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Comment letters received on the exposure draft proposed statement of position, Reporting of Investment Contracts Held by Health and Welfare Benefit Plans and Defined-Contribution Pension Plans

American Institute of Certified Public Accountants. Employee Benefit Plans Committee

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AcSEC + Employee Benefits Committee

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AICPA

American Institute of Certified Public Accountants

INTERNAL MEMO

Date: June 23, 1994

Reply:

To: Karen Neloms

File No. Q-1-502

From: Sue Hicks

Subject: **Comment Letters**

Enclosed are the comment letters received on the exposure draft proposed statement of position, *Reporting of Investment Contracts Held by Health and Welfare Benefit Plans and Defined-Contribution Pension Plans*. The comment period ended December 15, 1993.

Please keep these on file for future reference. Thank you.

Comment Letters Received

Reporting of Investment Contracts Held by Health and Welfare Benefit Plans and Defined-Contribution Pension Plans

Response Number	Respondent
1	The Minnesota Mutual Life Insurance Company
2	Becker & Rooney
3	Landmark Strategies
4	Massachusetts Society of CPAs, Inc.
5	Safeco Life Insurance Company
6	U.S. Agency for International Development
7	Hallmark Cards
8	Louisiana Society of CPAs
9	Illinois CPA Society
10	William A. Mutch
11	Institute of Management Accountants
12	Mobil Corporation
13	Shell Oil Company
14	Bankers Trust Company
15	Liberty Bank and Trust Company of Oklahoma City, N.A.
16	Lincoln National Life Insurance Company
17	The Minnesota Mutual Life Insurance Company
18	Nationwide Life Insurance Co.
19	T. Rowe Price Stable Asset Management, Inc.
20	M&I Investment Management Corp.
21	Aetna Life Insurance and Annuity Company
22	Certus Financial Corporation
23	Cooper Industries
24	The GIC Association, Inc.
25	Profit Sharing Council of America
26	American Council of Life Insurance
27	Arthur Andersen & Co.
28	Black & Decker Inc.
29	John Hancock Mutual Life Insurance Company
30	The New York GIC Exchange
31	Price Waterhouse
32	Financial Executive Institute
33	Metropolitan Life Insurance Company
34	GTE Corporation
35	Aetna
36	ITT Corporation
37	Florida Institute of CPAs
38	Morley Capital Management, Inc.
39	Northern Trust Company
40	The University of Alabama System

41	CIGNA Corporation
42	Kwasha Lipton
43	New York State Society of CPAs
44	Aluminum Company of America
45	Ernst & Young
46	Association of Private Pension and Welfare Plans

THE MINNESOTA MUTUAL LIFE INSURANCE COMPANY
400 ROBERT STREET NORTH
ST. PAUL, MINNESOTA 55101-2098
PH 612/298-3671
FAX 612/298-7938

JAYMES G. HUBBELL, FSA
SECOND VICE PRESIDENT AND ACTUARY

MINNESOTA MUTUAL

November 1, 1993

Susan W. Hicks
Technical Manager
Federal government Division
File Q-1-505, AICPA
1455 Pennsylvania Avenue NW
Washington D.C. 20004-1081

RE: COMMENTS REGARDING PROPOSED STATEMENT OF POSITION REGARDING REPORTING OF INVESTMENT CONTRACTS HELD BY HEALTH AND WELFARE BENEFIT PLANS AND DEFINED-CONTRIBUTION PENSION PLANS

Dear Ms. Hicks,

I have been working with retirement plans for the past 21 years in several different capacities. It is from this accumulated experience I conclude that the above-mentioned proposal, if implemented, will (1) provide financial statement users less meaningful information than is provided today, (2) cause considerable confusion and misunderstandings among plan participants (assuming participant-level reporting utilizes fair value instead of account value), (3) potentially force lower interest rates on plan participants and (4) result in increased expenses to the plans due to the compliance cost.

Financial information can be provided in numerical form or in verbal form. It is common for financial statements to be footnoted with additional information of interest to the users of the financial statements. Investment contracts may contain features which cause them to be something other than benefit responsive contracts. Those features can be presented verbally in financial statements. Instead, the proposal contemplates quantifying these features in a "fair value".

In most situations this will result in less meaningful information than the reporting of account value accompanied by a verbal description of the limitations on accessibility of funds. Why? First, because there is no right fair value. Consider an investment contract which has as its only limitation a limit on the amount of funds which can be transferred to another investment option during the year. These restrictions disqualify the contract as a benefit responsive contract. Ask ten different CPAs (or ten actuaries or ten of anything) to determine fair value and you will get ten different answers. Unless AICPA wants to prescribe how to determine the projected benefit stream for every conceivable contract and plan feature, there will be no consensus on how to determine fair value.

Secondly, the use of fair value can produce some very peculiar results. Consider a company which has two plans, one a defined contribution pension plan and the other a profit sharing plan. Suppose the defined contribution plan has a guaranteed investment contract as its only investment option. This contract provides that the participant can withdraw his/her funds at contract value at any time. Hence, it is benefit responsive and is reported at contract value. The profit sharing plan uses the identical guaranteed investment contract. Here, too, the participant can withdraw his/her funds at any time. However, this plan also provides additional investment options such as a money market fund, a bond fund and a stock fund. To protect against interest rate antiselection the insurer limits transfers from the guaranteed investment contract to these other investment options to 20% per year.

According to the proposal, this is not a benefit responsive contract and must be reported at fair value. In an increasing interest rate environment this fair value will likely be less than contract value, so reported values under the profit sharing plan will be less than reported values under the defined contribution plan (assuming identical contributions). This would be the case even though the profit sharing plan provides the same access to the contract value as the defined contribution plan participant. Indeed, the profit sharing participant has the added flexibility of being able to transfer at least some of his/her funds to other investment options. That features <u>adds</u> value--but the proposal would have the plan report <u>less</u> value. This is an illogical result.

In the above example it would be better to report the profit sharing plan at contract value and note verbally the restricted access. That would be far more meaningful than reporting fair value.

The proposal relates to the audited financial report. It does not address the values reported directly to each participant for their own account. If the application of "fair value" were limited to just the audited financial statements the confusion would be limited to the relatively few plan participants who review the audited financial report. Will an auditor find it acceptable to report fair value in the audited financial statement while the plan reports contract value to participants? The SOP should address the matter of consistency between participant level reporting and financial statement reporting.

Fair value would make no sense to plan participants whatsoever. The vast majority of plan participants are not CPAs. Few have any concept of present values. Many do not invest in stock and bond investment options because they do not understand the fluctuations in market value. Many have a poor understanding of how compound interest works. The most, and probably the only, meaningful thing to them is account value.

Imagine a participant in the profit sharing plan used in the example above trying to make sense out of a fair value which exceeds the account value. This could happen in today's environment where current market rates are well below the contract's crediting rate. Fair value can't be borrowed. It won't be paid as a death benefit. It's not available in case of lump sum distribution at termination. It isn't even used in determining what amounts can be transferred to other investment options. It doesn't relate to anything the plan participant will understand. Anything that is different than deposits minus withdrawals accumulated at interest will not be useful to plan participants. Indeed, reporting fair value to plan participants would be so confusing and meaningless that plan sponsors would be compelled to abandon investment contracts which were not benefit responsive.

This leads to my third point. The proposal would deny participants the higher yields available from non-benefit responsive investment contracts. To ensure the accessibility needed to qualify for benefit responsiveness, prudent insurance companies will maintain relative short duration assets to avoid capital losses should large withdrawals be made from the guaranteed investment contract. Under a benefit-responsive contract the insurer cannot assume investments can be made for the long haul. The traditionally higher yielding investments commonly used for funding retirement plans would entail too much risk for the insurer. Many participants are adverse to risk and will not use the marked to market investment options providing higher yield potential. Hence, they will opt for the benefit responsive guaranteed investment guaranteed contract no matter what.

The last point is that non-benefit responsive contracts would be burdened with the additional expense of calculating fair value. This cost becomes quite significant if the determination must be made on the individual participant level.

In summary, the proposal, if adopted, will not provide the intended more meaningful information to financial statement users. If adoption results in the reporting of fair value at the participant level, participants using non-benefit responsive contracts will be totally confused. Fair value, as presented in this proposal will be totally meaningless information. I encourage you to reconsider the entire proposal.

Yours truly,

Jaymes Hubbell

Jaymes Hubbell, FSA
Second Vice President and Actuary

JGH/dc

cc: Melissa Kahn, Senior Counsel--American Council of Life Insurance

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Becker & Rooney

Becker & Rooney, Inc. Glenpointe Centre East Teaneck, NJ 07666-6768 (201) 907-6880

Murray L. Becker, FSA
President

November 10, 1993

Ms. Susan W. Hicks
Technical Manager
Federal Government Division
Files Q-1-505
AICPA
1455 Pennsylvania Avenue, N.W.
Washington D.C. 20004-1081

Re: Reporting of Investment Contracts Held by Health and Welfare Benefit Plans and Defined-Contribution Pension Plans

Dear Ms. Hicks:

Becker & Rooney is a consulting and investment management firm specializing in developing competitive bidding strategies for investment contracts in defined contribution plans. In terms of major corporate clients, number of plan participants, and amount of dollars involved, our firm has by far the largest consulting practice in this field. Our clients include many Fortune 100 companies as well as other organizations of comparable size and stature. Their plans cover many millions of employees.

In general, our role is to act as a consultant to plan fiduciaries who exercise their responsibilities under ERISA for establishing investment policies and strategies on behalf of plan participants. Since our consulting advice is limited to defined contribution plans, the ultimate beneficiaries of our service are the millions of plan participants who enjoy the advantages of a competitive marketplace. We estimate that the total GIC/BIC and similar investment-contract holdings among our clients is about $13 billion. We are thus able to speak on behalf of a substantial segment of the plan participant population and their employers.

In general, we are in agreement with the SOP. We believe it meets the objective of reporting values that are meaningful to financial statement users, including plan participants. We have several comments to improve the end product.

1. The SOP (¶15e) states that Defined Contribution Plans should report fully benefit responsive investment contracts at contract value, *which may or may not be equal to fair value*. This wording could conceivably create a conflict with IRS Revenue 80-155, which requires participant account balances in defined contribution plans to be ascertained at "fair market value." We believe that the contract value of a fully benefit responsive investment contract is indeed fair value, and the SOP should not be ambiguous on this fundamental point.

Clearly, the fair value of an investment contract must reflect its terms. If the contract is fully benefit responsive, the participant is given the *right* to receive—and the *obligation* to accept—contract value. For the participant, contract value is fair value because the contract sets this value as the agreed-upon price for the transaction.

2. The effective date—plan years commencing after December 15, 1993—is impractical. Many plans hold contracts that are not fully benefit responsive, but can be amended by negotiation. Plan sponsors will need a reasonable period of time to bring their contracts into compliance. To remain on a calendar-year basis, we suggest setting back the effective date one year.

3. ¶A.8, Sub-section c, of the Appendix is ambiguous. For a plan that pays for benefits up to 30% of the contract at contract value, what are the "guaranteed" and "residual" amounts? Does this mean that 30% of the contract is fully benefit responsive and the remainder should be carried at some other fair value? The language should be clarified.

Aside from these points, we are fully supportive of the SOP's substance and intent.

Cordially,

Murray L. Becker

MLB/cs

Landmark Strategies
24 Westland Road
Weston, MA 02193
Tel/Fax: 617-899-2519

Judith Markland
President

November 9, 1993

Susan Hicks
Technical Manager
Federal Government Division, File Q-1-505
AICPA
1455 Pennsylvania Avenue, NW
Washington, D.C 20004-1081

re: Comments on the AICPA Proposed SOP *Reporting of Investment Contracts Held by Health and Welfare Benefit Plans and Defined-Contribution Pension Plans*

Dear Ms. Hicks:

As someone with lengthy professional experience with defined contribution plans and guaranteed investment contracts and whose firm works with institutional providers of such instruments, I am pleased to have the opportunity to comment on such a well-drafted document. The Task Force that developed the SOP obviously did their homework extremely well.

The principles established in the exposure draft capture the essence of stable value funds in defined contribution plans: that when participants are assured book value for their transactions, where benefit responsiveness is assured, the investments should be reported at contract value. The SOP recognizes that, because the financial statements are ultimately for the benefit of the participants, showing the values that they can actually expect to realize is vital. Establishing these principles preserves the unique risk-reward benefit that book value investment contracts provide to defined contribution plan participants.

Moreover, the SOP does an excellent job of defining benefit responsiveness, both conceptually and practically. It should give clear and explicit guidance to those working with it, while allowing sufficient flexibility to deal with future product variations.

The following are specific comments on various parts of the exposure draft.

I. Clarification of "guarantee"

One slight clarification that the AICPA might wish to make before the final SOP is released concerns the use of the word "guarantee". Paragraph 9 defines a fully benefit responsive contract as one which "provides a guarantee by a financially responsible third party of principal and previously accrued interest for liquidation, transfer, loans, or hardship withdrawals initiated by plan participants". Paragraph 10 further explains that the financial risk entailed in supporting benefit responsiveness must be effectively transferred to a financially responsible third party, neither the plan nor the participant.

The word "guarantee' has come to have fairly specific technical meanings in some parts of the financial community. Some feel that only financial guaranty insurance companies or certain types of life insurance contracts can offer "guarantees", as distinct from firm contractual commitments made by the same firm or others, such as an asset purchase agreement or an interest rate swap. Both of the latter instruments have been used by financial institutions to assume benefit risk.

The intent of the SOP is obviously to create a level playing field for all types of financial institutions to provide book value investment contracts. The examples indicate that it is anticipated that a wide variety of "financially responsible" third parties are contemplated to assume the benefit risk. To remove any possible lingering doubt that this was the intent, it would help to modify the definition of a benefit responsive contract to "one which provides a guarantee <u>or assurance</u> by a financially responsible third party".

II. Disclosure of Current Market Yields for Investment Contracts

The AICPA requested comments on the desirability of requiring disclosure of market rates of interest for fully benefit responsive contracts in addition to the current crediting rates. The intent of this requirement is to give the participant a better sense of the current value of his assets in the marketplace, for better informed investment decisions.

My personal opinion is that such a disclosure requirement would cause more harm than benefit. It would be exceedingly difficult for a plan sponsor to explain why the additional information is made available, and what it represents. It would also be very difficult for plan sponsors to obtain a current market yield for a stable value portfolio of their current duration and quality.

The information is not readily available from the asset managers. GIC issuers typically provide only a market value at surrender to defined contribution plan customers, and are reluctant to provide a market value on an ongoing basis because they do not believe it meaningful for plan sponsor transactions and for fears that it will produce confusion and legal difficulties. (Surrender value is typically lower than ongoing value.) Providing a market yield for the contract would present a similar problem. Separate account and synthetic GICs often provide contract market values that are adjusted for past gains and losses on any asset or benefit risks shared by the plan.

The alternative, publishing a money market yield, would indicate a possible market opportunity for plan participants but would be misleading, since the yield would be reflective of an instrument with different credit, maturity and interest rate volatility characteristics. Publishing this rate would be doubly deceptive if the money market option were not available to plan participants as a fund option. Many plan sponsors do not believe that money market funds are a suitable investment for retiree savings.

In addition, the presence of a market comparison rate would undoubtedly increase risk charges by providers of the benefit wrap for participant anti-selection risk. Where these anti-selection risks are passed through to the fund's blended rate via rate resets, any activity prompted by the market rate disclosure would lead to reduced returns for participants who choose not to act.

III. Reporting for Funds with "Limited" Participant Access

The AICPA also solicited comments whether plans which "limit" participant access to funds should be required to report investment contracts at market value. The primary concern seems to be single-fund plans, where participants do not have investment transfer capability while they are investors in the plan. In such cases, benefit responsiveness is limited to withdrawal activity.

There are many types of single-fund defined contribution plans. Many of these are capital accumulation plans rather than retirement plans, and employees may withdraw both their contribution and their employer's prior to termination or retirement. There is opportunity for many participant transactions. Even for retirement plans where there are limits on withdrawal of employer contributions or other fund assets before retirement, IRS rules now require that many tax-qualified plans allow participants to leave funds invested in the plan after retirement or termination of employment. Participants typically then have access to these funds for partial as well as full withdrawal.

There are also special purpose retirement funds. Some defined contribution plans have special stable value fund options for their employees nearing or at retirement. Other plans limit retiree investments to the stable value fund that is available to all plan participants. Both variations are intended to provide principal protection for the participant during retirement as well as ease of administration for non-employee plan participants, who can constitute a major expense for plan sponsors.

A requirement to report investment contracts at market value in any of these situations would create chaos. The funds were created specifically so that participants could receive principal protection, and participants have been promised that they will receive the principal value of their assets upon withdrawal from the plan. Reporting a different fund value in the meantime would be disruptive and counterproductive.

Some stable value funds contain assets both of participants with the right to transfer investments and participants who do not share this right. How would those contracts be valued?

The principle adopted in the SOP is that, when participants can reasonably expect to receive contract value for their transactions, those assets should reasonably be reported at contract value. It's a good principle. There is no reason to weaken it for single-fund plans or for participants restricted to single fund options, especially when these situations were created originally because principal stability was perceived to be of paramount importance for those participants. Including an example in the SOP illustrating that contract value is appropriate in these circumstances would be of enormous benefit to the defined contribution community.

Thank you again for the opportunity to comment on the exposure draft. Overall the SOP is extremely well designed and drafted and an excellent addition to accounting guidelines.

Sincerely yours,

Judy Markland

Judith Markland,
President, Landmark Strategies

MASSACHUSETTS SOCIETY OF CERTIFIED PUBLIC ACCOUNTANTS, Inc.
105 Chauncy Street, Boston, MA 02111 (617) 556-4000 FAX (617) 556-4126 Toll Free 1-800-392-6145

November 22, 1993

Susan W. Hicks
Technical Manager
Federal Government Division
File Q-1-505
AICPA
1455 Pennsylvania Avenue, N.W.
Washington, D.C. 20004-1081

Dear Ms. Hicks:

RE: Exposure Draft - Proposed Statement of Position Reporting of Investment Contracts Held by Health and Welfare Benefits Plans and Defined Contribution Plans.

The Accounting Principles and Auditing Procedures committee is the senior technical committee of the Massachusetts Society of Certified Public accountants (MSCPA). The Committee consists of over thirty members who are affiliated with public accounting firms of various sizes from the sole practitioner to the international "big six" firms, as well as members in both industry and academia.

The Committee has reviewed and discussed the exposure draft on the proposed statement of position and is in substantial agreement with its content.

The Committee has the following comments and suggestions in the areas where they were specifically requested:

1. Paragraph 17 effective date and transition

   It seems appropriate to have the effective date on a prompt basis since it is important to have the revised basis of reporting implemented as soon as possible; and the method of implemention is appropriate so that the financial statements for the year of change will reflect the effect of the change and the current year results will be presented in accordance with the revised basis of reporting.

   We also agree with not permitting restatement of financial statements of prior years since that would not result in presenting meaningful information since the purpose of the financial statements is to present the values of investment contracts held by health and welfare benefit plans and defined contribution pension plans as of the balance sheet date.

Very truly yours,

P. Daniel Hurley, Jr. Chairman
Accounting Principles and Auditing
Procedures Committee of the MSCPA

SAFECO

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November 22, 1993

Susan W. Hicks, Technical Manager
Federal Government Division, File Q-1-505
AICPA
1455 Pennsylvania Avenue N.W.
Washington, D.C. 20004-1081

Re: Exposure Draft - Reporting of Investment Contracts Held by Health and Welfare Benefit Plans and Defined-Contribution Pension Plans

Dear Ms. Hicks:

This is a response to your invitation for comments regarding the above referenced AICPA Exposure Draft. The following comments describe the negative impact of the Exposure Draft on pension plans, participants and insurance companies.

(1) For unallocated contracts, Appendix A.8.c does not adequately handle the situation where a portion of the contract value is benefit responsive. The provision requires the contract to be valued as if the entire amount would surrender immediately, as the sum of the benefit responsive portion valued at contract value and the non-benefit responsive portion valued at fair value. However, in most situations, only a portion of the contract is expected to surrender, leaving little or no surrender or market value adjustment charges.

It is unreasonable to value the contract assuming a contingency (100% surrender) which is not anticipated to occur. Often accounting standards relating to pension plans (e.g. FAS 87) allow use of <u>reasonable</u> assumptions and methods. The same approach should be taken here.

An example of how a plan's withdrawal rates can impact the surrender charges assessed under the contract under both book value accounting and under the Exposure Draft is shown in Attachment A. Where market value adjustments are operational, the illustrated impact would be greater.

(2) The nature of insurance company surrender charge schedules will ensure that in the first year of a contract, the contract will suffer an immediate loss. Each year's investment experience will be greater than that actually experienced under the contract as the plan emerges out of surrender charges and surrender value grades into contract value. This portrayal of investment experience may have the effect of distorting participant and employer decision-making. An example of how investment experience can be distorted is portrayed in Attachment B.

