

Disclosure of Average Yield

The FSP, in paragraph 11(c) includes parenthetical wording that might not communicate the intended meaning. We believe this wording can be enhanced, in order to avoid potential misunderstanding by participants.

Recommendation: We suggest the parenthetical wording be modified as follows: "(which may differ from the interest rate credited to participants in the fund)."

Sensitivity Analysis

The FSP, in paragraph 11(e), requires disclosure of two sensitivity analyses. We believe that such disclosure would provide financial statement readers relevant information regarding the effects of potential changes in interest crediting rates.

- For funds that reset interest crediting rates frequently, such as monthly or even more often, required use of "the next four reset dates" may result in sensitivity analyses for an inappropriately short time frame.
- Use of hypothetical changes in interest rates is likely to be less meaningful than use of hypothetical changes in market yields.



Without modification, the sensitivity analyses will not readily promote comparability across different stable value pooled funds, in light of differences in reset dates, durations, market/book ratios and underlying investments.

<u>Recommendation</u>: We suggest use of four quarterly reset dates instead of "the next four reset dates," and use of hypothetical changes in market yields instead of hypothetical changes in "interest rates."

Effective Date

We appreciate the relevance of information that would be required by the FSP in fund financial statements. However, while some of that information historically has been readily available, other information that would be required for the first time has not. This latter information relates to a number of the new disclosure requirements, which would require systems modifications necessary to developing the required information. Also, with regard to the requirement to present the fair value of wrapper contracts, it would be necessary to develop models appropriately reflecting the unique characteristics of the contracts. For many funds, it would take significant time to design and implement systems enhancements and modifications necessary to developing information for the required disclosures, and time to develop methodologies for valuing wrapper contracts.

<u>Recommendation</u>: In order to provide adequate time for funds to provide reliable financial statement information, we suggest an effective date one year later than that set forth in the exposure draft.

Grandfathering Non-Defined Contribution Assets

The FSP, in paragraph 13, states that in order to fall within the FSP's scope, all or essentially all of the investment company's net assets must be held by participants in one or more qualified employer-sponsored defined contribution plans. While we recognize the rationale for this type of requirement, we would like to point out that although a very large percentage of stable value fund assets are owned almost exclusively by defined contribution plans, some stable value funds have a somewhat larger percentage of non-defined contribution owners. If the requirement in the exposure draft were to remain in a final FSP, it would be necessary for such funds to divest the non-defined contribution assets. Such divestment would harm and economically disadvantage both the stable value defined contribution investors in the fund and the non-defined contribution retirement investors required to leave the fund. This result would occur even with the later effective date suggested above.

Recommendation: We suggest that the FSP contain a "grandfather" provision permitting existing non-defined contribution assets. Such provision might state that any portion of the net assets of an investment company not held, directly or indirectly, by qualified defined-contribution plans as of the FSP's issuance date must not be permitted to increase (exclusive of any automatic reinvestment of income).



Changes to SOP 94-4 and SOP 92-6

We request that modifications made pursuant to the above comments be carried through to the applicable sections of SOP 94-4 and SOP 92-6. Of course in doing so it may be necessary to refer to a "plan" rather than a "fund." In general, as much conformity as possible between the FSP and SOP 94-4 would help avoid technical or practical difficulties and promote desired consistency in financial reporting.