



Letter of Comment No: 29
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Mr. Lawrence Smith, CPA
Director, Technical Application & Implementation Activities--FSP
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Re: August 4, 2005 Proposed FASB Staff Position (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:

One of the objectives that the Council of the American Institute of Certified Public Accountants (AICPA) established for the PCPS Executive Committee is to act as an advocate for all local and regional firms and represent those firms' interests on professional issues, primarily through the Technical Issues Committee (TIC). This communication is in accordance with that objective. These comments, however, do not necessarily reflect the positions of the AICPA.

TIC has reviewed the Proposed FSP and is providing the following comments for your consideration.

GENERAL COMMENT

This letter documents TIC's face-to-face meeting with the Board on September 19, 2005, at which time the comments below were discussed.

TIC is commenting on this proposal from the point of view of the defined contribution plans that invest in guaranteed investment contracts (GICs), including synthetic GICs. Given this perspective, TIC opposes the application of the new presentation and disclosure provisions of the proposed FSP to the financial statements of defined contribution plans. Fair value disclosures and balance sheet presentation for these contracts will not provide value to plan participants (one of the primary users of plan financial statements), and the volume of new disclosures would be excessive in relation to regulators', as well as participants', needs. In addition, the information requested may be difficult, if not impossible, to obtain from the





issuers of the contracts.

If the Board decides to retain the amendments relating to employee benefit plans, TIC is concerned that the title of the proposed FSP does not accurately reflect the scope of the standard. The title refers only to investment companies and does not indicate in any way that the FSP will change the presentation and disclosure requirements for defined contribution plans. As a result, preparers and practitioners may bypass the standard as irrelevant thus creating significant confusion and inconsistency as to its application. TIC recommends that a separate FSP be published that would provide standalone guidance for employee benefit plans.

TIC also believes the effective date should be deferred and opposes the two-year retroactive presentation requirement based on concern regarding the potential additional cost and effort that would be required to restate the prior year's Form 5500, *Annual Return/Report of Employee Benefit Plan*.

Our specific concerns and recommendations, which discuss these and other miscellaneous matters, are enumerated below.

SPECIFIC COMMENTS

TIC believes the application of this standard should be limited to fully benefit-responsive investment contracts within an investment company, as requested by the AICPA in its November 30, 2004 letter to the Board that prompted this project. In this letter, the AICPA specifically indicated that employee benefit plans were not included in the scope of their request.

The proposal would require significantly more disclosure on the face of the balance sheet and in the footnotes for defined contribution plans that hold these investments. Some of the troublesome new disclosures include the:

- segregation of fair values for each investment and related wrapper contract (Paragraph 10 of the Proposed FSP seems to apply to the plans as well as the investment companies.); and
- narrative disclosures in the amended paragraph 15a of AICPA Statement of Position (SOP) 94-4, *Reporting of Investment Contracts Held by Health and Welfare Benefit Plans and Defined-Contribution Pension Plans*, especially the "key factors that could influence future average crediting interest rates" and "the basis for and frequency of determining crediting interest-rate resets." In particular, a description of how these investments work may not be cost beneficial if the plan has only a small fraction of its funds invested in these instruments.





The presentation and disclosure changes do not seem warranted compared to the relatively low significance of these instruments to the plans' financial statements, especially since synthetic GICs, rather than the traditional GICs guaranteed by insurance companies, tend to represent the heart of the problem. One TIC member estimates that GICs represent on average about 8% of the assets of a typical defined contribution plan. He further estimates that the new investment contract disclosures would require at least one full page of text for a plan that generally has only 4-5 pages of footnotes in total.

TIC questions cost/benefit when an investment representing a low percentage of total assets without high risk comprises a high percentage of the notes to the financial statements. High-risk GIC contracts are those that are not fully benefit-responsive. SOP 94-4 already requires that such contracts be reported at fair value with adequate disclosure. Therefore, there is little remaining risk for those at contract value, especially since the contracts will be settled at contract value, not fair value. In general, plans do not invest in GICs that have contractual terms that would include the risk of losing fully benefit-responsive status, thus further decreasing the overall risk associated with these instruments.