(3) The Exposure Draft thus directly impacts the payout of benefits under the plan. The effect is that lower paid, more mobile participants who terminate while surrender charges are in effect will get lower payouts, to the advantage of higher paid plan

participants whose tenure might normally outlast surrender charges. Such a bias against non-highly compensated employees appears to be inconsistent with AICPA's mission of protecting plan participants through accounting standards. Attachment C illustrates this situation.

(4) Required disclosure of a market rate of interest for fully benefit responsive contracts would be more costly to report. It may also require additional risk margins which would lower returns to participants. Consequently, requiring such a disclosure would actually be harmful to plan participants by increasing expenses and lowering returns.

(5) Appendix A.8.b discusses valuation of benefit responsive contracts where early retirement or layoff benefits are not guaranteed at contract value. Where such benefits are expected to be utilized significantly, the Exposure Draft precludes contract value treatment. Consistency would suggest that only the portion of the contract anticipated to be utilized for such employer-initiated events should be subject to fair market valuation.

(6) The requirement that plans be totally benefit responsive in order to receive book value treatment on their insurance contracts, seems to be outside the scope of this Exposure Draft. AICPA should avoid this attempt to influence plan provisions which justifiably fall under the purview of ERISA.

(7) Grandfather and transition rules similar to those adopted in FAS 110 should be incorporated into any final rules adopted by AICPA. Employers and participants with existing contracts should not be penalized as a result of the transition to new accounting rules under AICPA guidelines.

Additionally, insurance companies should be granted additional time in order to develop the fully benefit responsive contracts which would satisfy AICPA proposed requirements. The availability of such contracts is of particular importance in the smaller plan market where usage of insurance company general account products is high.

In summary, the Exposure Draft, as written, does not appear to be serving it's primary objective as outlined in item 7. under Reporting of Contracts. Item 7 states "The primary objective of a defined contribution plan's financial statements is to provide information that is useful in assessing the plan's present and future ability to pay benefits when they are due" (emphasis added). As indicated above, the Exposure Draft requires valuation as if all benefits were due on the valuation date rather than taking into account reasonable assumptions as to the benefit timing. Plan participants desire stability in their fixed investment vehicles and financial reporting in the fashion proposed would defeat that purpose.

Sincerely,

Michael J. Kinzer

Michael J. Kinzer
Vice President and Chief Actuary

Attachment A

Illustration of Fair Value versus Book Value Surrender Values for Various Withdrawal Rates

Consider a contract with a 30% benefit responsive feature as discussed in Appendix A.8.c, with a $100,000 account value and a 9% surrender charge. Assume no market value adjustment. The following surrender charges and surrender values result where withdrawal rates are as indicated.

Withdrawal Rates	Market Value under Exposure Draft ---Surrender--- Charge	Value	Book Value under Contract Provisions ---Surrender--- Charge	Value
5 %	315	4685	0	5000
10 %	630	9370	0	10000
20 %	1260	18740	0	20000
30 %	1890	28110	0	30000
40 %	2520	37480	900	39100
50 %	3150	46850	1800	48200
100 %	6300	93700	6300	93700

Note that where withdrawals are under the benefit responsive cap, losses which are not expected to be incurred are locked in for the affected plan participants who would otherwise be paid out at book value. Where withdrawals exceed the benefit responsive cap (until reaching 100%), losses are still greater than would otherwise be experienced by correctly assessing withdrawals first against the portion of the contract subject to benefit responsive provisions. If market value adjustments were assumed, the impact would be greater.

Attachment B

Illustration of Annual and Cumulative Return for
Assuming use of Fair Value

Assume a $100,000 contract, a 6% interest rate, a 10% surrender charge grading off to 0 in 10 years, and 10% benefit responsiveness, assume no market value adjustment.

Year	Accumulation Value	SC	Contract Value	Annual Return	Cum
0	100,000	10	91,000		
1	106,000	9	97,414	-2.59%	-2.59
2	112,360	8	104,270	7.04	2.11
3	119,102	7	111,599	7.03	3.73
4	126,248	6	119,431	7.02	4.54
5	133,823	5	127,801	7.01	5.03
6	141,852	4	136,745	7.00	5.35
7	150,363	3	146,303	6.99	5.59
8	159,385	2	156,516	6.98	5.76
9	168,948	1	167,427	6.97	5.89
10	179,085	0	179,085	6.96	6.00
11	189,830	0	189,830	6.00	6.00

Note how the annual return starts out negative at -2.59%, then increases to a level (7.04%) above the underlying investment return (6.0%), decreases gently for eight years and then falls back to the underlying investment return (6.0%) a year after surrender charges have worn off. The cumulative return grades into the investment return during this period. The assumptions of a market value adjustment in any of the years would change the pattern of investment returns.

Appendix C

Payouts to Non-Highly Compensated and Highly-Compensated Employees Comparing Fair Value and Contract Value Treatment

Assume a plan with one highly compensated employee and one non-highly compensated employee. The unallocated investment product has an initial 10% surrender charge, decreasing at 1% annually. There is a 10% benefit responsive provision in the contract. Assume that the investment return on the contract is 6% annually.

The plan has two employees. Employee "A" is highly compensated, starting with a $100,000 account balance, with $10,000 annual contributions. Employee "A" maintains employment through the end of surrender charges. Employee "B" is a non-highly compensated position which terminates every three years at the beginning of the year and is replaced by a rehire.

Assume that earnings are allocated based on the beginning of the year account balance. Assume there is no market value adjustment.

The following payout patterns result:

	Surrender	Book Value Payout		Market Value Payout	
Year	Charge	"A"	"B"	"A"	"B"
1	.10	0	0	0	0
2	.09	0	6367	0	5921
3	.08	0	0	0	0
4	.07	0	0	0	0
5	.06	0	6367	0	6055
6	.05	0	0	0	0
7	.04	0	0	0	0
8	.03	0	6367	0	6189
9	.02	0	0	0	0
10	.01	0	0	0	0
11	.00	310893	6367	312432	6323

Total Payouts	Book Value	Market Value	Percent Increase
Highly Compensated	310893	312432	0.5
Non-Highly Compensated	25469	24488	-3.8
Total	336362	336920	0.1

Note that total benefits paid to non-highly compensated employees decrease by 3.8 percent due to the imposition of fair market value accounting where contract value would otherwise have been paid. The results would be more extreme if a market value adjustment was applicable.

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U.S. AGENCY FOR
INTERNATIONAL
DEVELOPMENT

November 30, 1993

Ms. Susan W. Hicks
Technical Manager
Federal Government Division
File Q-1-505
AICPA
1455 Pennsylvania Avenue
Washington, DC 20004-1081

Dear Ms. Hicks:

We have read the exposure draft, "Proposed Statement of Position - Reporting of Investment Contracts Held By Health and Welfare Benefit Plans and Defined-Contribution Pension Plans" and offer no comment on it as presented.

Sincerely,

B R Howard

Reginald Howard
Director, Financial Audits
Office of the Inspector General

cc: J. Durnil, AIG/A

Hallmark Cards

December 6, 1993

Ms. Susan W. Hicks
Technical Manager
Federal Government Division, File Q-1-505, AICPA
1455 Pennsylvania Avenue, N.W.
Washington, DC 20004-1081

Dear Ms. Hicks,

This memo is in response to David Walker's and Gerard Yarnall's letter of September 15, 1993 (re: SOP Exposure Draft on Reporting of Investment Contracts) and, in particular, to their instruction to give special attention to the requirement to value investment contracts that are deemed not to be fully benefit responsive because of plan restrictions at fair value (paragraph 10).

Paragraph 10 of the 9/15/93 SOP draft addresses a situation that was described by Mr. Ken Dakdduk to FASB board members in a letter dated May 10 1993 (copy attached). Mr. Dakdduk noted that "...the proposed SOP does not address situations in which limits, restrictions, or conditions result from the terms of the *plan*" (italics mine). Specifically, Mr. Dakdduk objected that "...it is inappropriate to use contract value if there is any event that upon occurrence could result in participants receiving an amount that is less than contract value, regardless of the probability of such an event occurring." AICPA's apparent response to this objection was an addition to paragraph 10 which attempts to define "reasonable access" by plan participants to their funds in defined contribution plans. An example is cited in paragraph 10 which states: "...if plan participants are allowed access at contract value to all or a portion of their account balances only upon termination of their participation in the plan, it would not be considered reasonable access and, therefore, investment contracts held by that plan would generally not be deemed to be fully benefit responsive."

The example quoted above places new conditions on whether investment contracts will be deemed benefit responsive, i.e. if *all* or even a *portion* of account balances are not accessible until termination, investment contracts held by the plan would not be considered benefit responsive. The Hallmark Profit Sharing plan has used investment contracts extensively and has the following access provisions: (1) Hardship withdrawals of up to 25% of the total account balance are permitted after 5 years of service; (2) Up to 100% of the participant's balance may be transferred at 50 years of age and with 15 years of service; and (3) 100% of balances are immediately available upon termination. The motivation behind these plan rules is to encourage participants to accumulate value for use in their retirement years (as, for example, the way restrictions on 401(k) withdrawals do). However, the Hallmark plan includes no provisions for a "penalty" (i.e. use of some value other than contract value that could result in valuation below contract value) regardless of the volume of dollars transferring from or being paid out by the plan in response to participant-initiated transactions. It is conceivable that all contracts held in the Hallmark plan would have to be liquidated; in such an event all participants would receive contract value.

It seems unnecessary to me to use a broad definition of "fund access" in order to determine when investment contracts should or should not be reported at contract value. There are legitimate reasons for plans in governing access to plan assets. In our view it may be proper if (again citing the revised SOP paragraph 10) "...plan participants are allowed access at contract value to all or a portion of their account balances only upon termination of their participation in the plan." The existence of a plan rule such as this should not, of itself, cause investment contracts to be valued at market. In Hallmark's case participants can only receive contract value, and, in fact, will never receive market value.

In summary, we view the accounting pursuant to paragraph 10 as revised September 15, 1993 as *not* appropriate because it places an unduly harsh restriction on the ability of benefit plans to reasonably limit participant access to funds. The example used to define "substantially restricted" access implies that participants must have complete access to all assets at any time prior to termination in order for the plans' contracts to be considered benefit responsive and for contracts to be held at contract value. We would suggest one of two actions to correct this situation: (1) "substantially restricted" and "access" should be more clearly defined so as to allow reasonable limitation by plans on participant access, or (2) the February 17, 1993 draft of paragraph 10 should be adopted and the wording dealing with participant access omitted

Please let me know if you have any questions concerning these comments.

Sincerely,

Douglas M. Browning
Benefit Trusts Director
Hallmark Cards, Inc.
Tel: (816)-274-3381

MEMORANDUM

Financial Accounting Standards Board

To: Board Members

From: Ken Dakdduk

Subject: Proposed Statement of Position on Reporting of Investment Contracts Held By H&W Benefit Plans and Defined-Contribution Pension Plans

Date: May 10, 1993

CC: Lucas, Ball, Vernuccio

For Discussion at the May 19, 1993 Board Meeting

At its May 19, 1993 meeting, the Board will discuss the attached draft of a proposed AICPA Statement of Position (SOP) on reporting of investment contracts held by health and welfare benefit plans and defined-contribution pension plans. The AICPA undertook this project at the Board's request and now is asking the Board to clear this proposed SOP for exposure for public comment.

The proposed SOP would amend Chapters 3, 4, and 7 of the AICPA Audit and Accounting Guide *Audits of Employee Benefit Plans*, and Statement of Position 92-6, *Accounting and Reporting by Health and Welfare Benefit Plans.* It requires health and welfare benefit plans and defined-contribution pension plans to report investment contracts issued by an insurance enterprise or other entity at fair value and stipulates that contract value, which is defined as principal plus accrued interest, approximates fair value if an investment contract is fully benefit responsive. Contracts that incorporate mortality or morbidity risk can also be reported at contract value.

Relationship to Other Pronouncements

The proposed SOP would constitute Level B in the GAAP hierarchy. Accounting guidance for financial statements of defined-contribution pension plans and health and welfare benefit plans is not addressed by Level A GAAP. Thus, the proposed SOP would not conflict with existing professional literature in a higher category of GAAP. However, it would affect accounting literature in the same category of GAAP (i.e., Level B), by amending Chapters 3, 4, and 7 of the AICPA Audit and Accounting Guide *Audits of Employee Benefit Plans* and SOP 92-6, *Accounting and Reporting by Health and Welfare Benefit Plans*.

The requirement for defined contribution plans to report investment contracts at fair value is generally consistent with the requirements for defined benefit pension plans contained in FASB Statement No. 110, *Reporting by Defined Benefit Pension Plans of Investment Contracts*. Also consistent is the exception to the fair value requirement applicable to insurance contracts (i.e., contracts that incorporate mortality or morbidity risk) under both Statement 110 and the proposed SOP.

Improve or Prevent Deterioration in Practice

The staff understands that most plans now report investment contracts at contract value, which may or may not be fair value. Requiring the use of fair value at each reporting date can facilitate a financial statement user's assessment of the plan's ability to pay benefits and would provide information necessary for assessing both annual investment performance and the stewardship responsibility of plan administrators and other fiduciaries. To that extent, fair value reporting would result in an improvement in existing accounting practice.

The proposed SOP indicates that fair value can be contract value if investment contracts have fully benefit responsive features. Thus, the degree of improvement in practice arising from fair value reporting will depend on whether or not investment contracts are fully benefit responsive. Assuming that most plans report investment contracts at contract value under current guidance, there would be no change in the reported value of those contracts under the proposed SOP if they are fully benefit responsive. On the other hand, if most contracts are not fully benefit responsive and are being reported at contract value under current guidance, a switch to fair value reporting could be a significant change and, thus, could result in an improvement in practice. The staff cannot determine the extent to which defined contribution plans currently hold contracts that are fully benefit responsive.

Benefit responsiveness is discussed in paragraphs 9 and 10 of the proposed SOP.

> The extent to which a contract's terms or related agreement permit and require withdrawals at contract value for benefit payments, loans, or transfers to other investment options offered to the participant by the plan. Investment contracts must transfer principal and accrued interest risk to a financially responsible third party (that is, they provide for all participant-initiated transactions permitted by an ongoing plan at contract value with no conditions, limits, or restrictions) to be considered fully benefit responsive.
>
> A fully benefit responsive investment contract (whether with an insurance enterprise or other entity) provides a guarantee by a financially responsible third party of principal and previously accrued interest for liquidations, transfers, loans, or hardship withdrawals initiated by plan participants exercising their rights to withdraw, borrow, or transfer funds under the terms of the ongoing plan.

These paragraphs state that the "contract" must provide for all participant-initiated transactions permitted under the terms of the ongoing plan at contract value with no conditions, limits, or restrictions in order to be considered fully benefit responsive and, thus, be reported at contract value. This provision focuses on the contract itself and stresses that the contract cannot place limits, conditions, or restrictions on a participant's ability to access the full amount of his or her account balance at contract value. However, the proposed SOP does not address situations in which limits, restrictions, or conditions result from the terms of the plan. For instance, a plan may stipulate that if more than one-third of its participants request a hardship withdrawal, the amount of funds available to those participants will be limited. That stipulation may be necessary to prevent the plan from having to liquidate certain underlying contracts at a penalty (i.e., subject to a market value adjustment) if cash or other benefit responsive contracts would be insufficient to meet the large cash demand. In that situation, the proposed SOP would appear to support the use of contract value even though "under the terms of the ongoing plan" the dollar amount of funds the participants would receive or have access to would be limited by the plan and, therefore, be less than contract value.

The staff believes that the use of contract value under a document that requires the use of fair value is inappropriate in any situation in which a market value adjustment could be required at any time during the contract period, regardless of its probability and regardless of the limits of the plan, because in those situations participants are not guaranteed to receive the full amount of principal plus accrued interest in their accounts and contract value would not equal fair value. Further, if the contract cannot have limits on participant-initiated transactions to be fully benefit responsive, it is inconsistent to allow the plan itself to impose such limits and still get the use of contract value reporting. If the underlying motivation is to use contract value, the proposed SOP should simply require its use and not attempt to equate contract value with fair value. Alternatively, if the document is suggesting that contract value is appropriate in some circumstances and fair value is appropriate in others, it does not clearly distinguish those circumstances.

Need for the Proposed SOP

The staff believes that there is a need for guidance in this area. Many defined contribution plans have invested funds in investment contracts and, in light of the guidance in Statement 110 with respect to defined benefit plans, reevaluating the accounting treatment of investment contracts for defined contribution plans is appropriate. The FASB decided not to address this matter as part of the development of Statement 110 because doing so would have significantly slowed and expanded that project. Instead, the Board asked the AICPA to address the reporting issue for defined contribution plans in view of its experience with those plans. No new developments or events have occurred to reduce the need for the proposed SOP.

Cost/Benefit Considerations

The staff believes that the cost of complying with the proposed SOP is diminished since the guidance would allow the continued use of contract value reporting for fully benefit responsive contracts. Thus, only investment contracts that are not fully benefit responsive would have to be valued and, therefore, it would not be necessary for all plans to generate valuations of all contracts. However, the staff cannot determine the extent to which contract value will continue to be used.

STAFF RECOMMENDATION

The staff recommends that the Board not object to exposure of this proposed SOP if it is clarified regarding whether its requirement is to use contract value, fair value, or something in between. The staff believes that part of that clarification would involve addressing whether the terms of the ongoing plan would make it inappropriate to use contract value to report contracts held by plans whose terms may limit the amount a participant has access to.

If fair value reporting is to be required, the proposed SOP should make it clear that if a transaction or event that is permitted under the terms of the ongoing plan, including a plan-initiated transaction, could trigger a penalty at any time during the contract period, contract value is not fair value regardless of the probability of such an event occurring. Further, the staff disagrees with the use of probability in Example 2 in the Appendix. The guidance in this example under paragraph A.8 says that contract value approximates fair value unless it is probable that the plan will be terminated, spunoff, or amended, or a significant number of employees will terminate. The staff believes it is inappropriate to use contract value if there is any event that upon occurrence could result in participants receiving an amount that is less than contract value, regardless of the probability of such an event occurring.

If the task force desires contract value to be used, the proposed SOP should simply require its use rather than require the use of fair value and the document should not try to equate contract value with fair value.

If the task force believes contract value is appropriate in some instances and fair value in other instances, the staff believes the document should better distinguish the circumstances under which each would be appropriate.

The proposed SOP adequately complies with the remaining criteria required by the Board for clearance of AICPA accounting proposals.

Employee Benefit Plans Committee
Federal Government Division
American Institute of Certified Public Accountants

Exposure Draft: Reporting of Investment Contracts Held
By Health and Welfare Benefit Plans
And Defined Contribution Pension Plans
September 15, 1993

Response by: Accounting and Auditing Standards Committee
Louisiana Society of Certified Public Accountants
2400 Veterans Blvd., Ste. 500
Kenner, LA 70062 504-464-1040

<u>General</u> We basically concur with the provisions of this SOP. However, we have the following comments:

<u>Paragraph #</u>

1 - 2 No comment. Informational - introduction and scope.

4 Good guidance. Defined benefit plans should report investment contracts at fair value. Defined contribution plans, including both health and welfare and pension plans should report fully benefit responsive investment contracts at contract value and all other investment contracts at fair value.

5 - 7 Good guidance. Informational concerning certain aspects of defined benefit and contribution plans.

8 Agree that plan assets of defined contribution plans should be measured and reported at values that are meaningful to financial statement users.

9 - 10 Good guidance. Informational related to a fully benefit responsive investment contract.

11 Agree that health and wealth benefit plans and defined contribution pension plans should report insurance contracts in the same manner required by ERISA annual reporting requirements of DOL Form 5500 or 5500-C/R.

12 - 13 No comment. Background information.

14 Disclosure should be required to include a market rate of interest for fully benefit responsive contracts reported at contract value. The plan should disclose the money market rate as of the most recent statement of net assets date.

15 - 16 Good guidance.

17 No comment on the effective date and transition.

Appendix Good guidance.

ILLINOIS CPA SOCIETY & FOUNDATION

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December 1, 1993

Susan W. Hicks
Technical Manager
Accounting Standards Division
File Q-1-505
American Institute of Certified
Public Accountants
1455 Pennsylvania Avenue, N.W.
Washington, D.C. 20004-1081

The Committee on Accounting Principles of the Illinois CPA Society ("Committee") with the assistance of the Committee on Employee Benefits is pleased to have the opportunity to comment on the Exposure Draft of the Proposed Statement of Position, Reporting of Investment Contracts Held by Health and Welfare Plans and Defined-Contribution Pension Plans ("Proposed Statement"). The organization and operating procedures of the Committee are reflected in the Appendix of this letter. These recommendations and comments represent the position of the Illinois CPA Society rather than any of the members of the Committee and of the organizations with which they are associated.

