4 Daniels Farm Road, No. 377 Trumbull, CT 06611-3938



Phone: 203-261-5519 Fax: 203-261-5520

May 2, 2008

Mr. Russell G. Golden
Director of Technical Application and Implementation Activities
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

LETTER OF COMMENT NO. 37

File Reference: Proposed FSP FAS 132(R)-a

Dear Mr. Golden:

I am writing to comment on the Financial Accounting Standards Board ("FASB") proposed rules to promote a better understanding of investment risks assumed by defined benefit plans. I applaud FASB for its efforts. As I've written elsewhere, the current state of affairs is abysmal. Only a few privileged persons inside an organization are permitted access to information that is crucially important to shareholders, plan participants, taxpayers and policy-makers. It is virtually impossible to know (beyond a cursory assessment) which retirement plans are exposed to significant economic vulnerabilities that, if realized, could push a company into bankruptcy, disrupt cash payments to participants and/or invite regulatory or litigation action. At the same time, longer life spans make more urgent the need to know if private schemes are financially sound and can therefore stand solid as a third leg of the retirement stool (employer plans, Social Security, personal savings). The flip side is that capital markets cannot easily reward plan sponsors who do an outstanding job in the investment risk area. When information is unknown, stale or obtuse, share prices do not adjust accordingly.

This letter summarizes comments and questions about the proposed rule. Topics such as valuation deserve an in-depth commentary, outside the scope of this brief response.

Recognizing that more is not necessarily better, my comments reflect a preference for "smart compliance" (though industry self-regulation in this area would be most ideal). If the implementation of a revised FASB Statement No. 132 manifests itself as expensive busy work, employees can expect the disappearance of even more defined benefit plans. The hope is that new accounting rules encourage the release of point in time information as well as trend analyses and (perhaps most importantly) a detailed, user-friendly description of the pension plan's investment risk process. Volatile markets move quickly. Evaluating old data does little to help an external party understand what checks and balances exist that (a) enable pension investment committees to effectively monitor problems and (b) quickly mitigate "out of control" events.

If I may be of further assistance in clarifying any of these comments, please let me know.