Employee benefit plan financial statements are prepared primarily as a compliance requirement. Plan participants obtain needed information about the plan's investments from personalized statements from insurance or investment companies and other sources that are more current than the plan financial statements. SOP 99-3, *Accounting for and Reporting of Certain Defined Contribution Plan Investments and Other Disclosure Matters*, acknowledged these alternative sources and dropped previous requirements for detailed disclosures, by investment fund option, of information on benefit-responsive investment contracts (See paragraph 11), as well as other burdensome disclosures. The SOP then adopted necessary disclosures relating to aggregate amounts. TIC does not understand why such detailed and comprehensive disclosures are being added back to the standards now, especially since plan participants and administrators who do read the new disclosures would not understand the relevance of the information.

These changes were also motivated by a keen awareness of cost/benefit considerations (paragraph A.3), so that the net assets available to participants were not adversely affected by detailed compliance requirements that would not be useful. The proposed FSP would effectively nullify the positive changes enacted by SOP 99-3 without any evidence of the need for more elaborate disclosure. TIC recommends that the FASB staff contact the DOL to determine the level of disclosure needed by the agency to fulfill its compliance function.

In addition to finding little benefit to the disclosures, TIC members also anticipate difficulty in obtaining the required information. Plan sponsors will not know how to develop the required fair value and narrative disclosures proposed in the FSP and would have to contact the issuer for such information. TIC believes that the investment houses, banks and



insurance companies that issue these investment contracts will not readily disclose the required fair values or the narrative explanations relating to the nature of the contracts to the plans, especially the events that would cause the plan to not be able to transact at contract value.

Transition and Effective Date

TIC believes the transition and effective date provisions of this proposal are unworkable and would only add to the cost burden for defined contribution plans. The effective date is much too soon to launch an education plan for employee benefit plan sponsors and practitioners. The transition guidance requires retroactive balance sheet presentation for all periods presented. The Department of Labor (DOL) requires comparative balance sheets on the DOL Form 5500 for most large employee benefit plans covered by ERISA. TIC is concerned that the DOL may require revisions to the prior year Form 5500 to reflect the changed prior year presentation to the Statement of Net Assets Available for Benefits and disclosures required. TIC suggests that the FASB staff contact the DOL to determine the specific regulatory requirements for restatement of prior years before finalizing the transition provisions for the FSP.

Miscellaneous Matters

TIC believes the example used to define "fully benefit-responsive" in paragraph 7b (page 4) is misleading. It indicates that "a decline in creditworthiness of the contract issuer or wrapper provider" is an event that may affect the realization of the full contract value for a particular investment contract. If this event occurred, the contract would no longer be fully benefit-responsive and would have to be reported at fair value. TIC believes a change from one investment grade classification to another is not necessarily indicative of a contract that is not fully benefit-responsive. The entity may be less creditworthy, but the rating change doesn't necessarily mean that the company will default on a particular contract. Therefore, TIC recommends the language in paragraph 7b be changed to "a significant [or similar term] decline in creditworthiness of the contract issuer or wrapper provider."

TIC noted that the benefit responsive examples in the proposal do not address blackout periods, which occur to simplify recordkeeping whenever a change is made in the plan administrator. Blackout periods, which can last for two to three months, are generally contractual provisions that apply whenever transfers occur. During this time, participants cannot transact or shift funds. These provisions are much more common with our defined contribution plan clients than the examples noted in SOP 94-4, paragraph 11. TIC recommends that the final FSP clarify that blackout periods would not violate the benefit-responsive nature of the investment.

If the FSP is finalized as written, plan administrators and practitioners will need sample



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PRIVATE COMPANIES PRACTICE SECTION

language for the new disclosures describing the provisions of these contracts to ensure consistency of application.

TIC objects to including the employee benefit plan guidance in the appendix to the proposal. If the Board retains the employee benefit plan guidance within this FSP, which TIC does not favor (see comment above), the plan guidance should be moved out of the appendix and into the body of the standard. If one standard amends two different guides, every attempt should be made to ensure the prominence of the employee benefit plans' disclosures.

TIC also noted that the terms "plan," "issuer" and "fund" lacked clarity. This was especially true in the Appendix B amendment to SOP 94-4, paragraph 11a, where "funds" could be interpreted as references to either "plans" or "investment companies."

TIC appreciates the opportunity to present these comments on behalf of PCPS member firms. We would be pleased to discuss our comments with you at your convenience.

Sincerely,

Stephen M. McEachern, Chair
PCPS Technical Issues Committee

cc: PCPS Executive and Technical Issues Committees