The Committee supports the AICPA in its efforts to conform reporting of health and welfare plans and defined contribution pension plans ("defined contribution plans") with defined benefit plans. The Committee concurs with the requirements of the Proposed Statement. The Committee agrees with the document as drafted in not requiring disclosure of market rates of interest for fully benefit responsive contracts. This information would not be meaningful to plan participants. The Committee also concurs with the proposed transition rules and effective date.

We would be pleased to discuss our comments and recommendations with members of the Employee Benefit Plans Committee or staff of the Federal Government Division.

Very truly yours,

Bernard Revsine

Bernard Revsine, Chairman
Committee on Accounting
Principles

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60606-6098
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APPENDIX

ILLINOIS CPA SOCIETY
ACCOUNTING PRINCIPLES COMMITTEE
ORGANIZATION AND OPERATING PROCEDURES

1993-1994

The Accounting Principles Committee of the Illinois CPA Society (the Committee) is composed of 27 technically qualified, experienced members appointed from industry, education and public accounting. These members have Committee service ranging from newly appointed to 15 years. The Committee is a senior technical committee of the Society and has been delegated the authority to issue written positions, representing the Society, on matters regarding the setting of accounting principles.

The Committee usually operates by assigning a subcommittee of its members to study and discuss fully exposure documents proposing additions to or revisions of accounting principles. The subcommittee ordinarily develops a proposed response which is considered, discussed and voted on by the full Committee. Support by the full Committee then results in the issuance of a formal response, which, at times, includes a minority viewpoint.

WILLIAM A. MUTCH
CERTIFIED PUBLIC ACCOUNTANT
P.O. Box 33
Oceanport, NJ. 07757
(908) 747 - 6580

December 9, 1993

Susan W. Hicks, Technical Manager
Federal Government Division, File Q-1-505, AICPA
1455 Pennsylvania Avenue, NW.
Washington, DC. 20004-1081

Dear Ms. Hicks:

Here are my comments on reporting of investment contracts re: Exposure Draft 9/15/93.

Regarding paragraph 15g, a market rate of interest for fully benefit responsive contracts reported at contract value would not be useful for users of defined-contribution plan statements. That would be comparing apples and oranges. Reporting the yield rate for other options within the plan would be beneficial.

Regarding paragraph 10, there are no Internal Revenue Code implications. Contract value should be disclosed for investment contracts that are not fully benefit responsive where a plan also contains contracts that are fully benefit responsive to be comparable.

Sincerely,

Bill Mutch

William A. Mutch

INSTITUTE OF MANAGEMENT ACCOUNTANTS
10 PARAGON DRIVE
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MANAGEMENT ACCOUNTING PRACTICES COMMITTEE
1993-94 MEMBERS

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Samford University
Birmingham, Alabama

Martin Abrahams
Coopers & Lybrand
New York, New York

Philip D. Ameen
General Electric Company
Fairfield, Connecticut

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Diane M. Butterfield
Chemical Bank
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Patricia P. Douglas
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Motorola, Inc.
Schaumberg, Illinois

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Valuation Research Corporation
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New York, New York

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KPMG Peat Marwick
White Plains, New York

Staff -
Management Accounting Practices

Louis Bisgay, Director

December 8, 1993

Ms. Susan W. Hicks
Technical Manager
Federal Government Division, File Q-1-505
American Institute of Certified Public Accountants
1455 Pennsylvania Avenue, N.W.
Washington, DC 20004-1081

Re: PSOP: Reporting of Investment Contracts Held by Health and Welfare Benefit Plans and Defined - Contribution Pension Plans

Dear Ms. Hicks:

The Management Accounting Practices Committee (MAP) of the Institute of Management Accountants is pleased to respond to the referenced Proposed Statement of Position.

MAP believes that for defined contribution plans, the fundamental thrust of the PSOP is misplaced. Rather than trying (unsuccessfully) to meet plan participants' needs by determining if individual investment contracts are benefit responsive, the thrust of relevant reporting should be aimed at whether or not the plan as a whole is benefit responsive. MAP strongly urges AcSEC to carefully reconsider a rule that, as explained below, would force plan managers to either report misleading information to participants, or change their investing strategies, which will (and, in fact, has already begun to) needlessly result in a very real financial cost to the vast majority of the public who participate in defined contribution plans.

Specifically, employers/plan sponsors strive to select prudent fund managers to manage investment vehicles on behalf of the participants who own, and have investment vehicle selection responsibility for, their plan accounts. Traditionally, those managers continually forecast liquidity needs for all investment vehicles, including yield-type vehicles that typically include the investment contracts covered by the PSOP, and invest in appropriate instruments according to those needs. For instance, liquidity for account transfers, participant withdrawals, etc., can be satisfied by (in addition to future cash inflows from contributions and maturing contracts) a mix between cash-like investments (e.g., money market funds) and guaranteed investment contracts that have the guaranteed liquidity features described by the PSOP. The resulting liquidity portfolio may, for example, account for 20% of the vehicle's principal. The remaining principal may then be invested in investment contracts that do not guarantee immediate liquidity and, therefore, do not meet the PSOP's fully benefit responsive criteria. However, these contracts provide a greater yield to plan participants than fully benefit responsive contracts whose guaranteed liquidity features are expensive. As a result of the manager's efforts, the plan is fully benefit responsive while at the same time providing a high yield. Unfortunately, as described below, the participants of these plans will be unduly penalized because 80% of principal does not meet the PSOP criteria.

Conceptually, there should be no incremental cost to participants strictly because investment contracts do not meet the benefit responsiveness criteria of the PSOP. However, because of their fiduciary responsibilities to provide accurate information to plan participants, plan managers <u>must exit or restructure all</u> non-benefit responsive investment contracts that would be reported at fair value under the PSOP, and in their place, invest in the more expensive fully benefit responsive contracts. (While this would result in less principal invested in cash-type investments and a resulting re-coup of some of the lost yield in today's interest rate environment, the ability to maximize yields on behalf of the participants while still maintaining overall plan benefit responsiveness is severely diminished.) The reason for exiting or restructuring those contracts is that reporting them at fair value would not only provide each participant with irrelevant information, it would constitute gross negligence by misleading participants into erroneous investment decisions. This is because the plan cannot, and thus the participant cannot, receive anything more than contract value. The fact is that these plans traditionally hold investment contracts to maturity and, barring impairment problems of the issuer, receive no more or less than the originally contracted principal and interest. To highlight this point, imagine the participant who, in today's low interest rate environment, examines his or her quarterly 401(k) statement and finds a fair valued "guaranteed income fund" amount that is in actuality 5% greater than contract value and, upon relying on this information, makes a change in investment vehicles or takes out a hardship loan. The participant then receives the lower contract value payment (or, if they receive the reported value, would be short changing the remaining plan participants who will receive an amount lower than contract value upon contract maturity).

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Therefore, to avoid reporting erroneous information under the PSOP, plan managers must replace or restructure existing investment contracts with the more expensive fully benefit responsive contracts so that they can continue to report relevant information, unfortunately at the cost to plan participants. (This replacement process has already begun in anticipation of this accounting rule.) This result seems to us to be unacceptable.

To remedy this situation, MAP recommends that AcSEC consider a higher level approach by providing guidance for accounting for the assets of defined contribution plans on a unified portfolio basis. For instance, the criteria of FAS 115, Accounting for Investments, could be applied to determine the ability of the plan to hold investment contracts to maturity after assuring that all foreseeable liquidity needs are met with instruments that would be fair valued. This approach would mimic the results of efficient plan managers that continuously maintain a fully benefit responsive portfolio.

Failing acceptance of that recommendation, it is imperative that AcSEC provide for prospective application of the proposed accounting to investment contracts purchased after the PSOP's effective date, thus grandfathering existing investment contracts (which often have a 5 year maturity) so as to prevent plan participants from incurring losses from the premature replacement or restructure of those contracts. Please be mindful that this alternative solution (as well as a third choice - making the PSOP effective after December 31, 1998) does not prevent the additional cost to plan participants of paying contract manufacturers a premium for fully benefit responsive contracts in the future.

With respect to other specific points in the PSOP, MAP agrees that fully benefit responsive investment contracts, whether issued by insurance companies or other credit worthy institutions, clearly should be reported at contract value in the financial statements of defined contribution retirement plans. We also agree that plan restrictions that severely limit plan participants' access to their accounts for investment decisions, such as transfers between plan investment vehicles, can preclude benefit responsiveness. We recommend that a plan which limits access to less than once per year be considered non-benefit responsive.

Finally, regarding the question posed by the PSOP about the usefulness of disclosing the market interest rate of investment contracts carried at contract value, MAP sees no merit to providing this information since it would be confusing to plan participants.

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We would be pleased to discuss with you any of the points raised in this response or any other matters of interest to you.

Sincerely,

Frank C. Minter

Frank C. Minter
Chairman,
Management Accounting Practices Committee

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Mobil Corporation

3225 GALLOWS ROAD
FAIRFAX, VIRGINIA 22037-0001

ROBERT C. MUSSER
CONTROLLER

December 3, 1993

Ms. Susan W. Hicks
Technical Manager,
Federal Government Division
AICPA
1455 Pennsylvania Ave., NW
Washington, DC 20004-1081

FILE Q-1-505 - PROPOSED SOP
REPORTING OF INVESTMENT
CONTRACTS HELD BY
HEALTH AND WELFARE
BENEFIT PLANS AND
DEFINED-CONTRIBUTION
PENSION PLANS

Dear Ms. Hicks:

We have reviewed the proposed Statement of Position (SOP) - "Reporting of Investment Contracts Held by Health and Welfare Benefit Plans and Defined-Contribution Pension Plans."

We agree that defined benefit health and welfare plans should value investment contracts at fair value, and that defined contribution plans (health and welfare as well as pension plans) should value fully benefit responsive investment contracts at contract value. These valuation methods will provide users of the financial statements with highly relevant information. Also the accounting for contracts held by defined benefit health and welfare plans would be consistent with the requirements of FAS 110 for defined benefit pension plans.

While the proposed SOP effectively addresses the issues of accounting for investment contracts, we are somewhat concerned with the expansive definition of full benefit responsiveness in paragraph 10. We believe that a contract is benefit responsive if its contract value will be realized by plan participants. Plan provisions that restrict how a contract can be realized but do not alter the amount of realization should not have an impact on whether a contract is fully benefit responsive for reporting purposes. For example, plans with older type class period, fixed rate investment contract options typically restrict transfers to other investments before maturity, but allow and provide contract value for ongoing participant loans or withdrawals. Those with more modern "blended" or "floating" rate investment contract options typically provide contract value for all participant-initiated transactions but require a three or six month "equity wash" before funds can be transferred to competing fixed income investments. These types of restrictions do not impair contract value payments and should not result in "fair" rather than contract value reporting. Only if Plan actions or restrictions cause the contract not to be benefit responsive (i.e., realization at a value other than contract value), would we then agree to a fair value measurement.

You specifically requested comments on the need to disclose market rates of interest for fully benefit responsive contracts. In our view, the addition of these disclosures would add an unnecessary complexity without providing meaningful information. Since contract value is the amount that participants will receive from fully benefit responsive contracts, we fail to see how market value disclosures would enhance the investing and borrowing decisions of the plan participants.

In conclusion, we believe that by correlating the underlying economic relationships of these investment contracts with the type of plans that hold them, this proposed SOP, along with FAS 110, establishes well reasoned accounting guidance.

Very truly yours,

Bob Musser

Robert C. Musser

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Shell Oil Company

One Shell Plaza
P. O. Box 2463
Houston, Texas 77252

W. J. Ihlanfeldt
Assistant Controller

December 10, 1993

Ms. Susan W. Hicks
Technical Manager
Federal Government Division
File Q-1-505
American Institute of CPA's
1455 Pennsylvania Avenue, N.W.
Washington, DC 20004-1081

Dear Ms. Hicks:

Shell Oil Company is pleased to have the opportunity to comment on the AICPA's September 15, 1993 proposed Statement of Position (SOP) entitled "Reporting of Investment Contracts Held by Health and Welfare Plans and Defined-Contribution Pension Plans."

We are in general agreement and particularly supportive of features allowing the reporting at contract value of investment contracts with fully benefit-responsive features for defined-contribution pension plans. However, the cover letter to the ED asks that consideration be given to requiring disclosure of a market rate of interest for such fully benefit-responsive contracts reported at contract value. We feel that this would not be beneficial or relevant to plan participants. We continue to stress that the only relevant market value for such fully benefit-responsive contracts is the contract rate. Implying otherwise by disclosure of the market rate would only serve to confuse participants and clutter the financial footnotes with non-value added data at an unnecessary cost.

Another issue that concerns us is the disclosure requirements for benefit-responsive investment contracts in the last sentence of paragraph 14 that calls for providing "a general description of . . . . and any limitations on guarantees (for example, premature termination of the contracts by the plan, plant closings, layoffs, plan termination, bankruptcy, mergers, and early retirement incentives)." Every contract written has some type of limitations that are typically employer initiated. We feel that the word "probable" should be added after the word "any." This would prevent this disclosure requirement from becoming boiler-plate and causing plan participants undue concerns by implying risks when the risks are only remote possibilities.

If you would like to discuss this further, please contact me at (713) 241-3219.

Very truly yours,

W. J. Ihlanfeldt

W. J. Ihlanfeldt

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Bankers Trust Company
One Bankers Trust Plaza, New York, New York 10006

Tami Pearse
Vice President
GIC Derivatives
Tel: 212-250-1711
Fax: 212-250-8309

December 13, 1993

Ms. Susan W. Hicks
Technical Manager
Federal Government Division, File Q-1-505
AICPA
1455 Pennsylvania Avenue, N.W.
Washington, DC 20004-1081

Dear Ms. Hicks:

The Bankers Trust GIC Derivatives Group is a leading provider of BICs and synthetic GIC products to the defined contribution marketplace and we welcome the opportunity to respond to the AICPA Exposure Draft of the Proposed Statement of Position, "Reporting of Investment Contracts held by Health and Welfare Benefit Plans and Defined Contribution Plans" (the "Exposure Draft" or "ED"). We broadly agree with the guidance provided in the Exposure Draft, in particular with the AICPA's views on the objectives of defined contribution financial statements and regarding the reporting at contract value. However, we have several comments to present with regard to Paragraph 10 of the Exposure Draft. In discussions both internally and with our clients we have focused on two concepts as they relate to full benefit responsiveness: 1) reasonable access and 2) the requirement of a zero percent crediting rate floor on variable rate products. The arguments which follow are intended to bring about further clarification of issues related to contract value accounting.

Reasonable Access and Full Benefit Responsiveness

In paragraph 10 of the Exposure Draft, the committee asserts that reasonable access by participants to make withdrawals at contract value for benefit payments, loans or transfers to other investment options is an required element in determining full benefit responsiveness. Following this logic, plan structure may impact on the determination of full benefit responsiveness of the contracts held by the plan.

However, ERISA does not mandate specific terms regarding plan structure, including access. Section 404(c) concerning the structure of defined contribution pension plans was offered as guidance, not as a requirement, to plans. ERISA allows each plan sponsor to make decisions regarding the structure of their plan and we believe many plan sponsors will choose not to adopt 404(c) recommendations. Participants in the plan have the ability to participate (or not) given the plan structure. Therefore, in a plan which offers more restrictive access to funds relative to some undefined standard, a participant does not expect to access the funds unless a plan-qualified withdrawal event occurs. The fact that the terms of the plan restrict a participant's access in certain circumstances does not alter the fact that, if withdrawals were to occur, the funds available to a participant in a benefit responsive contract would be paid out at book value.

We believe, therefore, that the proposed requirement of reasonable access under the terms of the plan for a contract to be considered fully benefit responsive would result in misleading financial statements. Paragraph 7 of the ED notes that "[t]he primary objective of a defined-contribution plan's financial statements is to provide information that is useful in assessing the plan's present and future ability to pay benefits when they are due." Paragraph 8 continues "[i]nformation that is useful to plan participants includes the amount they would receive currently if they were to withdraw or borrow funds from or transfer funds within the plan." When participants invest in contracts which cover withdrawals at book value under the terms of the plan, the funds which would be available to them for a withdrawal would be the book value amount. Restricted access to funds does not affect their value in the case of a withdrawal. If contracts which cover withdrawals at book value have to be reported at fair value because they are not considered fully benefit responsive, the financial statements would reflect unrealized gains or losses which, under the contract's terms, would never be passed on to the participant. Therefore, carrying such a contract at a value other than book value would give participants misleading and inaccurate information as to the amount available for withdrawal. A contract which is benefit responsive in accordance with the withdrawal terms of the plan should be considered fully benefit responsive and should be carried at contract value because that is the fair value to the participant if he were to withdraw the funds. The value of the potential withdrawal is the information which is most useful to the participant in assessing benefits availability.

Zero Percent Crediting Rate Floor and Full Benefit Responsiveness

Paragraph 10 also proposes a requirement that a contract which provides for prospective interest rate adjustments must have a zero percent interest crediting rate floor ("zero floor") to be considered fully benefit responsive and to qualify for contract value accounting. There are several reasons why this proposed requirement would result in misleading financial statements and may actually hurt participants.

For reasons similar to those stated above we believe that contracts which provide for prospective interest rate adjustments and which do not include a zero floor would still need to be reported at contract value. In the event of a withdrawal by a plan participant, the absence of a zero floor does not make the contract value equal to the fair value of the securities. The amount available to a participant upon a withdrawal from the plan is, and remains, the contract value whether or not there is a zero floor. Under Examples 4 and 5 of the ED (pp. 18-19), the logic is drawn that contract value accounting is appropriate in the event "that participants can, and must, execute plan transactions at contract value." Therefore it would be misleading to present any value other than contract value on a participant's statement, whether or not a zero floor exists.

Paragraph 4 of the ED supports the idea that certain events which may affect the value of a contract may make it appropriate to value the contract at something less than contract value. This rationale is sound for events in which the value realized upon a participant withdrawal could result in a payout which is less than the expected contract value on any given day. This difference in valuation would not result simply from the absence of a zero floor. The plan's crediting rate may decline, but the participant continues to realize the value shown on his statement. In particular, if the crediting rate is announced at the beginning of each reset period, any participant withdrawal made prior to the next reset would be honored at the expected value. If there is a difference between market and book value at the time of withdrawal, the participant is paid out at book value. Therefore, showing other than contract value would be misleading and incorrect.

Examples 4 and 5 of the ED emphasize the importance of the guaranteed return of principal and accrued interest. Synthetic GIC products structured with zero floors and an undefined and flexible maturity (which characterizes the majority of products currently being offered), however, are allowed to be carried at contract value. In effect, products with these terms are simply passing what would be current negative crediting rate adjustments into the future. The zero floor is assumed to provide risk reduction that in practice does not exist. In the event of a withdrawal by the contractholder when market value is below book value, in order to preserve contract value accounting, the issuer of the benefit-responsive feature simply requires the contract to be held at a crediting rate of zero for some period to be determined at that time.

Paragraph 5 of the ED states that "defined contribution plans provide benefits based on amounts contributed to an employee's individual account plus or minus forfeitures, investment experience, and administrative expenses. The Internal Revenue Code generally requires that all investment experience under defined-contribution plans be allocated to individual account balances." In a product with a zero floor, actual portfolio returns are not credited to participants during this undefined zero percent holding period. Indeed, the crediting rate will not change, regardless of the performance of the portfolio. In light of these statements in Paragraph 5 of the ED, the plan fiduciary may not believe a zero crediting rate floor of this type is beneficial to the participants. Therefore, we believe that contracts without zero percent crediting rate floors which honor participant directed withdrawals at contract value should be carried at contract value.

As a practical concern, a structure which includes a zero percent holding period has potential credit risk. To preserve contract value accounting, the plan is forced to accept the credit risk of the issuer or of the wrap provider for an indeterminate period. If the plan sponsor, in his fiduciary role, determines it to be appropriate to accept some risk of a negative crediting rate instead of an undefined and potentially long period at a zero percent crediting rate, there should be no impact on the accounting treatment.

Also, requiring a zero floor would force the plan to pay for a feature which may or may not be needed or desired. A zero floor could, in some cases, provide true protection against the investment risk in the portfolio. However, in most cases, the contract is constructed so the investment and default risk is almost completely borne by the plan. Due to the perception that the zero percent floor reduces the risk to the plan, it must pay for the floor. The plan, however, continues to shoulder the risk. It is not usually in the interest of the participants to incur this expense.

Finally, requiring a zero floor may inhibit the ability of the plan to diversify the portfolio into certain investments which are expected to give added value to the participants in the plan. Many plan sponsors would like to diversify into other classes of securities to reduce the overall investment risk of the portfolio. Defined benefit plans are able to use these asset classes because of their long investment horizon. Much has been written of late in the press about the risk of overly conservative investments (read: GICs/fixed income) being chosen by participants who are risk averse. Plan sponsors are concerned about the ability of participants to accumulate enough savings to retire with financial security. Many plan sponsors would like to offer their employees the opportunity to diversify conservatively into some classes of investments with higher risk in the short term and higher reward in the long term. A zero floor, however, may add significant cost to a product aimed at achieving more diversification for participants. The inability to carry at contract value such products greatly impedes the effort of plan sponsors to diversify and the requirement of a zero crediting rate floor is a significant roadblock. In its role as fiduciary the plan sponsor should be allowed to determine whether a zero floor is necessary or beneficial within the context of the plan, but the decision should not be driven primarily by accounting treatment if the end result is detrimental to the plan and its participants.

