

Letter of Comment No: 170
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Dear Mr. Belcher:

I understand that the FASB will soon discuss the merits of using contract plus accrued interest for valuing GICs and SICs in stable value funds. Please do not rush through this process. Please, take your time and understand the insurance contracts that form the basis for this unique (and highly questionable) accounting treatment. Ask yourselves, has the insurance companies ever paid on these contracts? When and how? Also, has FASB looked at the other side of this issue? Please look at this from the insurer's side (the insurance companies and banks). How are they accounting for the risk associated with these products? That may help you better understand whether this is truly proper accounting or all "smoke and mirrors."

The history of stable value funds (while the Stable Value Association may say otherwise) is short. At the end of 1995, the banking regulators permitted this unique accounting treatment after significant pressure from the SVA and its banking constituents. The industry was eager to offer a new product to compete with money market funds. This product offered all parties tremendous new types of fee income. Please look at the insurance costs and the investment management fees. It will be then obvious to you who benefits from the product.

And, please look at the risk. The product only recently (within the last five years) has attracted the attention of money managers. Why? Since 2000, the declining interest rates have made this a very attractive investment. But, what happens in a rising interest rate environment? We saw it in the 1980's. This would not be my investment choice, when rates rise. I suspect that if you stress test this product properly, you will find breakage. It can't compete with a product that is truly fairly valued. Look at it today in comparison to money market funds. A sharper rate increase and a yield inversion will break it. This means that the investor is the ultimate loser. Please consider the investors of the funds. Don't be persuaded by the lobbyist and the plan sponsors. They all benefit from the hidden fees in the product. Try to get a handle on these fees. Then, you will see why there are so many unsolicited letters to FASB on this topic.

Fair Value is the only way to properly measure risk and proper accounting should disclose that risk to the underlying investors. This should be done daily, if this is a daily valued product (and it is). Also, note that the investors are trapped in the fund. This is because the insurance contracts have requirements that say the plan sponsor can not have another competing fund option and the plan must have a withdrawal waiting period. Ask yourselves, what is that all about? It is to stabilize the cash outflow to prevent early liquidation of the contracts, which would result in a loss to the insurer. How is this true FV, if the investor cannot get out? Is this really what SOP 94-4 intended? With the restrictions in place and the fact that the insurers are constantly monitoring the duration of the underlying investments, why pay for insurance? The reason is simple. It is done to perpetuate the myth that contract plus accrued interest equals FV. This is not only wrong; it masks the possibility of investor loss. Poor timing getting into these funds by unsophisticated investors will subsidize the more savvy investors getting out. Pension fund managers are the savvy ones and the 401(k) participants are the unsophisticated, and

most likely the losers. In fact, the recent participation of pensions in these funds (even though your SOP 94-4 seems prohibits it) has resulted in increased cash flow volatility. Be advised that the industry is not strictly adhering to your guidance. Pension funds are investing in these funds and so are IRAs and other (Hot Money) types of accounts.

Lastly, please look at the whole issue of fair value methodology. While the FV of traditional guaranteed investment contracts (GICs) can be estimated using a present value approach, how do you value the wrapped products? There is no easy way to do this. The wrap may be thought of as some sort of option or swap. But, valuing it is not only difficult, it is useless. If the insurance contract is drawn upon, the insured will suffer higher insurance premiums and will eventually be priced out of the market. That is a strong disincentive. They are unlikely to make a claim. Even if a claim is made, the insurer has a number of contract restrictions that make payment unlikely. FASB should answer the valuation issue from both sides, the GIC/SIC investor and the GIC/SIC provider. It is easy to say that contract plus accrued interest is FV, but if the wrappers never pay off do they really have value? Why permit this special treatment? Small investors deserve your proper attention and consideration on this important topic. Please do not rush through your analysis.

Sincerely,
Jim Franken, Retired.