Sincerely Yours,

Susan Mangiero, PhD, AIFA, AVA, CFA, FRM President and CEO

4 Daniels Farm Road, No. 377 Trumbull, CT 06611-3938



Phone: 203-261-5519 Fax: 203-261-5520

## COMMENTS

- 1. You have asked for feedback about whether generic categories are sufficient (item #6, page 2). An assessment of fair value should, at a minimum, reflect transferability restrictions. A plan may report stellar returns and yet be unable to liquidate a position. Plan sponsors require cash to write monthly retirement checks. It is unclear as to whether the categories you propose will fully inform about the ability to exit a position and raise cash.
- For example, even if derivative instruments are segregated by type of contract, it is important to know much more, especially since FAS 133 disclosures do not reflect a pension's use of swaps, options, futures and hybrids. Other items of interest include (but are not limited to): (a) type and quality of posted collateral, frequency of monitoring and identification of monitoring parties (b) whether the derivative instrument is being used to hedge (c) efficacy of hedge (d) concentration of counterparties by type of instrument on a net and gross basis (e) which, if any, independent parties value the various derivative instruments and (f) what risk metrics are used to determine likely economic impact of derivatives.
- A category such as "equity securities" is overly broad. A pension fund may invest in both blue chip stocks and
  "wallflowers" that are followed by few, if any, securities analysts and tend to trade in thin markets. They are
  dissimilar in many ways, not the least of which is the ability to unwind a position with ease.
- In a similar fashion, outright ownership of land or buildings would be categorized as "real estate" as would an investment in a real estate investment trust or, as you indicate, a hedge fund that owns real estate or invests in infrastructure. The risk-return tradeoff, fees and legal protections vary considerably. These differences would be camouflaged if different types of holdings are lumped together.
- Some hybrid instruments could be categorized in one of several ways. Convertible bonds may, given prevailing market conditions, trade more like equity than debt. A balanced mutual fund invests in both debt and equity. Complex securities embed derivatives. International stock and/or bond pools may be partially or fully hedged with foreign exchange contracts. Could disparate treatment of hybrid instruments give rise to difficulties in financial statement interpretation across plan sponsors and pension plans?
- 2. Regarding concentration (item #9, page 3) disclosures, is FASB asking that <u>only</u> gross numbers be provided? Lumping concentration numbers together with the use of a filter such as country may be helpful but insufficient. It would be nice to know how a plan sponsor decides on a particular concentration, what person(s) monitors the concentrations, what triggers a "fire alarm" breach and what should happen when a concentration is exceeded. Perhaps FASB assumes that this kind of information will be included in a narrative description of the pension plan's investment policies and procedures.
- 3. FASB is proposing that valuation information be provided on an annual basis. This renders much of the reported data worthless for anyone seeking to assess whether a plan sponsor is likely to encounter liquidity problems in meeting its obligations to existing retirees. While frequent valuations may be overly expensive (and possibly misleading), a financial statement user needs to understand what keeps pension plan managers up at night. The creation and disclosure of a risk factor matrix is one approach. Disclosing periodic stress test results is another approach. In any event, one hopes that the pension plan is already conducting risk analyses at regular intervals. If true, disclosing information about test results should not cause an undue burden on plan sponsors.
- 4. It is critical to know whether an independent third party is being used to vet valuation models. External money managers have an inherent conflict in communicating marks to their investors since their compensation is almost always tied to reported performance. FASB proposes the disclosure of "information about valuation techniques and inputs." Does FASB want information about the use of an outside vendor to be disclosed? Does FASB expect disclosure text to include a discussion about (a) how often models are tested and by whom (b) when models are revised and for what reasons and (c) whether model errors are consistent or vary?

4 Daniels Farm Road, No. 377 Trumbull, CT 06611-3938



Phone: 203-261-5519 Fax: 203-261-5520

- 5. In the event that an external money manager refuses to disclose information about his or her model, does that put a pension plan at risk for disclosure non-compliance?
- 6. For hedge funds, will a pension plan be in disclosure non-compliance if a side pocket arrangement is in use? It would be extremely helpful to know how hedge fund managers determine what goes inside a side pocket. If the side pocket is "large," disclosures about the contents and a qualitative assessment of risk factors is recommended.
- 7. Financial statement users stand to benefit from disclosure of multiple metrics (Appendix A, A6, page 6). However, not all metrics are created equal. Reliance on a single measure such as the Sharpe Ratio is misleading at best. It is a snapshot assessment based on standard deviation of returns. It says little about a pension fund's risk control processes, including the selection and vetting of external money managers. Additionally, some prices (returns) are not normally distributed. While there is merit in allowing pension plans latitude, hopefully there will be some uniformity of appropriate metrics across plan sponsors. Otherwise, a financial statement user may end up comparing apples and oranges.
- 8. The current proposal requires a discussion about the "relationship between plan assets and benefit obligations" (Appendix B, B1 (2), page 9). It is unclear whether the proposed rules will allow a financial statement user to identify if, when, and to what extent, a pension plan is (a) engaging in a Liability-Driven Investing ("LDI") strategy (b) if that LDI strategy employs derivative instruments and (c) how the risk-return tradeoff is expected to change as a result.
- 9. Regarding valuation adjustments such as discounts for lack of marketability, it is imperative to understand whether a formulaic approach is being employed and why. Many valuation standards forbid the use of an arbitrary approach.
- 10. When a pension plan invests in private equity for strategic long-term reasons, the position is often held at cost unless a write-down is deemed inevitable. Will FASB require annual valuations (even if the pension plan deems the resulting numbers "illusory") or allow for an exemption of assets held specifically for long-term reasons? Will the length of the expected holding period be a consideration?
- 11. Has FASB given any consideration to the existence of competing valuation standards (binding or voluntary) and possible reconciliations thereof? They include, but are not limited to, USPAP, PEIGG and IOSCO/MFA.
- 12. Will revisions to FASB Statement No. 132 comport with relatively recent changes in Form 5500 reporting rules?