Summation

The decision of whether a contract should be carried at contract value or fair value should be based on what amount participants realize in the event of a plan-qualified withdrawal. Participants use financial statements to determine the amount of funds available for withdrawal and that is the information which should be given to them. Consistent with the statements cited above from Paragraphs 5, 7 and 8, the values reported to participants are only useful if participants realize those values when a qualified withdrawal is made in accordance with the terms of the plan. Where a contract provides that all participant-directed, plan-qualified withdrawals are to be paid at book value, such contract should be valued at book value.

Thank you for taking our position into consideration. Please feel free to contact me with any questions or comments.

Sincerely,

Tami Pearce

Liberty

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December 13, 1993

Susan W. Hicks
Technical Manager
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Dear Board,

On behalf of Liberty Bancorp (Liberty Bank and Trust Company of Oklahoma City, N.A., Liberty Bank and Trust Company of Tulsa, N.A., and Liberty Bank and Trust Company of Midwest City, N.A.), I want to express comments against the AICPA's Statement of Position (SOP) proposal to the extent that it sanctions the use of contract price for the valuation of guaranteed investment contracts owned by defined contribution (retirement) plans. Such a valuation practice is a great disservice to those whose dollars are really invested in the contracts, the financially unsophisticated workers of America. We also feel that insurance companies and extremely large financial institutions enjoy an unfair competitive advantage over smaller investment institutions because of the non-valuation privilege. Liberty Bancorp is especially concerned with some of the misguided logic being promulgated to justify the exception.

Guaranteed investment contracts in substance are merely debt instruments like any other corporate bond. The fact that they will never pay more than the contracted benefit merely puts a cap on their market value.

The proposed SOP will allow valuation of these contracts at contract price if the contracts are "fully benefit responsive". As defined, the term "fully benefit responsive" glosses over the reality that the contracts are not fully responsive. They are dependent upon the creditworthiness of the issuers and guarantors, no matter how sound those companies appear to be. They do not pay at contract prices under all conditions.

There is a simple test as to whether the concept of contract price accounting is appropriate, whether or not the contracts are "fully benefit responsive". Would you allow a retirement trust to use contract pricing for any other corporate debt instrument if the maturity of the instrument coincides with the date payment is due and interim payments were generally impermissible? Do you allow corporations to price debt securities at book price if they don't intend to liquidate them prior to maturity. The same rationale that restricts book-price reporting in these situations applies to guaranteed investment contracts.

Also, the term "benefit responsive" is misleading when it doesn't require book price payments in the event of real life contingencies such as plant closings, plan terminations or other premature contract withdrawals. Calling a conditional contract "fully benefit responsive" is like terming the following statement as "fully benefit responsive", "We guarantee to pay 100% plus interest on your investment except when you ask us to respond in less than ideal circumstances for us financially." Such a guarantee is not responsive; it is contingent.

One market factor that can cause an investment contract to have a fair value that is lower than its contract price is the effect that interest rate changes in the market place have on the underlying collateral for the contract. You have asked for comments as to the need for disclosure of current market rates. The cleanest and easiest-to-understand disclosure would occur if the market value of the contracts were disclosed. Thus, if current interest rates were higher, the negative impact of this differential would be disclosed. If current interest rates were lower, the positive impact would be disclosed. To not require a prominent disclosure of some kind would be a travesty of integrity.

The proposed SOP calls for a disclosure of valuation reserves. This disclosure takes into consideration (belatedly) the obvious impairment in an investment contract's value due to significant credit problems of the issuer or guarantor. It does not address the effect of an issuer's financial condition upon the value of the contracts when reserves for valuation haven't occurred. Yet, when the issuer or guarantor's creditworthiness is not highest, the market value of its investment contracts are less than their contract prices. In addition, it is unrealistic to expect the average participant to be able to appreciate, much less quantify, the impact that a reserve has upon his or her benefit. On the other hand, market value reporting measures and discloses the effect of the issuer and guarantor's financial condition in a straight forward manner.

The proposed SOP seems to assume that, if a contract is issued by a company that has the appearance of being financially sound, there is no risk of loss to plan participants. The risk that the "financially sound" issuers of guaranteed investment contracts will not be able to pay the promised returns according to the terms of the contract is still real today. The examples of Executive Life Insurance Company and Mutual Benefit Life Insurance Company, etc., should have broken the illusion that negative scenarios of credit risk never occur. Executive Life Insurance Company became insolvent due to its risky investments going sour. It is generally surmised that Mutual Benefit Life became insolvent because many of their contract owners withdrew from its contracts in a short period of time. The insolvency of Mutual Benefit Life surprised everyone, including the guaranteed investment contract experts. There have been numerous other companies since then who have been quietly absorbed by other companies, with transferred annuity holders getting less than face value for their annuities.

Regarding the solvency of guaranteed investment contract issuers, any particular company that issues guaranteed investment contracts might be called upon to pay on a large number of their guaranteed investment contracts in a short period of time. There is never any assurance that a Defined Contribution Plan's contracts will not need to be liquidated in a shorter period of time than anticipated. When participants of a plan are able to direct their investments, they can all choose to withdraw from a particular guaranteed investment contract fund, motivated only by whim. Even when plan participants do not have the right to direct investments, they could all simultaneously be entitled to benefits under a scenario such as a plan termination or a site disaster resulting in the death of many participants. In addition, when many plans elect to not renew their guaranteed investment contracts with a particular guaranteed investment contract issuer, that issuer may incur a major cash flow problem. If an issuing company is required to pay on a substantial number of guaranteed investment contracts when insolvent or when there has been a fall in the value of the issuer's assets (the only significant collateral for the guaranteed investment contracts), the terms of the contract will not be able to be met. The only "guarantee" of a guaranteed investment contract is the issuer's general assets and sometimes the marginal possibility of assistance from the local state insurance fund. Even in those states that have insurance funds capable of assisting an insolvent guaranteed investment contract issuer, most state funds will not give preferred creditor status to guaranteed investment contract owners. The bottom line is: a $1 million guaranteed investment contract is not worth a million dollars when the issuer's credit rating is less than perfect or when the assets in which it invests the guaranteed investment contract proceeds have declined in value.

One invalid argument used to justify the contract price valuations of guaranteed investment contracts is that when the underlying assets backing the guaranteed investment contract go up in market value, the plan participants do not receive a greater return than what is promised in the contract. In the same breath, the converse is added, "And when the underlying assets go down in value, the plan participants still receive the return contracted for in the guaranteed investment contract". This converse thought incorrectly assumes that market risk never has any victims and that negative scenarios never happen. Putting aside the issue of market risk for a moment but conceding that fair value does fluctuate during the life of a guaranteed investment contract, it is further invalidly argued that if Defined Contribution Plan participants who withdraw from a guaranteed investment contract investment fund before the maturity of the guaranteed investment contract are paid a return that is greater or lesser than the stated rate of the contract, then there will be a shortfall or surplus to be allocated to the remaining participants when the plan receives the full contract amount from the guaranteed investment contract. This is supposedly unfair. Rather than unfair, this allocation of unrealized appreciation/depreciation as of each allocation-of-earnings date is exactly what fairness requires. It is exactly what occurs for all other non-short term investments (even secure U S Treasury Notes) which Defined Contribution Plans invest in. Rather than justifying contract price valuation, the fact that guaranteed investment contracts state a fixed return should only dictate that their fair value is never higher than their contract price as well as not ever being higher than their market value which is significantly impacted by interest rate changes and by the value of their collateral (the guaranteed investment contract's share of the net worth of the guaranteed investment contract issuer).

A second invalid argument used to justify contract price valuation for guaranteed investment contracts is the impracticality or impossibility of determining a fair value that can be allocated to plan participants because of the absence of a secondary market to determine market value. There are two flaws in this "practicality" argument. The first flaw is that the existence of a readily ascertainable contract price (in the face of an elusive fair value) does not justify calling the contract price what it is not. The contract's terms are not definitive of its fair value just like the term of a U.S. Treasury Note does not define its fair value. The fact that it is universally agreed (feared) that the contract price of a guaranteed investment contract will not equal its fair value is the strongest of evidence that contract price does not reflect economic reality. The second flaw in the "practicality" argument is that the argument supposes that expediency justifies deception. It is deceptive to hide the reality of market risk.[1]

A third invalid argument used to support the contract price valuation of guaranteed investment contracts is that the status quo is the best. It is not "best" to let plan participants retain the illusion that they are getting the higher earnings of a longer term investment without the increased risk of a longer term investment. The status quo is only "best" for those who truly profit from the existence of guaranteed investment contracts, i.e., insurance companies and guaranteed investment contract analysts.

There is a final thought to consider regarding the risk of owning guaranteed investment contracts. The ongoing viability of insurance companies in general is not guaranteed, much less the viability of any one company. Up until 1991, the average

American lived longer than those of earlier years. Sophisticated analysts are beginning to realize the impact that the halt in the growth of the national average life expectancy might have on insurance companies. Historically, insurance companies have had their earnings subtly (and substantially) propped up by the fact that their obligation to pay benefits under life insurance policies have occurred at a later point in time than their actuarial tables assumed because the tables were always based on outdated data. The extra earnings that the insurance companies have made on the *delayed payments of benefits* will no longer be available when life insurers' cost projections occur as projected. This is occurring as the national life expectancy average continues to remain the same.

In summary, when the Board issued Statement 110, it noted that a guaranteed investment contract is not a true insurance product and that the original rationale behind Statement 35 does not apply to guaranteed investment contracts. In reality, Statement 35 became a loophole that was grabbed upon by promoters. The loophole should have been closed a long time ago. Just because it has expanded into a billion dollar industry that employs vocal lobbyists does not justify the continued existence of the loophole now that there is an awareness of the problems with the accounting exception.

Very Truly Yours,

James L. Veerkamp

James L. Veerkamp

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It might be noted that there are many investments which prudent plan fiduciaries shun solely due to the difficulty in determining market values. Difficulty in determining the market value of an investment is actually an indicator that there are not willing buyers for the particular investment in question; and, by definition, a lack of willing buyers indicates that the investment in question has less market value than the seller/owner wants to admit. It is foreseeable that if the Board required the fair valuation of guaranteed investment contracts, a secondary market might spring up as guaranteed investment contract issuers redesign their contracts to make them assignable and marketable, and as buyers appear who are willing to assume guaranteed investment contracts at discount which would reflect the true market value of the guaranteed investment contracts.

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Lincoln National Life Insurance Company
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LINCOLN NATIONAL PENSION INVESTMENT
A part of LINCOLN NATIONAL CORPORATION

December 13, 1993

Susan W. Hicks
Technical Manager, Federal Government Division
File Q-1-505
AICPA
1455 Pennsylvania Avenue, N.W.
Washington, D.C. 20004-1081

Re: Proposed Statement of Position for Reporting of Investment Contracts Held by Health and Welfare Benefit Plans and Defined-contribution Pension Plans

Dear Ms. Hicks:

I am commenting on behalf of Lincoln National Life Insurance Co. Lincoln National issues GIC and deposit administration contracts and has over 2000 clients with $3.2 billion invested in contracts which will be affected by the above statement.

In general, we applaud the concept of allowing fully benefit responsive contracts owned by defined-contribution plans to be reported at contract value. Since most transactions in such contracts are processed at contract value, we agree that contract value is the most meaningful number to report.

You have asked for comments about specific sections of the SOP, and I would like to address several sections where changes would be appropriate:

1. Effective date (Paragraph 17)

The effective date should be postponed to no sooner than 12 months after the statement is finalized, so that plans will have the time to implement necessary plan redesign or contract renegotiation.

The December 15, 1993 effective date listed in the exposure draft means that the statement will be effective before it is finalized. To comply with the language of the draft, many plan sponsors will initiate plan changes or enter into negotiations with contract vendors to renegotiate contract provisions. Time is needed to adjust plan and contract design to the requirements of the final statement. Implementation before such changes are made could cause much confusion by requiring plans to report on a fair value basis temporarily and then reverting to a contract value basis.

2. Transition for existing contracts (Paragraph 17)

The final statement should include a transition period for existing contracts, in order to minimize the cost to plans of adding features to existing contracts and to reduce confusing reporting of contracts which cannot be renegotiated.

As mentioned above, it will be the objective of most plans to report contracts at contract value. They will attempt to modify existing contracts which do not comply with the requirements of the statement. Usually, this will entail adding benefit-responsive features to non-responsive contracts. In some cases, contract vendors may be unwilling to make these changes. If changes are made, there will normally be additional cost to the plan. In almost all cases, these changes would not be made in the absence of the statement, since investment portfolios were structured so that existing non-responsive contracts would not have to be accessed for benefit payments at contract value. Therefore, these additional costs are the direct result of the statement and should be mitigated through transition provisions.

A transition period would allow contracts to mature. Matured funds could be reinvested in contracts in compliance with the statement. This would avoid the expense of modifying existing contracts.

A period of five years would allow almost all existing contracts to mature without ill effect. A shorter period would decrease proportionately the number of contracts that would mature.

3. Plan restrictions on access to funds (Paragraph 15e)

There is a requirement in paragraph 10 to value contracts that are deemed not to be fully benefit responsive because of plan restrictions at fair value. This language should be deleted from the final statement. The ability of a plan sponsor to design plan features that offer participants an option which provides stable returns with reduced liquidity, while retaining contract valuation, should not be restricted. Valuation at contract value is appropriate if a contract's terms permit and require contract value for withdrawals available under the plan.

In order to continue contract value reporting, a plan is required to provide reasonable access to funds. This language and the example given may cause several problems. There are a substantial number of plans where participants are not involved in investment decision making and do not have access to plan balances until they terminate their participation in the plan. For example, some plans have all assets invested in a single investment contract. Other plans have multiple investments, including benefit-responsive investment contracts, but investment decisions are made by plan fiduciaries, not participants. Transactions under such contract are executed at contract value, and contract value is the most appropriate reported value to participants, even though participants do not have access to funds in the contract before termination of their participation in the plan.

When participants <u>are</u> involved in investment decisions, plans restrict participant activity for a variety of reasons. These include restrictions to control administrative cost, restrictions to preserve plan benefits for retirement purposes, and restrictions to protect participants from anti-selection and disintermediation caused by other participants. The purpose of some plan restrictions is to protect the bulk of participants from the actions of a minority of participants. Lacking such restrictions, participants could take advantage of book value transactions in certain economic environments and arbitrage among investment options. Such activity can create investment losses in the guaranteed fund. The impact of these losses is ultimately borne by remaining participants through lower investment returns.

In existing plans, guaranteed products have attracted significant contributions from employees, in spite of the existence of some restrictions on movement of money from these products. This demonstrates the willingness of participants to sacrifice liquidity for stable and attractive investment return. The statement as drafted will reduce the investment choices available to participants by effectively prohibiting sponsors from implementing plan restrictions which allow them to purchase book value contracts at high yields. All investments have tradeoffs among features that contribute to risk or return.

4. Disclosure of market rate of interest (Paragraph 15g)

I recommend that accounting disclosures about existing plan assets should not include any kind of market rate of interest. Disclosures should be limited to characteristics of existing contracts.

Presumably, the benefit of disclosing a market rate would be to assist the investment decision maker in future investment decisions. The amount of information needed to make investment decisions is the responsibility of the plan fiduciary, or the participant in 404(c) plans. 404(c) regulations already cover the disclosure requirements which must be provided to plan participants.

A market rate of interest could also be misleading. Current market rates and portfolio rates are not directly comparable. In addition, the wide variety of plan and contract provisions would make it difficult to determine a market rate which would be appropriate.

I appreciate the opportunity to comment on the exposure draft. Please feel free to call me at 219-455-4723 if you have questions about my comments.

Sincerely,

Mark Laurent

Mark Laurent

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SECOND VICE PRESIDENT AND ACTUARY

MINNESOTA MUTUAL

December 13, 1993

Ms. Susan Hicks
Technical Manager
Federal Government Division, File Q-1-505
AICPA
1455 Pennsylvania Avenue NW
Washington, DC 20004-1081

RE: COMMENTS ON PROPOSED STATEMENT OF POSITION ON REPORTING OF INVESTMENT CONTRACTS HELD BY HEALTH AND WELFARE BENEFIT PLANS AND DEFINED CONTRIBUTION PENSION PLANS

Dear Ms. Hicks:

I am pleased to have this opportunity to comment on the above referenced Statement of Position. I have over 20 years of experience in working with insurance company contracts and pension plan sponsors that I bring to my comments.

I think the Statement places appropriate focus on the plan participants. The statement notes that:

- "The primary objective ... is to provide information that is useful in assessing the plans present and future ability to pay benefits when they are due."
- "Information that is useful to plan participants includes the amount they would receive currently if they were to withdraw or borrow funds from or transfer funds within the plan."

I believe that the statement's accounting guidelines fully support this focus when the investment contract is a standard GIC type. Further, the examples illustrate many of the GIC variations in use today so it is clear that the group that developed this Statement has thoroughly researched GIC and similar contracts.

However, I do not see in this statement, the same kind of acknowledgment of another very common type of investment contract utilized by defined contribution plans and offered by many insurance companies. Briefly, this contract:

- Permits and requires withdrawals at contract value for all benefit payments and loans.
- Permits transfers to other options but with some limitation. A typical provision is that a participant can transfer each year 20% out of the guaranteed option into the alternative options.

Possibly, these types of restrictions would be considered to be "reasonable access" and therefore these investment contracts would be considered to be fully benefit responsive. However, if that is not the case, consider the implication of providing a plan participant with a statement that shows fair value instead of contract value.

- This fair value, however it might be calculated, would be more or less than the contract value.
- But, if the participant chooses to transfer, he or she can transfer 20% of the <u>contract value</u>.
- And, if the participant becomes eligible for a benefit, that benefit is the <u>contract value</u>.

  The result is that this participant is very confused and does not have information that includes "the amount that they would receive currently if they were to withdraw or borrow funds from or transfer funds within the plan."

Therefore, plan participants in plans investing in the types of contracts described above, would benefit from a change to the Statement of Opinion clarifying that limitations on transfers do <u>not</u> prevent a contract from being fully benefit responsive.

> *Technical note: A contract, like an investment, cannot be both long duration and fully liquid. Typical GIC contracts protect against anti-selection by prohibiting transfers to competing fixed income options and requiring that transfers to an equity option remain there for a certain period, a so called equity wash. Types of contracts described in this letter tend to be a bit longer in duration than GICs and control anti-selection with the transfer limitation and do not require an equity wash.*

My final comment is on the effective date. This Statement is of great importance to plan sponsors and plan participants. It will be impossible for them to begin using this Statement before it is finalized. Extensive changes in participant statement preparation will be necessary for some plans. **To allow these plans to make these changes, it would be very helpful if the effective date were delayed until December 15, 1994.**

Thank you for the opportunity to comment on this Statement of Opinion and thank you for your consideration of my comments. I urge you not to require the reporting of a value that is not available to plan participants.

Sincerely,

Jenean C. Cordon

Jenean C. Cordon

JCC\wh

cc: Melissa Kahn, Senior Counsel - American Counsel of Life Insurance

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PETER F. FRENZER
President - Nationwide Life Insurance Co.
Chief Investment Officer - Nationwide Cos.

December 13, 1993

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Re: <u>Exposure Draft--Proposed Statement of Position Reporting of Investment Contracts Held by Health and Welfare Benefit Plans and Defined Contribution Pension Plans</u>

Dear Ms. Hicks:

Thank you for inviting industry comments on the above Proposed Statement of Position (SOP). I appreciate the opportunity to give AICPA the perspective of Nationwide Life Insurance Company (Nationwide), a life insurance company with substantial pension assets. Nationwide's pension products include group annuity investment contracts with guaranteed and variable fund options which are used as funding vehicles for its customers' defined contribution plans.

Although Nationwide finds the SOP to be carefully drafted and believes it provides useful accounting guidance to most plan sponsors, we are concerned about the impact of the benefit responsive definition on certain guaranteed investment contracts ("GICs") typically issued to small-to-medium sized defined contribution pension plans. Specifically, the SOP appears to provide more applicable accounting guidance to issuers of guaranteed investment contracts ("GICs") used for the large case market. Nationwide, therefore, suggests the following changes to the SOP.

1. Benefit Responsiveness

The AICPA SOP defines a fully benefit responsive contract (page 8, paragraphs 9 and 10) as one which by its terms and the terms of the plan permit and require withdrawals at contract value for all participant-initiated events. These events include payments, loans, or transfers to other investment options offered to the participant by the plan. The SOP requires participants to have reasonable access to their funds. The SOP generally indicates that reasonable access is unrestricted access, with minor exceptions. The SOP indicates that fully benefit responsive contracts can be valued at contract value. Otherwise, the contract must be valued at fair market value.

Many guaranteed contracts issued to defined contribution pension plans contain provisions which prohibit transfers from a fixed option investment to a variable option investment after aggregate participant transfers exceed a specified percentage of the fixed option investment book value during a 12-month period. This restriction is essentially an interest rate anti selection provision. It protects the majority of plan participants from the actions of the minority of participants. Lacking such restrictions, participants could take advantage of book value transactions in certain economic environments and arbitrage among investment options. This activity can cause investment losses in the guaranteed fund. The impact of these losses is ultimately borne by remaining participants through lower investment returns.

The transfer provision is designed to serve the same type of function as a "equity wash" provision serves in many benefit-responsive guaranteed contracts issued to defined contribution plans. An "equity wash" provision typically provides that if a participant wants to transfer money from a guaranteed fixed investment option to a competing fixed investment option offered by the plan, such as a money market fund, the participant must first transfer the funds to an equity investment option for a specified period of time, often three months. Because a participant would be exposed to equity market risk during this three month period, a participant may be discouraged from transferring money from the guaranteed fund to another fixed investment option during a rising interest rate environment simply because of higher interest rates available in another investment option, e.g. a money market fund.

A benefit-responsive guaranteed contract otherwise meeting the definition of "fully benefit responsive" would not appear to be non-benefit responsive simply because the contract contains an equity wash provision. Although this provision imposes some limits on the free transfer of funds among plan options, an important factor is that contract value reflects the amount that a plan participant would actually "receive currently if they were to withdraw or borrow funds from or transfer funds within the plan", as stated in paragraph 8 on page 8 of the SOP. Contract value reporting would therefore appear to be appropriate for this type of contract.

However, the accounting treatment for a contract that limits aggregate contract level transfers from a fixed investment option to a percentage of the contractual book value during a 12-month period, but pays all benefits, loans, hardship withdrawals, or transfers (to the extent permitted) at contract value, is less clear. Paragraph 10 on page 8 requires that "all participant-initiated transactions permitted by an ongoing plan" be made at contract value "with no conditions, limits, or restrictions" in order to receive contract value accounting treatment. In addition, Example 2:A-8.c. of the Appendix states that a contract which pays benefits of up to 30 percent of the contract at contract value and any excess benefits at some adjusted value would be reported at fair value. These paragraphs seem to require "fair value" accounting treatment for these contracts.

However, the amount participants in this type of fixed contract would "receive currently if they were to withdraw or borrow funds from or transfer funds within the plan" would be contract value. That is, any benefit payment, loan, hardship withdrawal, or transfer (to the extent permitted), would be made at contract value. Under no circumstances would "fair value" be available. Since contract value is the only amount available to a plan participant, it would seem to be consistent with the stated intention to provide meaningful information to plan participants that these contracts be reported at contract value.

For example, paragraph A-3 of the Appendix states that the "valuation must reflect the ability of the plan to pay benefits from the perspective of the participants. This value is then reflected on participants' statements to disclose the amount they can expect to receive when they exercise their rights to withdraw, borrow, or transfer funds under the terms of the plan." If a contract is required to disclose a "fair value" that is greater than contract value when contract value is all the participant can ever receive, then this requirement would appear to be violated.

In order to provide meaningful information to plan participants with respect to the "amount they would receive currently if they were to withdraw or borrow funds from or transfer funds within the plan", we believe that the AICPA should allow contracts that provide all benefit payments, loans, or hardship withdrawals at contract value to use contract value reporting, even if there are contractual limitations on transfers which are designed for the protection of plan participants. Reporting of a "fair value" for these contracts would lead to misleading results that would not be understood by plan participants.

In addition, a requirement to report "fair value" rather than contract value for this type of contract could lead to other inequitable results. Consider the situation of a defined contribution plan in which only one investment option, a "guaranteed option", is available. Because no other investment options are permissible under the SOP, there are no restriction on transfers. If this contract provides that benefits are always available at contract value, then contract value accounting is permissible under the SOP. However, if another investment option were added to the plan, but certain transfer restrictions were included in the "guaranteed option" contract to protect plan participants from the actions of other participants in a rising interest rate environment, contract value may no longer be available. This could lead to a situation where the addition of an investment option to a plan may add value to a plan participant, but lead to lower reported benefits in a situation where "fair value" is lower than contract value. This would be the case even though the plan provides the same access to contract value as the single fund plan.

Finally, to the extent that insurers amend contracts to eliminate restrictions on transfers in order to receive contract-value accounting treatment, a likely result may be a reduction in the level of interest rates credited to these contracts as insurers shorten their investment strategy for this type of product. This type of result would not be in the long-term best interest of plan participants.

Nationwide, therefore, recommends that reference to transfers be deleted from the proposal's benefit responsive definition and from a discussion of the definition. Additionally, Nationwide recommends that the following example be added to Example 2 (pages 17 and 18).

e. *The contract prohibits transfers from a fixed investment option to a variable investment option if aggregate participant transfers exceed 20 percent during a 12-month period as specified by the contract.* The contract should be reported at contract value. Since the restriction is on transfers between investment options only, the contract is fully benefit responsive.

2. Effective Date

The SOP is effective for financial statements for plan years beginning after December 15, 1993. Since many plan years begin on January 1, the SOP would apply to some financial statements or participant statements issued after the first quarter of 1994. The software needed to produce the statements would have to be modified and extensive adjustments in procedures may have to be made to accommodate a change in reporting. Additionally, since the SOP is proposed and may be modified after the effective date, Nationwide recommends that the effective date be deferred to plan years beginning after December 15, 1994.

In addition, Nationwide recommends that a revised SOP include a transitional rule for existing contacts. The transitional rule should provide that the SOP would be effective for existing contracts at a future date beyond December 15, 1994, to allow time for existing contracts to be renegotiated if permitted by the insurer, or to expire.

3. Applicability of the Benefit Responsive Definition to Employer-Directed Defined Contribution Plans

Nationwide also has a concern with the broad scope of the benefit responsive definition. The SOP, on page 9, states that

> The plan itself must allow plan participants reasonable access to their funds. If access to funds is substantially restricted by plan provisions, investment contracts held by those plans may not be considered to be fully benefit responsive.

The SOP should clarify how the above definition and the proposal itself apply to contracts issued to defined contribution plans for which the employer alone has investment direction authority. The proposal refers only to participant-directed transactions. Nationwide is uncertain if or how the SOP applies to contracts where the participant has no right to direct its investments. These plans are often referred to as fiduciary or trustee directed plans. The above definition, if read literally, could make all contracts for employer-directed plans non-benefit responsive since the participant has no access to direct his funds. Nationwide does not believe that AICPA intended this result. Nationwide, therefore, recommends that AICPA clarify this issue.

If you have any questions or need additional information, please contact John Bath, Senior Actuarial Officer-Pensions (614) 249-2834 or Mary Jane Risen, Director, Pension and Public Sector Compliance, at (614) 249-8255.

Sincerely,

Peter F. Frenzer
President

JB:jn

T.RowePrice

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Kenneth L. Walker
President

December 13, 1993

Ms. Susan W. Hicks, Technical Manager
Federal Government Division
File Q-1-505
American Institute of Certified
Public Accountants
1455 Pennsylvania Avenue, N.W.
Washington, DC 20004-1081

Dear Ms. Hicks:

I am writing this letter in response to Statement of Position 92-6, *Accounting and Reporting by Health and Welfare Plans* dated September 15, 1993. T. Rowe Price Stable Asset Management, Inc. commends the A.I.C.P.A. for its work in bringing about definitive guidelines for the valuation of Guaranteed Investment Contracts and other stable value alternatives.

We note several items we wish to address with regard to this SOP, as more fully described below. We believe action on these items will further strengthen the SOP and its intended use.

1. Effective Date: We suggest the effective date be changed to one hundred eighty days after release of the final regulations in lieu of December 15, 1993. Delay of implementation will provide both issuers and plan sponsors alike the opportunity to deal with known facts; not probable facts. It will provide more time to develop prudent alternative strategies where appropriate, and eliminate the possibility that the plan sponsor might have to "pay up" in any issuer renegotiation process due to limited time.

2. Non-Benefit Responsive Contracts: The language used throughout the SOP refers to *fully benefit responsive* features. Paragraphs 7 and 8 of FASB Statement No. 97 describes investment contracts which provide for annuity purchases. If an investment contract is purchased in a defined contribution plan exclusively for the purpose of providing annuity payments and not ongoing participant-initiated withdrawal payments, does the contract qualify for contract value?

3. Fixed Income Fund Investment Restrictions: It has been our understanding throughout that contracts which prohibit participant directed investment transfers to competing fixed income funds are eligible for contract value. We suggest specific reference be made to provide definitive guidance.

4. Implied Guarantee: The SOP makes reference to the term "...that provide(s) a guarantee by a financially responsible third party of principal and previously accrued interest ...". Most *synthetic* GICs do not use the term "guarantee", yet provide a zero net floor rate. In addition, most managed synthetic GIC structures provide that credit risk are borne by the plan. In this event, principal is not fully guaranteed. We suggest definitive guidance on this issue.

We continue to be concerned with certain circumstances which require fair value accounting, even though the participant would ultimately receive contract value; e.g. Section 3.18. An example would be the case where the plan limits access to funds only upon termination of employment, or where the portfolio is not totally made up of 100% benefit responsive contracts. It is possible that the participant could receive quarterly statements showing significant market value gains, yet, when paid his or her distribution, would receive a book value payment much less than market, as the benefit responsive issuers were only obligated to pay pro-rata at contract value.

In summary, we believe the draft SOP will provide guidance to those who both audit and utilize stable value instruments. Clarification of some of the issues outlined above would be helpful.

Sincerely,

Kenneth L. Walker

KLW:mmh

20

M&I Investment Management Corp.
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December 13, 1993

Ms. Susan W. Hicks, Technical Manager,
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1455 Pennsylvania Avenue, N.W.
Washington, D.C. 20004-1081

Re: Reporting of investment contracts in defined contribution plans

Dear Ms. Hicks:

We are writing in response to the AICPA Exposure Draft regarding the reporting of investment contracts in health and welfare benefit plans and defined contribution pension plans. As trustee, custodian, and investment adviser for these types of plans, we would like to comment on two points proposed in the Draft.

First, in the Appendix, Example 6, A.16, it is proposed that for a synthetic "repurchase" type investment contract, fair value be assigned to the option for the plan sponsor to sell the bond to the issuer when fair value of the bond is above contract value. We believe that valuation of such an option would be somewhat arbitrary given the absence of a market for the option, and would therefore suggest that such contracts be accounted for at contract value assuming that they provide the appropriate provisions for benefit responsiveness.

Second, the process of checking the provisions of each contract to determine if it meets the criteria for contract value accounting will be very time-consuming. In order to provide trustees, custodians, investment advisers and plan sponsors adequate lead time to check contracts for compliance, we would suggest an implementation date beyond that proposed in the Draft. Specifically, implementation for plan years beginning after December 15, 1994 would seem reasonable.

Respectfully Submitted,

Tami L. Blonde

Tami L. Blonde, C.F.A.
Vice President

TLB/jse

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December 14, 1993

Susan W. Hicks
Technical Manager
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1455 Pennsylvania Avenue, NW
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RE: Proposed Statement of Position
Reporting of Investment Contracts... Defined Contribution Plans

Dear Ms. Hicks:

Aetna Life Insurance and Annuity Company (ALIAC) appreciates the chance to comment on this exposure draft. Our comments reflect those of Aetna's "small case" pension unit. You will be receiving a separate letter from Jim Geyer representing Aetna's large case pension group. We are in agreement with Jim's comments, and we'd like to add our comments from the small case view.

The draft reflects a major effort by those involved to tackle some difficult issues. While the draft will lead to development of more uniform standards for reporting "investment contracts", much of the focus appears to have been on **guaranteed investment contracts (GICs) as well as similar products sold by banks (BICs) and insurance company book value separate accounts.** Because of that focus, we are concerned that it might undermine a significant class of contracts that appear not to be addressed and for which contract value reporting is appropriate.

In a nutshell: There's more to this than GICs and BICs!

The draft covers the dominant products (by asset volume) that insurers offer to "big plan" funding arrangements, characterized by GICs and book value separate accounts. The **off-the-shelf** products for the "small employer / keep it simple" market, which offer a variety of general account contract value options, will be unfairly treated in comparison to GIC/BIC contracts the way the SOP is currently written.

ALIAC provides coverage for about **10,000** small employers that might be impacted by the draft. Our contracts primarily fund defined contribution plans, though some defined benefit plans are also covered. Our products, like those of many other insurers, are designed for plan sponsors looking for a simple **off-the-shelf** funding arrangement. They offer fixed income (general account) and equity (pooled separate accounts, mutual funds) investment options. They are distributed through independent pension professionals that provide local servicing and counseling to the plan sponsor and its participants. Third party administrators are also involved in the servicing of these plans.

It is important that the treatment of these contracts be clarified such that these products are not subject to debate regarding "benefit responsiveness", and that certain contract types are not given more favorable treatment than others.

Our contracts normally provide for unadjusted transfers within the insurer's family of funds and unadjusted payments at retirement, death, disability, separation from service, hardship and loans. They're designed to be **"participant benefit responsive".** But, they include risk control features:

- A **contingent** deferred sales charge (CDSC) may be assessed on transfers to another company during the first few years of the contract's existence. This rear-end sales charge allows every dollar to be invested and recoups up front expenses from pre-mature contract cancellations. The CDSC generally lasts five years or less, follows a declining pattern (5%, 4%, 3%, 2% 1% and then disappears) and usually does **not** apply to benefit payments or transfers within the insurers family of funds.

- General Account contracts are designed for long term investing and, per state insurance law, may not earmark assets for any particular class of contract. One or more of the following generic **risk control measures** are built into off-the-shelf contracts for general account management purposes:

    - A market value adjustment may be assessed on funds transferred to another funding institution or withdrawn prior to maturity of a "yield to maturity type of investment".

    - Contingency provisions may limit the amount that can be transferred (within the contract) to or from fixed income options depending on interest rate movements.

    - Alternatively, funds may be paid from the general account option to another funding agent in annual installments over a given period (e.g.., five years).

Where we and our insurance company competitors offer these contracts, they have been **approved by the state insurance departments** (all insurance funding vehicles are subject to state approval before being sold). Also:

- The **Department of Labor** has said that reasonable adjustments and expenses don't prevent a funding option from qualifying for 404(c) protection.

- Perhaps most importantly, these potential adjustments are **disclosed** to participants and plan sponsors **in writing** prior to acceptance of funds under the contract.

The main issue we see: It won't make sense to report these contracts at other than contract value. This will only confuse.

> If, for example, someone had a $10,000 account balance in a contract and all plan "benefits" (death, retirement, disability, termination of employment,...) would be at the $10,000 level, but there **could be** a 5% CDSC or a "market value adjustment" if the employer decided to discontinue the contract and move to another funding agent it would be wrong to report that account balance as only $9,500. The draft allows "contract value" here, as we read it, as long as there is no pending contract termination.
>
> If, for the same individual, there might be some transfer restrictions to/from the general account (depending on interest rate levels), does this preclude a contract from being benefit responsive? If the contract said that no more than 50% of money in a general account (contract value) option could be transferred to the market value options in any one year, we're not sure what the draft would require. If all "benefits" are at contract value, what is the "fair value" in this situation, just 50%? If the contract/plan meets 404(c) guidelines for fund options and reasonable access to funds, should this type transfer restriction result in a confusing "fair value" report? Should plans/contracts that allow only quarterly access to certain funds be allowed contract value accounting when plan/contracts which allow access to at least some portion of funds on any business day be required to report an artificial "fair value"?

It will be misleading to report these contracts at anything other than contract value and the SOP needs to reflect this type of small employer insurance contract.

The proper disclosures and controls are already in place to assure that plan sponsors and participants know what they have. Plan sponsors and participants need to select among liquidity/risk/return tradeoffs. To provide a higher yield on its fixed income option the insurer has to invest in longer duration assets, but, general account options must build in risk control features. The off-the-shelf contracts will tend to deal with risk through contract provisions, not the case specific plan underwriting that is applied to the GIC/BIC contracts. Plan specific underwriting for small plans would require higher selling expenses. This is not a realistic option given the increasing margin pressures from plan sponsors.

Insurance company general account funding options continue to play an important role as a stable return, stable value option. Across all of our funding options, we see about 50% of deposits continue to be directed to the general account. "Contract value" funds that provide more stable returns, are an important plan option, especially for older individuals trying to assure the value of their retirement "benefit".

The risk protections inherent in these contracts should not be considered in a way that leads them to be less competitive or worse, not available.

Also important, some existing contracts do not allow for "pre-retirement" benefits, since they were designed for use with plans designed before the new style defined contribution plan.

- Initial products, those developed through the 1970s were designed when the retirement concept was in terms of "no withdrawals before retirement". They're **meant to be restrictive**, as was tax policy back then. These plans emphasized retirement benefits, not pre-retirement spending. Plan sponsors continuing with this type of "retirement" plan and contract, should not be subject to added reporting because their plan restricts benefits before retirement, and their contract meets their plan needs.

Implementation Issues

If the draft is adopted as is, insurers and plan sponsors will need time to respond, and guidance regarding what to report.

What plan/contracts would be subject to this new procedure?

- Only those funding 401 plans subject to audit?
- What if employers direct investments; not employees?
- If plan doesn't allow any pre-retirement benefits is that "benefit responsive"?

Timing

- How get done for 1994 plan year with no time to change systems/processes?

Which reports would have to be at fair value?

- Plan sponsor's summary annual report to participants?
- Annual reports from "insurer" to plan sponsor?

How should fair value be determined?

- What rates/factors to use
- Will auditors have to accept the stated value?
- When contracts do not allow transfers, but pay full "benefit", is fair value equal to zero? Or is fair value some average that is between the "benefit" value and the "zero" available for transfer?

The Q and A section implies some "interpretation" in reaching a "benefit responsive" conclusion

- Apply to parallel situations for other than GICs and BICs?
- How much time/cost debating decisions?

Conclusion

In 1980, the Accounting Standards Board came to the following conclusion:

> "The Board recognizes that presenting contracts with insurance companies at contract value is inconsistent with requiring all other plan investments to be presented at fair value. However, ... the information required for determining contract value is readily available, whereas a fair value approach would necessitate extra calculations, that .... might be extremely complex."

This statement is still true; complexity has increased. More and more types of funding arrangements are available with various investment strategies. Contract value reporting is appropriate, and understood. The introduction of "fair value" might add confusion rather than clarity.

In summary we suggest the following:

1. Clarify how the SOP applies to other than GIC's, BICs and book value separate accounts.

2. Allow for "retirement" plans that don't desire pre-retirement benefits. In general, contract value is appropriate when a contract is "benefit responsive" <u>to the benefits provided by the plan</u>.

3. Extend the effective date to allow necessary developments of process/system changes.

4. Replace example A.8.c. with the following to allow contracts with state approved, reasonable expense recoupment and risk control features to continue to be reported at contract value unless all "benefits" are discounted to reflect a specific adjustment.

Example:

An insurance company contract approved by the state insurance department where offered, has fixed income and equity investment options among its family of funds. The contract allows unrestricted transfers within its market valued funds (separate accounts or mutual funds) but may have restrictions on the amount of funds that can be transferred into or out of its fixed income book value options or cashed out at full contract termination. It also permits unadjusted access to funds for participant benefit payments at least for retirement, death, disability, separation from service, hardship withdrawals and loans if permitted by the corresponding plan. All participant "benefits" are paid at contract value.

Such contract is generally benefit responsive and may be reported at contract value.

We appreciate the chance to comment. And we'd welcome to the chance to meet with you and discuss our comments .

Thank you again.

Sincerely,

Thomas J. Hudson

c: J. Geyer, Vice President & Actuary, Aetna
J. Nikander, Assistant Vice President, Aetna

Robert A. McCormish
Senior Vice President

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VIA AIRBORNE EXPRESS

December 14, 1993

Ms. Susan W. Hicks
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AICPA
1455 Pennsylvania Avenue N.W.
Washington D.C. 20004-1081

Re: Exposure Draft: Proposed Statement of Position on Reporting of Investment Contracts Held by Health and Welfare Benefit Plans and Defined-Contribution Pension Plans.

Dear Ms. Hicks:

This letter is intended to provide our review and commentary on the September 15, 1993 AICPA Exposure Draft referred to above. Certus Financial Corporation is a registered investment advisor under the Act of 1940 and specializes in the management of stable value assets, such as those described in the Exposure Draft. Currently, we manage in excess of $4 billion of stable value assets for over 300,000 defined contribution participants.

We support the AICPA's efforts in undertaking this project which will formalize many of the common practices of the stable value industry. We believe the proposed Statement of Position (SOP) reasonably and correctly codifies many of these practices. However, after studying the SOP we feel the need to express certain comments and concerns. We have passed along some of these comments to the GIC Association to incorporate in their response, but felt it was important to formulate an individual response as well.

I) Effective Date and Transition: page 16, Paragraph 17

We believe that the effective date of the SOP should be postponed until December 15, 1994 and that a transition period should be established for non-benefit responsive contracts. The most compelling argument for postponing the effective date is the fact that the AICPA does not have any time to review the public commentary which is due on December 15, 1993. We suggest a one year deferral to keep the SOP in line with calendar year plans.

With respect to a transition period on non-benefit responsive contracts, we would suggest the following elements:

i) All non-benefit responsive contracts purchased prior to December 31, 1993 be allowed the potential for contract value accounting.

ii) Contract valuation for these non-benefit responsive contracts would be subject to the same issuer solvency considerations as are outlined for benefit responsive contracts in the revised paragraph 3.17 on page 11.

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iii) Contract valuation for non-benefit responsive contracts would be valid only if the plan sponsor has determined that there are no imminent events which would result in withdrawal or termination. Specifically, those plan sponsors that structured their portfolios to prevent withdrawals from their non-benefit responsive contracts in all but the most extraordinary circumstances, could reasonably account for them at contract value during the transition period. Plan sponsors should adhere to the same determination process as required under FASB Statement #5, *Accounting for Contingencies.*

II) Disclosure Requirements: page 16, Paragraph 16e

As you are aware, the Department of Labor (DOL) has recently released a new set of regulations pertaining to defined contribution plans. These regulations have several requirements with respect to participant communication.

The short list of disclosure requirements added to Paragraph 53 raises two issues:

i) Some of these are redundant or potentially conflicting with respect to the 404(c) regulations.

ii) There is no suggested format (nor is there generally a readily available format) within which to disclose "the basis and frequency of determining crediting interest rate resets and any minimum crediting interest rate under the terms of the contracts and any limitations on guarantees... on benefit responsive investment contracts."

We would like the SOP to state that compliance with the new DOL 404(c) regulations, as they pertain to participant communication/information, would be viewed as reasonable compliance with the SOP in this area.

III) Reporting of Contracts: page 8, Paragraph 4

We believe it is confusing and potentially contradictory to state that pension plans "should report fully benefit responsive investment contracts at contract value, which may or may not be equal to fair value..." It appears to us that throughout the SOP it is established that fair value on fully benefit responsive investment contracts is indeed contract value. It is important that this relationship be explicitly stated because various regulatory agencies will look to this SOP for guidance as to the fair value of these investment contracts. We believe the SOP establishes fair value equal to contract value for fully benefit responsive contracts by:

i) stating that participant withdrawals from fully benefit responsive contracts must always be made at contract value;

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ii) establishing that the appropriate (and fair) value for an investment contract is that value which is relevant to the participant; and

iii) requiring plan managers to consider a value other than contract value when either non-participant related withdrawals may occur or there are issuer solvency concerns.

V) Reporting of Contracts: page 8, Paragraph 4

At the end of this paragraph the SOP states that if events occur which may result in solvency concerns or early terminations, plan sponsors may want to consider reporting these investment contracts "at less than contract value." This excludes consideration of those contracts which may be terminated at above contract value in some circumstances. We believe it would be more appropriate to suggest that when faced with these extreme circumstances, plan sponsors consider reporting the investment at other than contract value to accurately reflect the expected value that participants will realize.

V) Appendix: page 17, A.2

Although the body of the changes to the *Audit and Accounting Guide* does not contain any specific required valuation methodology for the non-benefit responsive contracts (or portions of contracts), the Appendix does suggest that discounting cash flows would be acceptable. Further, it suggests that a contract's termination or penalty clauses are not particularly relevant unless a termination situation is eminent. We disagree with this recommendation for several reasons:

i) A discounted cashflow (or similar value) is not the most likely value a participant could expect to receive upon a withdrawal;

ii) The expected termination value of a non-benefit responsive contract is the probable value in a withdrawal scenario;

iii) Use of the termination value would be consistent with revised paragraph 3.17 on page 11 which determines the fair value of benefit responsive contracts in contingency circumstances; and

iv) The unique nature of these investment contracts makes the most relevant value to participants either carrying value (contract value) during normal plan operation or a termination value during extreme withdrawal conditions.

We believe that the SOP should allow for the possibility of contract value for non-benefit responsive contracts beyond the transition period suggested earlier in section I of this letter. The responsibility should be placed on plan fiduciaries to determine the appropriate, fair, and relevant value for non-benefit responsive contracts. Under paragraph 3.17, plan sponsors are required to determine when benefit responsive contracts should be carried at other than contract value. A similar determination can be made by plan sponsors as to when non-benefit responsive contracts should be carried at other than termination value.

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CORPORATION

Thank you in advance for your time and consideration of our comments. I am available to answer any questions or to provide any additional input into your review process should it be needed.

Very truly yours,

Robert A. McCormish

Robert A. McCormish

Cooper Industries
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COOPER

December 14, 1993

Ms. Susan W. Hicks
Technical Manager
Federal Government Division
File Q-1-505
American Institute of Certified
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1455 Pennsylvania Avenue, N.W.
Washington, DC 20004-1081

Dear Ms. Hicks:

This letter is in response to Statement of Position 92-6, Accounting and Reporting by Health and Welfare Plans dated September 15, 1993. Our comments are as follows:

- Either the effective date should be extended to plan years beginning after December 15, 1994 or current contracts should be grandfathered. The current effective date of December 15, 1993 does not provide enough time for Plan sponsors to divest their funds of non-benefit responsive contracts without paying premiums or penalties.

- A comment made in paragraph "3.18" indicates that "if access to funds is substantially restricted by plan provision, investment contracts held by those Plans may not be considered to be fully benefit responsive." The statement of Position goes on to give specific examples, however, one example that was not identified is the "equity wash rule" plan restriction, which is typical in many fixed income fund investments. This rule restricts participants from directly transferring their Fixed Income Fund investments to competing funds such as our Money Market Fund, and requires that transfers be made first through a non-competing fund such as our Equity Fund. It is unclear whether this plan restriction would affect the definition of fully benefit responsive.

- The additional disclosure required in paragraph "4.26" to report the average yield for the investments and the crediting interest rate for investments could possibly be misleading to participants. Since this calculation may not represent the

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actual earnings received by the participant, this additional information may, in fact, mislead a user of these financial statements into thinking this return is what he should or could receive from investing in this Fund. Typically, we report on a quarterly basis, the investment fund's rate of return, which includes all cash flow transactions including expenses that are paid from the funds. This information, we believe, is of more use in assisting plan participants in deciding what investment funds to transfer in or out of. Reporting additional market rates of interest and aggregate gross interest calculations may only confuse the users of these financial statements. Currently, our Fixed Income Fund, made up primarily of Guaranteed Investment Contracts is viewed as a stable investment with determinable income and principal. If Fair Value Accounting is required, there could be circumstances where reporting would vary the returns on a short term basis, and change the stable return nature of this Fund from period to period. For this reason, we believe every effort should be made to minimize the accounting treatments that would trigger unrealized market fluctuations in contracts that are expected to be held to maturity.

We appreciate the opportunity to comment.

Sincerely,

Donald R. Sheley
Vice President & Controller

DRS\1214d:amkrow

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December 14, 1993

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Re: Exposure Draft - Proposed Statement of Position on Reporting of Investment Contracts Held by Health & Welfare Benefit Plans and Defined-Contribution Pension Plans.

Dear Ms. Hicks:

This letter sets forth our comments on the AICPA's September 15, 1993 Exposure Draft entitled "Proposed Statement of Position on Reporting of Investment Contracts Held by Health & Welfare Benefit Plans and Defined-Contribution Pension Plans." We support the proposed Statement of Position and believe this standard in many ways will improve current practice.

In response to your specific request for comments, we would like to submit the following input.

1. Timing of Implementation: Page 16 - Paragraph 17
We recommend that the effective date of this SOP be for financial statements with plan years beginning after December 15, 1994. We believe this is reasonable because there will not be enough time between the comment period ending December 15, 1993 for the AICPA to review comments, issue the SOP, and have plan fiduciaries comply with the SOP between December 15, 1993 and January 1, 1994.

In addition, we recommend a transition period for contracts -- presently held in health & welfare and defined contribution pension plans and purchased prior to September 15, 1993 -- that do not presently meet all of the proposed requirements to be considered "fully benefit responsive." This would be consistent with the FAS No. 110 which grandfathered DAs and IPGs issued prior to the date of the exposure draft.

We believe these contracts should continue to be valued at contract value until plan years beginning after December 15, 1998. We make this recommendation because the present contracts were purchased on behalf of plan participants with the understanding that they would be carried at contract value. To change the valuation methodology on existing contracts could cause undue concern about the meaningful value of the account statement balances and/or financial damage to the plan participants. Fair valuation of existing contracts resulting in a premium or a discount would create a bias against participants entering or existing the fund, and create significant confusion regarding appropriate valuation of actual benefit payments.

Should plan sponsors wish to maintain a stable value portfolio as an investment option for their participants, this transition period would enable them to restructure the type of contracts purchased to comply with the "fully benefit responsive" provisions of this proposal. Requiring immediate compliance for previously placed contracts might result in a significant cost to plan participants, either through unexpected wrap charges or lower yield if contract provisions were renegotiated. For many contracts this might not even be possible.

The proposed transition period would also limit the difficulty and expense inherent in trying to value partially benefit responsive contracts.

2. Inclusion of Market Interest Rate: SOP Cover Letter
Relating to the issue of reporting a "market rate of interest for fully benefit responsive contracts," we suggest that the current SOP without this requirement is appropriate. Market values are only appropriate in certain circumstances such as: when there is an active secondary market, the issuer is financially unsound, the contract is not fully benefit responsive, or a triggering event has occurred which will result in premature termination. Otherwise, contract value is the only appropriate valuation that should be reported. The main issue is: "What can the participant expect to receive at the present point in time if the account is accessed?" Any valuation or interest-rate scenario that differs from the value that would be received would, at best, confuse the primary users of the financial statements and, in the worse case, mislead these plan participants.

3. Valuation Implications Due to Plan Restrictions: SOP Cover Letter
We are not currently aware of any ERISA or IRS Codes implications that, by definition, will arise from a plan restriction causing a contract to be valued at other than contract value. It is not a matter that has been extensively researched by our organization. This issue should be specifically addressed to the Department of Labor and the IRS.

We are concerned that the plan not be required to create a situation in which it would increase its fiduciary liability exposure. This might occur if a plan is required to report contracts at fair value when they are unable to deliver fair value to participants when contracts held in the portfolio are accessed.

Each plan sponsor must comply with its fiduciary responsibility to disclose any material items that will impact the plan participant and the value of plan assets. This is done through many means in addition to plan financial statements: SPDs, participant communications, mandated education -ala DOL 404(c)- and periodic participant statements. Disclosure should include: restrictions that will impact contract valuation, liquidity provisions, access restrictions, rates of return, penalties on any withdrawal or transfer and any significant event that will affect the value of plan assets. However, we believe that each plan fiduciary should have the discretion to determine the best means to fulfill its responsibility to disclose financial information to plan participants.

Therefore, no further disclosure should be required in the SOP other than fulfillment of current fiduciary reporting responsibility.

4. Types of Plans Covered: Page 8-9 - Paragraph 10; Page 11 - Paragraph #15(e)(3.18); Page 13 - Paragraph #15(i)(4.14); Page 15-16 - Paragraph #16(c)(30)

We recommend that full benefit responsiveness be defined as it was in the 2/17/93 draft SOP. This prior SOP defined full benefit responsiveness as permitting all participant-initiated requests permitted by the plan to be withdrawn at contract value.

If this recommendation were adopted, it would entail deleting the following section in each of the above listed paragraphs:

"For example, if plan participants are allowed access at contract value to all or a portion of their account balances only upon termination of their participation in the plan, it would not be considered reasonable access and, therefore, investment contracts held by that plan would generally not be deemed to be fully benefit responsive. If however, a plan limits participants' access to their account balances to certain specified times during the year (for example, semiannually or quarterly) to control the administrative costs of the plan, that limitation generally would not affect the benefit responsiveness of the investment contracts held by that plan."

As currently written, the proposed SOP and its definition of fully benefit responsive contracts addresses issues relating primarily to 401(k)-type plans. There are other defined contribution plans, such as many multi-employer (Taft-Hartley) annuity plans, and some Section 457 and profit sharing plans which currently have benefit responsive contracts that will not meet the proposed "access" standards defined in the SOP. The contracts within these plans still transfer the risk of benefit payments, as designed by the plan, to a financially responsible third party. The participants of these plans are still the main users of the financial statements and bear the investment risk of the portfolio. Selection of a contract-valued asset by the plan fiduciary was made specifically to provide a stable return for conservative plan participants. Any adjustment in value from contract value will create significant concern among these plan participants and might force them to invest in shorter-term, lower-yielding assets to provide stable valuation. In the long run, this would significantly impact the retirement benefits of millions of participants.

If necessary, reasonable access examples might be contained in the "Application of Fair Value & Contract Value Reporting For Defined-Contribution Plan Investments" attached to the SOP. In our Attachment A, we have included examples of reasonable access for the different types of plans, both Health & Welfare and Defined-Contribution Pension Funds.

In conclusion, the SOP will be a positive event for investors in stable asset investments. There are a number of significant issues that should be clarified, and we hope this brief commentary will be useful in defining the outstanding issues.

Thank you for the opportunity to present our views. We look forward to the issuance of the final SOP. Please feel free to contact Larry Mylnechuk, Executive Director of the GIC Association with any questions.

Respectfully Submitted,

Harold H. Morley
Chairman, Contract Valuation Committee

enc.

ATTACHMENT A

Example #1: Benefit responsive contracts in a participant elected deferred compensation plan, such as a 401(k) plan.

For participant directed deferred compensation plans, it would not be considered reasonable access to plan assets if plan participants are only allowed access at contract value to all or a portion of their account balances upon termination of their participation in the plan. Therefore, investment contracts held by this type of plan would generally not be deemed to be fully benefit responsive. If, however, a plan limits participants' access to their account balances to certain specified times during the year (for example, semiannually or quarterly) to control the administrative costs of the plan, that limitation generally would not affect the benefit responsiveness of the investment contracts held by that plan.

Example #2: Contracts in a health & welfare plans (e.g. medical, vacation, strike fund, training funds, etc.)

Investment contracts in a health & welfare fund may be deemed to be fully benefit responsive if all participant initiated events allowed under the plan can be paid at contract value. These events may be either voluntary (e.g. taking accrued vacation & applying for training programs) or involuntary (e.g. applying for strike benefits & medical payments due to claims.) Should 100% of the benefits allowed under each plan not be covered under the benefit responsive provisions, the contracts would generally not be deemed to be fully benefit responsive and should be carried at fair value for any portion of the contract that will not cover plan allowed benefits.

Example # 3: Contracts held in Taft-Hartley annuity plans or some non-participant directed Section 457 plans.

In these plans, reasonable access is determined by the purpose of the plan and is contained within the collective bargaining agreement which establishes and supports the plan. Each negotiating cycle, official representatives of the plan participants and employers are able to negotiate on the issue of reasonable access in the specified plan. Since the participants of these plans are the primary users of the financial statements, bear the investment risk of their accounts, and participate in the definition of the benefits allowed under the plan, all investment contracts which cover 100% of the benefits due under the plan can be considered benefit responsive. Contracts which do not cover 100% of the benefits of the plan generally would not be deemed to be fully benefit responsive and should be carried at fair value for any portion of the contract that will not cover allowed benefits.

Example # 4: Contracts held in Employer Directed Profit Sharing plans.

In these plans also, reasonable access is determined by the purpose of the plan. Plans which contain provisions that allow withdrawals, at no penalty, prior to termination from the plan should also be deemed to have granted reasonable access. The participants of these plans are the primary users of the financial statements, bear the investment risk of their accounts, and can determine the timing of withdrawals. All investment contracts which cover 100% of the benefits due under the plan can be considered benefit responsive. Contracts which do not cover 100% of the benefits of the plan generally would not be deemed to be fully benefit responsive and should be carried at fair value for any portion of the contract that will not cover allowed benefits.

THE GIC ASSOCIATION
MEMBERSHIP LIST
BY COMPANY

A.W. Chesterton Company
AAA Michigan
AAAA Benefits, Inc.
Aetna Capital Management, Inc.
ALCOA
Allstate Life Insurance Co.
Altheimer & Gray
AMCORE Capital Mnagement, Inc.
American Express Company
American NuKEM
Americhem Inc.
AmSouth Bank N.A.
Analytical Risk Management, Inc.
Annuity Bd of So Baptist Convention
Appleton Papers
Ashland Oil, Inc.
AT & T

Bain & Company
Bankers Trust Co.
Bankers Trust Co.
Becker & Rooney, Inc.
Beckman Instruments, Inc.
Bell Atlantic Corp
BellSouth Corporation
Blair Corporation
Blue Cross Blue Shield of Michigan
Blue Cross Shield of Connecticut
Blue Shield of California
Bobst Group
Brentwood Asset Advisors
Buck Consultants
Buckeye Pipe Line Co.
Burroughs Wellcome Co.

Canada Life Assurance Company
Capital Holding Corporation
Carpenter Technology Corportion
Certus Financial Corporation
Chevron Corporation
Chicago Title & Trust Co.
Ciba Geigy
Citibank
CNA Insurance Companies
Commerce Clearing House
Constitution Life
Construction Specialties, Inc.
Cooper Industries, Inc.
Covia Partnership
Crown Life

Daniel Freeman Hospitals, Inc.
Dow Chemical Company
Dow Corning Corporation
Dreyfus Service Corporation
Du Pont Company

Eaton Corp
Elder Beerman Stores
Eli Lilly & Company
Entergy Services, Inc.
Esterline Corporation

Federal Reserve Emply Bnft. Syst
Federated Research Corp.
Fidelity Investments
Fiduciary Capital Management
Financial Security Assurance
First Interstate Bank of Oregon
First National Bank of Chicago
Fitch Investors Service, Inc.
Fleet Investment Advisors
Flint Ink Corporation
Ford Motor Company
Franklin Distributors, Inc.

Gencrop Inc.
General American Life Ins. Co.
General Motors
GIC Association, Inc.
GIC Inc.
Global Advanced Technology Corp.
Grumman Corporation

Halliburton Company
Hallmark Cards, Inc.
Hawaiian Trust Company, Ltd.
Hazeltine Corporation
Houghton Mifflin Company
Hyster Company

ICI Americas Inc.
ICMA Retirement Corporation
IDS Trust
Inland Container Corporation
Int'l. Brotherhood Elec. Wrkrs

Irex Corporation

J. H. Albert International
J.P. Morgan Securities, Inc.
James River Corporation
Jnt Indust. Bd of Elect. Industry
John Hancock Financial Services
John K. Dwight, Inc.

K.H. Hueler Inc.
Ketchum Communications Inc.

LaSalle National
Lehman Brothers
Life of Virginia
Liggett Group Inc.
Lincoln National Life Insurance Co.
Locals 813 & 1034 Pension Fund

Manville Corporation
Marriott Corporation
Matsushita
MD Teachers & St. Empl. Retire.Plan
Merrill Lynch
Mid-Jersey Trucking Local 701
Mine Safety Appliances Co.
Monsanto Company
Moody's Investors Service
Morley Capital Management
Mutual Benefit Life Insurance Co.
Mutual of New York

National Fuel Gas Company
Nationwide Life Insurance Co.
NCH Corporation
NERCO
New Castle Advisors, Inc.
New York Life Insurance Co.
Norwest Bank Minnesota N.A.
NYNEX

Ocean Drilling & Exploration Co.
Ohio Edison Company

Pacific Mutual
Pacific Telesis Group
PaineWebber Trust
Payless Drug Stores
Penn Central Corp
Penn Mutual Life Insurance
Pension Portfolio Advisors
Philip Morris
Pillsbury Madison & Sutro
Precision Castparts Corp
Premark International
PRIMCO Capital Management Inc.
Procter & Gamble
Protective Life Insurance Co.
Provident Natl. Assurance Co.
Prudential Asset Management Co.

Regent Advisory Corporation
Reliance Standard Life Ins. Co.
Research Triangle Institute
Reynolds Metals Company
Rochester Gas & Electric Corp.
Rubin/Chambers & Dunhill Ins. Svcs

SAFECO Life Insurance Company
Salomon Brothers, Inc.
Sargent & Lundy
Schwan's Sales Enterprises
Shearson Lehman Brothers
Shell Oil Company
Signet Trust Company
Simplex Time Recorder Co.
Simpson Thatcher & Barlett
Society Management Company
Stephens, Inc.
Sumitomo Bank Capital Markets, Inc.
Sun Life of Canada (U.S.)
SunAmerica Corporation
Super Valu Stores, Inc.

T. Rowe Price Guaranteed
Teacher's Retirement System
The Equitable Life Assurance
The Gates Corporation
The Kroger Company
The Laughlin Group
The M.W. Kellogg Company
The MITRE Corporation
The New York GIC Exchange
The Putnam Companies, 11-A
The Travelers
The Vanguard Group
Transamerica Life Ins & Annuity Co.
Trinova Corporation
TRW Inc.
Turco & Mercier

U S WEST
U. S. Trust Company
Union Bank of Switzerland

Union Carbide Corp.
Union Special Corporation
Unisys Corporation
United Wire Metal & Machine

Varied Investments, Inc.

Westinghouse Electric Corporation
William M. Mercer Asset Planning
Woodbridge Capital Management
Wyatt Asset Services, Inc.
Wyle Laboratories

Xerox Corporation. MS 2-2-D

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PSCA

PROFIT SHARING COUNCIL OF AMERICA ■ THE PROFIT SHARING AND 401(K) ADVOCATE
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December 14, 1993

Ms. Susan W. Hicks
Technical Manager
Federal Government Division, File Q-1-505
AICPA
1455 Pennsylvania Avenue, N.W.
Washington, D.C. 20004-1081

Re: Exposure Draft - Proposed Statement of Position on Reporting of Investment Contracts Held by Health and Welfare Benefit Plans and Defined-Contribution Pension Plans.

Dear Ms. Hicks:

The Profit Sharing Council of America (PSCA), on behalf of its 1,200 member companies that sponsor profit sharing and other defined-contribution plans and their two million participating employees, has the following comments concerning the Exposure Draft:

Effective Date. The effective date should be delayed by one year. Paragraph 17 provides that the new accounting procedures are effective for plan years beginning after December 15, 1993. The closing date for comments is also December 15, 1993, and it is likely that publication of the final requirements will not take place until some time later. It will be impossible for many plan sponsors and their service providers to reprogram their valuation accounting systems within this time frame. For example, calendar year plans with daily valuation will have to be in compliance by January 1, 1994.

Transition Period. PSCA recommends that for investment contracts purchased before December 16, 1993 (Old Contracts), the new accounting rules be applied for plan years beginning after December 15, 1996. The proposed SOP would require existing contracts that are not fully benefit responsive to be reported at fair value. Such an accounting change, which could flow through to the account statements of individual participants, would create sudden, unexpected changes in account values that would be disconcerting to plan participants who expect stable account values. A three-year transition period will allow many Old Contracts to mature. For those Old Contracts that do not mature, the delayed implementation would give plan sponsors the opportunity to:

- Negotiate a fully benefit responsive feature with the current investment contract provider.
- Negotiate a fully benefit responsive wrapper with another financially responsible institution.
- Explain to participants why their account balances will fluctuate after 1996.

Earlier application of the new rules to Old Contracts would be permitted, provided that they were applied to all Old Contracts purchased before the effective date. For investment contracts purchased after the effective date, the new accounting rules would be applied as provided in the Exposure Draft.

If a transition period is not allowed, PSCA recommends that fair value reporting for Old Contracts not be included in individual participant statements. If such reporting is required, significant and unfair discrepancies could occur. For example, current low interest rates probably will result in contracts that have a fair value higher than their contract value. To report this higher value to participants would inflate their plan balances. If this inflated plan balance was paid to retiring employees, the remaining employees would suffer a loss, because on a fair value basis the contract assets, which are fixed, would be depleted to the detriment of remaining employees. If the inflated plan balance is not paid, plan participants will challenge the final benefit payout.

<u>Class-Year Contracts</u>. Existing class-year contracts should be exempt (grandfathered) from the non-benefit responsive valuation requirements. Under class-year contracts participants agree to withdrawal and transfer restrictions in exchange for higher interest rate guarantees. Plan participants elect to participate in these contracts on an individual good faith basis. Existing class-year contracts should be allowed to continue under current accounting until they mature.

<u>Inclusion of Market Interest Rate.</u> Fully benefit responsive contracts that are reportable at contract value should not be reported at a "market rate of interest." Such reporting would be misleading and would thoroughly confuse participants, which could easily result in their making incorrect investment decisions.

<u>Other Code Provisions.</u> Defined-contribution plans that do not permit distribution of benefits prior to termination of employment should not cause the underlying contracts to be deemed non-benefit responsive. For example, money-purchase plans, by regulation, do not permit benefit distribution until employment is terminated.

Thank you for considering PSCA's comments. Please contact me if you have any questions.

Sincerely,

David L. Wray
President

American Council of Life Insurance

Stephen W. Kraus
Chief Counsel, Pensions

December 15, 1993

Ms. Susan Hicks
Technical Manager
Federal Government Division,
File Q-1-505
American Institute of Certified
Public Accountants
1455 Pennsylvania Avenue, N.W.
Washington, D.C. 20004-1081

Dear Ms. Hicks:

On behalf of the American Council of Life Insurance (the "ACLI") I am pleased to submit our comments on the AICPA's Proposed Statement of Position for Reporting of Investment Contracts Held by Health and Welfare Benefit Plans and Defined-Contribution Pension Plans (the "SOP"). The ACLI is the major trade association of the life insurance business. Its 634 member companies have, in the aggregate, 90% of the assets of all life insurers in the United States and account for more than 93% of the funds related to all pension business with insurance companies.

The ACLI is most appreciative of the efforts expended by the AICPA in drafting this SOP. We applaud you for the SOP's important and realistic financial statement reporting requirements with regard to investment and insurance contracts used to fund stable value accounts in health and welfare plans and defined contribution pension plans. For the most part, the SOP provides clear and explicit guidance to accountants who prepare financial statements for these plans. We commend the AICPA for recognizing the underlying and guiding principle of stable value funds: that when plan participants are assured, and do in fact receive, contract value when they withdraw money from these funds, contract value is the appropriate amount to be reported on the plans' financial statements.

While we are generally supportive of the SOP, we do have several concerns with certain aspects of the draft, as discussed below:

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FACSIMILE 202/624-2319

Reasonable Access

The SOP requires that not only the terms of the investment contract be examined to determine whether the contract is fully benefit responsive, but the terms of the plan also be examined. Specifically, the SOP requires that plan participants be allowed "reasonable access" to their funds. If access to their funds is "substantially restricted" by the plan, then the investment contracts held by that plan, which would otherwise be considered fully benefit responsive and reported at contract value, would not be considered to be fully benefit responsive and would be required to be reported at fair value.

By insisting that the terms of a plan be examined to determine whether participants have reasonable access to their funds and, further, whether access to funds is substantially restricted by the plan, the SOP creates a difficult analysis to determine what is reasonable access. This difficulty can arise in several contexts, particularly with respect to defined contribution pension plans where in-service withdrawals are limited. Accordingly, we urge the AICPA to revisit the issue of creating criteria for reasonable access at the plan level as a qualification for a contract to be fully benefit responsive.

Defined Contribution Pension Plans

The example in paragraph 10 of the SOP appears to overlook the type of defined contribution plan which is specifically intended for retirement savings, i.e., a defined contribution pension plan. These plans do not always provide participant access through in-service withdrawals, investment direction and loans, as these provisions are viewed as counter-productive to the objectives of the plan.

Since the purpose of a pension plan is to provide retirement benefits, the right of an employee to make withdrawals from a plan is restricted. Such restrictions are compelled by IRS rules covering qualified programs. For example, money purchase pension plans are required by law to limit access to a participant's account balance (other than voluntary employee contributions) during the accumulation stage. Thus, a pension plan must not permit participants, prior to any severance of employment or termination of the plan, to withdraw all or part of the funds accumulated on their behalf consisting of employer contributions or the earnings thereon. In addition, such plans do not provide participants with the opportunity to direct investments.

Individuals under these plans typically become eligible for benefit distributions at normal or early retirement, death, disability or termination of employment. These participants receive the same benefit guarantees under investment contracts and therefore require the same contract value information as do participants in plans which have more liberal withdrawal provisions. Therefore, the proposed use of fair value for plans with more restricted access during active employment would have the effect of creating inconsistencies and inequalities in reporting financial information for contracts containing the same benefit responsive features at termination or retirement.

We submit that both participant groups should be able to rely equally upon the contract values reported under investment contracts that are fully benefit responsive based on plan provisions. This view is supported by paragraphs 6 and 7 of the AICPA's explanation of the scope of the SOP, which notes that plan participants, as the primary users of the plan's financial statements, are chiefly interested in "the value of the assets" that can "currently be made available..." We interpret this language to mean that the appropriate value to reflect on a participant's benefit statement from a pension plan that only allows withdrawals upon termination of employment or retirement (whether normal or early) is what that participant would receive from the pension plan were he/she to terminate employment at that point or, if eligible, retire at that point.

A participant's benefit from a defined contribution plan depends on the value of the investments that comprise his/her benefit account. The committee recognizes this when it states in paragraph 7 that "the plan's net assets available to pay benefits equal the sum of participant individual account balances." Contract value, then, as the sum that is payable to participants from investment contracts, either in-service or following termination of employment, is more relevant for the users of financial statements.

As required by law, the money purchase pension plan does not allow in-service withdrawals; nor does it allow plan loans. The plan also does not permit plan participants to choose into which investment options they can put their account assets. However, all benefits to participants under the plan are stated in contract value terms. We believe these plans do provide "reasonable access" in the context of the purpose of money purchase plans and participants' understanding of the terms of their plans. Consequently, we believe contract value reporting remains the best accounting basis for these plans. Furthermore, we believe that it would be quite inappropriate for the SOP, or plan auditors in the future, to hold money purchase plans to "reasonable access" provisions that 401(k) plans normally provide.

<u>Disclosure of Market Interest Rate for Contracts Reported at Contract Value</u>

The AICPA has requested comments as to the need to disclose a market rate of interest for fully benefit responsive contracts that are reported at contract value. The thought behind this request is that with such information, plan participants would be better able to make informed investment decisions.

In our view, this type of disclosure would not be helpful to participants, but would instead create confusion and possibly mislead participants. Most importantly, current market rates and portfolio rates are not directly comparable. The most important interest rate to the participant is the rate that has been recently credited to the contract, and the rate that will be credited to the contract in the near future. Moreover, the wide variety of plans and contract provisions would make it difficult to determine a market rate that would be appropriate.

In addition, at any given time many plans will typically have a portfolio of investment contracts with a number of providers. This creates an additional problem. If market rate disclosure were required, a plan sponsor would have to collect information from all of those providers and create a method of presentation to participants that would be meaningful. First, it is not clear that such information would be readily available from providers. Second, it would be extremely difficult for a plan sponsor to translate this information in a way that would be useful to participants even if it were available. For example, a plan sponsor offers participants a blended interest rate that reflects three existing contracts with interest rates of 9%, 8%, and 7%, respectively and a new contract with an interest rate of 6%. Information regarding the market rates of the existing contracts would not assist, and more likely confuse, participants in gaining a better understanding of the investment under the plan.

The only "market" values which GIC issuers have historically reported to contractholders are surrender values, which contain penalties for early termination of the contract. Because plan sponsor transactions can only occur at the surrender values and participant transactions can only occur at book, no realistic market value of the ongoing contract has been needed. Therefore, disclosure of a market rate of interest for fully benefit responsive contracts reported at contract value should not be required.

Basically, we feel this disclosure is unnecessary because the SOP already appropriately provides for the reporting of investment contracts in the way that is most meaningful to participants. By focusing on the principle that what is reported is what the participant can expect to receive, the SOP captures the essence of what is most useful to participants.

Guide Sections, 7.37 and 7.39b

The SOP includes amendments to the Guide in Sections 7.37 and 7.39b (third bullet), both of which refer to valuation at fair value only. We support these amendments; however, we are concerned that the principle that contract value is appropriate for fully benefit responsive contracts established elsewhere in the SOP could be overlooked. We propose, therefore, that the suggested amendments be expanded to include a reference such as "see Section 3.17 with respect to defined-contribution pension plans and Section 4.12 with respect to defined-contribution health and welfare plans." This would make that relationship clear to guide users.

Effective Date

The draft states that the SOP is effective for financial statements for plan years beginning after December 15, 1993. As many plans are calendar year plans, they will have only two weeks to come into compliance, prior to the effective date of the SOP. We believe it is inappropriate to make the SOP effective prior to its finalization, since there may be revisions to the draft prior to its finalization. Further, since plans that wish to maintain book value accounting may have to undergo numerous changes to comply with the SOP, possibly including contract renegotiations and plan design changes, we urge the AICPA to change the effective date to plan years beginning after December 15, 1994. This will provide time for the AICPA to finalize the SOP and for plan sponsors to make the necessary adjustments to comply with the final statement.

Transition Rule

As mentioned above, many plans may need to renegotiate their insurance and investment contracts with their issuers. This could be an extensive process, once plan sponsors and issuers become aware of the final SOP requirements. Due to pricing and other considerations, some issuers may be reluctant to make contract changes. Further, in cases where contract changes are made, these new contracts may have to be filed with state insurance departments for approval. Such approval usually takes a considerable amount of time to receive. Accordingly, we ask that the AICPA provide at least an additional one year transition period beyond the December 15, 1994 effective date we are requesting for existing contracts to come into compliance with the final SOP.

We appreciate the opportunity to furnish these comments on the proposed SOP. If you have any questions or need any additional information, please do not hesitate to let us know.

Sincerely,

Stephen Kraus

Stephen W. Kraus

SWK:kmc

ARTHUR
ANDERSEN

ARTHUR ANDERSEN & CO, SC

Arthur Andersen & Co.

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Chicago IL 60602-3002
312 580 0069

December 15, 1993

Ms. Susan W. Hicks
Technical Manager
Federal Government Division, File Q-1-505
AICPA
1455 Pennsylvania Avenue, N.W.
Washington, DC 20004-1081

Dear Ms. Hicks:

This letter contains our comments on the AICPA's exposure draft of a proposed statement of position (SOP), *Reporting of Investment Contracts Held by Health and Welfare Benefit Plans and Defined Contribution Pension Plans*. We support the AICPA's efforts to clarify the accounting guidance in this area and we generally agree with the provisions of the SOP. We agree that plan assets should be measured and reported at values that are meaningful to the primary financial statement users--plan participants. Our specific comments are included below.

Issues for Which Comment Is Specifically Requested

Effective Date and Transition

Contract value accounting is important to many plan sponsors, and a stable asset value is important to many plan participants. Many investment contracts currently owned by defined contribution plans were purchased in part to achieve book value accounting for the plan and stable account values for the participants. To the extent that those existing contracts are not fully benefit responsive, the proposed SOP would require them to be reported at fair value. Such an accounting change, which we believe would flow through to the account statements of individual participants, could create sudden, unexpected changes in account values that would be disconcerting to participants who expected stable account values. To avoid this result, we suggest a delayed effective date as follows:

o The new accounting should be required to be applied for plan years beginning after December 15, 1996. Earlier application of the new accounting would be permitted. During the three-year delayed implementation period, many of the existing contracts will likely mature. For those contracts that do not mature, the delayed implementation would give plan sponsors an opportunity to (1) negotiate a fully benefit responsive feature with the investment contract provider, (2) negotiate a fully benefit responsive wrapper with another financially responsible enterprise, or (3) communicate to participants why their account balances will be less stable after 1996. In addition, if contracts will be reported at fair value, some plans' underlying accounting and computer systems may have to be modified.

Disclosure of a Market Rate of Interest for Fully Benefit Responsive Contracts

We believe that the financial statements of defined contribution plans have two primary objectives, not just the one identified in paragraph 7 of the Exposure Draft. The second objective should be to provide information to plan participants that is useful in assessing the plan's investment performance and making personal investment decisions. Such investment decisions include decisions to transfer investments in plans that have participant directed investment choices and decisions to liquidate investments versus borrowing from the plan for plans that permit participants to borrow.

- When market yields exceed the yield on a fully benefit responsive investment contract, the fair value of the investment contract (where fair value is estimated by discounting the future cash flows at a market interest rate for investments of similar quality and duration) is less than its contract value . In this situation, from the participant's point of view, the benefit responsive feature represents an early redemption premium. The participant could perhaps obtain more value by redeeming early than by holding to maturity depending on the other investment options available under the plan.

- Conversely, when the yield on a fully benefit responsive investment contract exceeds market yields, the fair value of the investment contract (where fair value is estimated by discounting the future cash flows at a market interest rate for investments of similar quality and duration) exceeds its contract value. In this situation, from the participant's point of view, the benefit responsive feature represents an early redemption penalty. The participant could perhaps obtain less value by redeeming early than by holding to maturity depending on the other investment options available under the plan.

We believe that the disclosures in paragraph 14 should be expanded to require disclosure of *either* (1) the fair value of fully benefit responsive investment contracts (where fair value is estimated by discounting the future cash flows at a market interest rate for investments of similar quality and duration) or (2) the market yields currently available on fixed income securities with quality and duration comparable to the investment contract. We believe either of those disclosures could be useful to participants in assessing the plan's investment performance and making personal investment decisions.

Investment Contracts Recorded at Fair Value

We agree with the approach in the Exposure Draft of limiting contract value accounting to fully benefit responsive contracts as defined in paragraphs 9 and 10. Some partially benefit responsive contracts that, for example, pay benefits of up to 30 percent of the contract at contract value, are designed to pay all expected withdrawals over the life of the contract at contract value. However, we do not believe that it is possible to define in a clear or operational manner which partially benefit responsive contracts are sufficiently benefit responsive to be measured at contract value. The approach in the Exposure Draft, by contrast, is understandable and easy to apply. We also concur with measuring each individual contract separately. No aggregation or fund of contracts can be fully benefit responsive unless every individual contract is fully benefit responsive. We are not aware of any problems or ERISA or IRC implications that arise from the requirement to account for partially or non-benefit responsive investment contracts at fair value.

Other Comments

Paragraph 9

We suggest including the word "liquidity" immediately before the word "guarantee." This clarifies the type of guarantee and agrees with the discussion in paragraph A.6.

Paragraph 10

The paragraph indicates that the plan must allow participants "reasonable access to their funds." We suggest that reasonable be defined as at least on an annual basis.

Some have read paragraph 10 of the Exposure Draft to require that a fully benefit responsive investment contract permit investment transfers. We do not believe the Exposure Draft has such a requirement. However, we suggest that the final Statement be clarified to indicate that the requirement is reasonable access to funds without termination of employment. That access can be provided through withdrawals, loans, or transfers, but not necessarily all three.

Paragraphs 11, 15.b,15.i, 16.b

Paragraph 4.10 of the Audit Guide, as revised, still indicates that plans not subject to ERISA annual reporting requirements must follow such requirements. Paragraph 3.15 of the Audit Guide indicated the same point; however, it was replaced by the changes in paragraph 15.e of the proposed SOP. The SOP should indicate the accounting to be followed without referring to outside regulations. The existing and proposed language places an undue level of effort on plans to monitor changes in ERISA even when they do not fall within its jurisdiction. We propose that the last sentence of paragraph 4.10 be deleted.

Paragraphs 15.g, 15.l, 16.e

We suggest that the language in the additions to paragraphs 3.23, 4.26 of the Audit Guide and paragraph 53 of SOP 92-6 be revised as shown below:

p. A general description of the basis and frequency of determining crediting interest rate resets and any minimum crediting interest rate under the terms of ~~the~~ fully benefit responsive investment contracts and any limitations on related liquidity guarantees (for example, premature termination of the contracts by the plan, plant closings, layoffs, plan termination, bankruptcy, mergers, and early retirement incentives) ~~on benefit responsive investment contracts~~.

Paragraph 15.j

Paragraph 4.15, as amended by paragraph 15.j of this proposed SOP, should be adjusted to reflect the changes in paragraph 4.26 for sub-paragraphs 4.26.i and 4.26.j.

Paragraph A.2

As worded, the paragraph implies that a measurement method other than fair value or contract value is required.

We suggest that the paragraph be clarified as follows:

A.2 The fair value of ~~I~~investments contracts that do not provide a liquidity guarantee as discussed in paragraph A.1 may be ~~valued~~ determined according to the guidance of FASB Statements 35 and 107. Generally, this may be estimated by discounting the related cash flows based on current yields of similar investments with comparable duration. In determining the similarity of investments, appropriate consideration should be given to the credit quality of the contract issuer. Generally, contract termination (penalty) clauses need not be considered absent information that would indicate the plan's intent to terminate the contract.

Inconsistency Between Examples in Appendix

We believe that Examples 4 and 6 (paragraphs A.11 and A.16) are inconsistent. In A.10, the plan may terminate the contract at any time and receive the value of the assets in the separate account. If market interest rates decline, this would permit the plan to capture the appreciation in the assets. Conversely, if market interest rates increase and the investments depreciate, the plan would look to the issuer to pay contract value for participant-initiated withdrawals. A.11 concludes that the contract should be reported at contract value.

By contrast, A.16 deals with a situation in which the plan has an *option*, but not an obligation, to sell the bond to the contract issuer if funds are needed for participant-initiated withdrawals. Similar to A.10, the option permits the plan to capture the appreciation of the bond if market interest rates decline but protects the plan against depreciation of the bond if market interest rates increase. A.16 concludes that the contract should be reported at the greater of contract value or the fair value of the bond.

We believe that A.16 has the appropriate conclusion and that A.11 should be conformed to A.16. If the plan has the ability to capture the appreciation of the investments at a point in time, it is inappropriate for the plan to carry the contract at a lower contract value.

Paragraphs A.10 and A.11

Aside from the inconsistency in examples 4 and 6 as noted above, the wording in paragraph A.10 suggests that the interest is adjusted at the time of an initiated transaction. The wording should suggest that the contract credits interest on a formula basis.

We suggest that the paragraph be clarified as follows:

A.10 A financially responsible issuer pays contract value for participant withdrawals, regardless of the value of the assets in the separate account. <u>On an ongoing basis,</u> ~~T~~<u>t</u>he credited interest rate <u>used to determine the contract value</u> is a function of the relationship between the <u>outstanding</u> contract value and the value of the assets in the separate account. The rate is reset periodically, daily, monthly, quarterly, and so on, by the issuer and cannot be less than zero. There may or may not be a specified maturity date on the contract. The contract holder may terminate the contract at any time, and receive the value of the assets in the separate account.

A.11 The contract should be reported at contract value because participants are guaranteed return of principal and accrued <u>"formula"</u> interest.

Paragraph A.13

The paragraph includes a phrase "When considered together." In these situations, the assets and wrapper would always be considered together. However, the language suggests that there may be some cases where they would not be considered together.

We suggest that the paragraph be clarified as follows:

A.13 Inasmuch as trust assets are owned by the plan, the wrapper contract and the assets in trust should be separately valued and disclosed. The wrapper contract would be valued at the difference between the fair value of the trust assets and the contract value attributable by the wrapper to such assets. ~~When considered together,~~ –Thus, the combined carrying amounts of the trust assets and the wrapper contract ~~should be reported at~~ will equal the wrapper contract value because participants are guaranteed return of principal and accrued interest.

Paragraphs A.14 and A.16

Aside from the inconsistency in examples 4 and 6 noted above, the term "issuer" could be interpreted differently. It could be interpreted as "contract issuer" or "bond issuer".

We suggest that the paragraph be clarified as follows:

A.14 Under this arrangement ~~contract~~, the plan purchases a bond and places it in trust. The plan then contracts with a financially responsible third party to provide benefit responsiveness. Under the contract, should the bond need to be sold to meet a participant-initiated withdrawal benefit, loan, or transfer, the plan is obligated to sell the bond to the financially responsible third party ~~contract issuer~~, and the third party ~~issuer~~ is obligated to buy the bond. The transaction price is defined under the contract (for example, amortized cost). The financially responsible third party ~~issuer~~ is not obligated, however, to purchase securities that are in default.

A.16 If the contract provided only an *option* for the sponsor to sell the bond to the financially responsible third party ~~issuer~~, rather than an obligation to do so, contract value would only apply when the fair value of the bond was less than contract value, because the option would then have value. Fair value may be determined as the greater of the estimated discounted cash flows or the option price.

* * * * * * * *

We appreciate the opportunity to respond to the Exposure Draft of the Proposed Statement of Position and will be happy to discuss any of our comments at your convenience.

Very truly yours,

Arthur Andersen & Co.

Arthur Andersen & Co.

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BLACK&DECKER®

December 15, 1993

Ms. Susan W. Hicks
Technical Manager
Federal Government Division
File Q-1-505
American Institute of Certified Public Accountants
1455 Pennsylvania Avenue, NW
Washington, DC 20004-1081

Dear Ms. Hicks:

The Black & Decker Corporation is pleased to comment on the September 15, 1993 Exposure Draft of the AICPA proposed Statement of Position (SOP) *Reporting of Investment Contracts Held by Health and Welfare Benefit Plans and Defined-Contribution Pension Plans* (herein referred to as the Exposure Draft).

Regarding the proposed requirement to value investment contracts that are deemed not to be fully benefit responsive at fair value, the cover letter to the Exposure Draft questioned:

> "In particular, are there any ERISA or Internal Revenue Code implications that should be considered, and what, if any, additional disclosures should be considered?"

At the present time, it remains unclear to us how the provisions of the Exposure Draft interact with regulatory provisions imposed by the Federal government. We have received differing, albeit informal, opinions of individuals familiar with such regulations as to whether a GAAP requirement to value non-benefit responsive contracts at fair value would require like accounting in the individual plan participants' account statements (herein referred to as the Account Statements). Some of those whom we consulted believe this to be the case while others believe that contract value accounting may still be appropriate in certain instances. Those others argue that the use of a "mark-to-market" approach in the Account Statements by a plan which has the intent and ability to hold non-benefit responsive contracts to maturity would be, at best, misleading to plan participants. They point out that the logical conclusion of fair value accounting in the Account Statements is that a plan would be required to execute plan transactions at fair value. In cases where a plan has the ability and intent to hold the non-benefit responsive contracts to maturity, use of fair value for plan transactions may, at worst, result in a disproportionate sharing of risk among plan participants, which is contrary to the provisions of ERISA.

In order for the Employee Benefit Plans Committee of the AICPA to receive responsible comments to the Exposure Draft, we believe that it is imperative that the ERISA and Internal Revenue Code (IRC) implications be made known to all potential respondents. In addition, we believe that it is likely that the Committee will receive fewer comment letters than if such implications had been fully addressed. We urge the Committee to fully address these implications and consider re-exposure of the Exposure Draft.

Irrespective of the Committee's actions on potential re-exposure, we believe that the effective date as proposed in the Exposure Draft does not permit plans sufficient time to react to its provisions. The required adoption date of January 1, 1994 for calendar year plans does not provide sufficient time for such plans to address the ERISA and IRC requirements if it is determined that symmetry is required in a plan's GAAP financial statements and its underlying Account Statements. Accordingly, we recommend that the Committee provide for a delayed effective date in the event that the Exposure Draft is adopted.

Paragraphs 6 through 8 of the Exposure Draft note that the primary users of defined contribution plan financial statements--plan participants--require information that is useful in assessing the plan's present and future ability to pay benefits when they are due. Further, it is noted that information useful to plan participants "includes the amounts they would receive currently if they were to withdraw or borrow funds from or transfer funds within the plan." We believe that plans may demonstrate the intent and ability to hold non-benefit responsive contracts to maturity; this may be accomplished due to sufficient liquidity in the plan, by pre-funding of contributions by the plan sponsor, or by obtaining loans from the plan sponsor. In cases where the intent and ability to hold non-benefit responsive contracts can be demonstrated by the plan, we believe that the information useful to plan participants is contract value *not fair value*. Accordingly, we urge the Committee to modify the provisions of the Exposure Draft to permit contract value accounting for non-benefit responsive contracts for which plans can demonstrate their intent and ability to hold to maturity. Such a valuation alternative would be consistent with that afforded under SFAS 115 *Accounting for Certain Investments in Debt and Equity Securities*.

Should you wish to discuss any of the comments included in this letter, please contact Tina McMullen at (410) 716-3567.

Sincerely,

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December 15, 1993

Via Fax

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Washington, D.C. 20004-1081

Re: Exposure Draft - Comments on the Proposed Statement of Position on Reporting of Investment Contracts Held by Health & Welfare Benefit Plans and Defined-Contribution Pension Plans

Dear Ms. Hicks:

The John Hancock Mutual Life Insurance Company is one of the nation's leading insurance companies. For over half a century we have been a major provider of products and services to sponsors of all forms of pension plans. Currently, we are managing over $25 billion of assets supporting both defined benefit and defined contribution plans. As one of the first issuers of guarantee investment contracts, we have developed a substantial expertise with guaranteed products.

In that light, we welcome the opportunity to offer our comments to you. At John Hancock, we feel the AICPA has done an excellent job of identifying and responding to the critical issues involved in the reporting of investment contracts by defined contribution pension plans. The result is a well thought out document that clearly recognizes that the essential feature of these contracts is that they provide benefits to participants at book value. By tying the concept of full benefit responsiveness to the contract value reporting, the AICPA has responded directly to the needs of plan sponsors and participants.

We offer the following comments on certain portions of the draft:

Disclosure of Market Rate of Interest

The AICPA has requested comments as to the desirability of disclosing a market rate of interest for fully benefit responsive contracts that are reported at contract value. The thought behind this request is that with such information, plan participants would be better able to make informed investment decisions.

To fulfill such a requirement, a plan sponsor would first need to acquire accurate information and then develop a means of presenting that information in the financial statements in a way that would be meaningful to users. We believe the information simply doesn't exist in the normal procedures of GIC issuers.

Except for plan-provided benefit responsiveness, GIC's are illiquid. There is no active market from which realistic values can be derived. This means that any so-called market value would, of necessity, be subject to approximations and assumptions. GIC contracts do provide for a market value adjustment in the case of a plan sponsor initiated surrender of the contract. In this case, however, the adjustment includes penalties resulting from premature termination. These surrender values are clearly inappropriate for disclosure since they would only be realized in an actual event and do not represent an actual current value. This is also true for separate account and synthetic GIC's to the extent they are invested in illiquid asset classes.

It has been suggested that money market rates could serve as a proxy for a contractual market rate. Money market rates in this context would be inappropriate due to limitations caused by the comparison of what are basically generic money market rates to individually underwritten investment contracts that take into account specific plan and cash flow risks. Such a comparison would be further distorted by differences of duration, liquidity and credit characteristics between money market funds and investment contracts.

As a major issuer of GIC's, we are highly reluctant to provide estimates of current market values as a part of our regular procedures. Differences between these estimates and contract surrender values would inevitably lead to confusion and potential legal disputes with plan sponsors.

If a market comparison rate is available, we perceive a greater anti-selection risk to ourselves. This increased risk would eventually evidence itself through decreased yields to participants as issuer risk charges are increased. This cost to participants far outweighs any benefit from the disclosure information.

We feel that the unavailability of accurate market value data, coupled with the difficulty faced by plan sponsors in explaining why the information is being presented and how it is to be used, leads to the conclusion that the use of a market value reference rate is not workable on a practical basis.

Interpretation of Reasonable Access

The AICPA also sought comments on the requirement of valuation at fair value of investment contracts deemed not to be fully benefit responsive due to plan restrictions.

It would seem difficult for an auditor to conclude that contracts issued to a given plan must be valued at fair value simply because it has fewer forms of access available to participants, when all payments are in fact paid at contract value and such payments can occur over the participant's full investing period. Certainly the absence of additional investment options in the plan should not be the basis for a determination of failure to provide reasonable access.

While the multi-fund 401(k) plan has become thought of as the "typical" defined contribution plan, according to 1987 Form 5500 data as reported in 1992 by the Department of Labor, only 8% of all defined contribution plans were 401(k) plans and only 38% of defined contribution plan participants were 401(k) participants[1]. Other plans represent a variety of types - profit sharing, deferred profit sharing, thrift, money purchase, etc. - many of which are single fund in nature.

In fact, from an analysis of approximately 2800 defined contribution plans that John Hancock has provided investment contract quotes to, we estimate that 3-5% are single-fund, employer directed plans that use investment contracts specifically for the purpose of providing contract value benefits.

While these plans do not allow investment transfers, they permit in-service or hardship withdrawals. Loans are often permitted. Non-hardship withdrawals may often occur with a tax penalty. Retired and term vested participants may leave funds in the plan and withdraw or roll-over to an IRA at any time. In fact, the IRS requires that plans allow these participants to leave their funds in the plan. After age 70 1/2 phased withdrawal becomes mandatory. Transactions occur continually over the expected life of the participant and spouse (if married). This can cover a time frame of 20-30 years during which contact value payments will be made.

Reflective of situations where transactions that participants can initiate transactions when investment options are not available are:

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1. U.S. Department of Labor, Trends in Pensions, 1992 P. 164.

According to the U.S. Department of Labor, fully 9 percent of employees participate in capital accumulation defined contribution plans, as distinct from retirement plans[2]. Capital accumulation plans are defined as those which allow employer, as well as employee, contributions to be withdrawn before retirement. It is unknown how many of these employees have employer-directed plans invested in GIC's. However, for those who do, there is an ongoing need for an accurate assessment of the current value of the fund so that the participant may know whether to leave funds in the plan or withdraw. Only contract value reporting provides an accurate value of the withdrawal amount for participants in these plans.

Twenty-four percent of participants in defined contribution savings and thrift plans are allowed to withdraw employer contributions at any time prior to disability, retirement age or termination of employment[3]. For such employees, whether in single or multi-fund plans, this option to withdraw may only be meaningfully evaluated for investment contracts if contract value reporting is allowed.

Many plans, (including 401(k)) allow participants to deposit post-tax contributions. These contributions are always subject to immediate withdrawal from the plan at contract value.

Additionally, there are plans that offer various investment options but which encourage, or require, the use of stable value funds as participants approach or enter retirement. This practice is consistent with the intent of pension plans to provide for the accumulation of funds over a participant's working life and income during his retirement. The idea is to preserve the value of the accumulated balance and maintain stability of income for retirees. Although participants in this situation may not transfer to other investment options, there are significant opportunities for benefit payments at book value.

An example of the way retirees value principal stability is found in John Hancock's own plan. ***Forty-three percent*** *of the John Hancock Stable Value Fund assets* ***belong to retirees.*** *Of the retirees who choose to leave their funds in the plan,* ***approximately 90% opt to leave the assets in the stable value fund,*** *although other investment options are available to them. Regular reports of their funds at contract value are important to them in determining whether to make full or partial withdrawals from the plan.* ***Such reports would be equally valuable and necessary if only that one fund option were present.***

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2. *U.S. Department of Labor, Employee Benefits in Medium and Large Private Establishments, 1991, May 1993, p. 104.2.*

3. *Ibid pg. 117*

Even when participants elect to receive their funds at retirement, rather than leaving them in the plan, 52 percent have the option to elect installment payouts.[4] *Since the participant is assured the right to a series of payouts at contract value, it is important that the fund value be reported to him on that basis. Where funds are left invested in the plan, payout on a gradual basis is mandatory after age 70 1/2. This is a gradual fund reduction occurring over many years. Ultimately then, even if the participants have no ability to transfer to another investment option within the plan, there are many ongoing opportunities for transactions at book value, where the provider incurs market risk. It is critical that fund values be reported at contract value.*

Plans which restrict participants solely to the GIC option have done so precisely because principal protection and liquidity offered are most appropriate for their participants. Requiring fair value reporting for these funds would create an enormous amount of havoc and disruption in the defined contribution marketplace - for no valid cause.

Amendments to Guide Sections 7.37 and 7.39b

The SOP includes amendments to the Guide in Sections 7.37 and 7.39b (third bullet) both of which refer to valuation at fair value only. We support these amendments; however, we are concerned, since this is the only reference to GIC's in the auditing of investments section, that the principle that contract value is appropriate for fully benefit responsive contracts established elsewhere in the SOP could be missed. We propose, therefore, that the suggested amendments be expanded to include a reference such as "see Section 3.17 with respect to defined-contribution pension plans and Section 4.12 with respect to defined-contribution health and welfare plans." This would make that relationship clear to Guide users.

Effective Date and Transition

The Exposure Draft suggests that the SOP be effective for plan years beginning after December 15, 1993, with accounting changes to be adopted as of the beginning of the plan year. In effect, a calendar year plan would be required to implement any accounting changes as of January 1, 1994, even though the provisions of the SOP will not have been finalized. Assuming the SOP is finalized by the FASB during 1994, in order to allow plan sponsors affected by this SOP adequate opportunity to evaluate their plan provisions, portfolios, contracts, etc., and to be able to implement any necessary accounting change - especially as they pertain to transactions involving benefit payments, loans, or transfers - it would be preferable to defer the effective date to plan years beginning after December 15, 1994, with conforming accounting changes to be made as of the beginning of that plan year.

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4. Ibid pg. 117

Again, we thank you for the opportunity to offer these comments. We compliment you on the positive results you have achieved on a difficult and complex subject and look forward to the issuance of the final Statement of Position.

Sincerely,

Jeanne M Livermore

Jeanne M. Livermore
Senior Vice President
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December 15, 1993

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VIA FAX: (202) 638-4512

Re: Exposure Draft - Proposed Statement of Position on Reporting of Investment Contracts Held by Health & Welfare Plans and Defined Contribution Pension Plans.

Dear Ms. Hicks:

This letter sets forth our comments on the AICPA's draft September 15, 1993 Exposure draft entitled "Proposed Statement of Position on Reporting of Investment Contracts Held by Health & Welfare Plans and Defined Contribution Pension Plans". We support the efforts as expressed in the Statement of Position as a means of providing a consistent standard practice for valuing these contracts.

The AICPA guidelines for Statement of Position on GIC contracts appears to minimize the discussion and actual presence of traditional insurance components in many of these contracts.

<u>General Comments</u>

Fundamentally, interest crediting rates are utilized substantially as a determining factor after credit when selecting contracts. This factor is a means of a "common denominator" method of evaluating alternative issuers. Historically, issuing contracts with maturities is relatively new. Insurers always experienced difficulty marketing and explaining investment contracts without maturities. Contracts with maturities satisfy customer needs by permitting the pension trustee to reconsider its option periodically without making open ended commitments to contracts without maturities.

FASB needs to be consistent in recognizing the presence of insurance within contracts whether they are open end or closed end, with maturities. Pension policy should not be dictated through accounting methodology. Many large profit sharing plans settle liabilities through the purchase of annuities at retirement time. Many of these plans invest through open end contracts which provide death, annuity, disability and other benefits. In addition, annuity benefits are paid commencing with Normal Retirement Date. Insurers agree to aggregate pre and post interest experience in determining ultimate benefits, ultimate investment returns, and ultimate annuity prices through dividends and participation credits to the contract.

Accounting treatment should not be different for contracts that are longer term in nature merely because the plan provisions are long term in nature. If contractual benefits are transferred to a responsible third party an insurance function is present.

Insurance Present in Contracts

Insurers provide viable contractual guarantees and functions. Participant benefits are often paid in lump sum or annuity for death, retirement, disability, and other events. Plan design often permits participant initiated events in 401(k) plans and these events when insured at book value are provided in exchange for a risk adjusted rate or yield on the contract. The risk adjustment is for: death, retirement, disability, termination of employment, and investment transfer.

Cost of Insurance

Most consumers understand that insurance requires payment of a premium. Investment contracts with insurance features operate to provide an interest accumulation component. This is the primary benefit of these contracts. Investment contracts with insurance features charge a premium in the form of "Risk Adjusted Yields" determined by the issuer. Contracts containing provisions for these events provide for loss. This loss is not insignificant. It is real. These attractive features are a requirement of some contract structures that are long term in nature because long term benefits are prescribed by the plan.

Historically during the late 70's and early 80's participants were permitted to withdraw liberally from investment contracts within certain plans. The interest and investment losses for investment contracts appeared on the insurer balance sheets - not on the participant statements. These losses occurred because the benefits were contractually guaranteed; therefore, the issuer paid.

Contracts are drafted pursuant to the style of benefits. So long as participants are provided benefits by a responsible third party, contract value should prevail whether that provision is long term or short term.

Market Interest Rate

Market interest rate does not relate in any way to GIC fund rates. Users of financial statements, the participants, can move freely within the context of a given plan design regardless of current market rates. Transactions for the GIC account are not done based upon market rates unless the style of GIC Fund management is to acquire contracts annually or manage the Stable Asset Account through an "insured" rate. Participant events should be covered at book value within the contracts in order to carry these assets at contract or book value.

Pension Benefit Contracts

Investment Contracts with insurance benefits are purchased from financially responsible insurers. There should be no valuation concern if these contracts contain elements of insurance whether for long range or short range plan events. There is no secondary market for these contracts. In many instances, benefits are provided pursuant to "annuity plans". Examples are TSA 403(b) annuity plans and defined benefit IRC Sec 412(i) fully insured plans. These contracts are provided pursuant to IRS rules and regulations.

Plan Design

Merely because plans do not provide for distribution of accumulated assets is not justification to value other pension benefit contracts at something other than contract value. Merely because benefits are limited by plan design in an effort to maintain the long term nature of some plans is not reason to ignore the presence of insurance within the contracts. This concept should not be based upon or guided by the perception that participant control or lack of direct control over assets should determine their value. Degree of participant control should dictate the guidance on valuing these contracts. The presence of insurance risk is what should govern their valuation approach.

Contracts are drafted according to plan design requirements. The plan design and plan of operation dictates the style of benefit benefits to be presented to employees. As long as participants are provided benefits by a responsible third party, then contract value should prevail. The issue is whether financial responsibility is transferred or assumed. The frequency of events that relate to some plans should not dictate policy for others.

Unilateral Contracts

Responsibilities are driven by events that are either insured or uninsured. Insurance contracts are unilateral contracts. Offers of risk are made by the insured (the plan and its operation) to the issuer which are then requested to be transferred to insurers. The insurer will assess the risk and determine the degree of risk. If the risks are agreeable, the insurer agrees to undertake that risk and the events related to it in exchange for a premium which is expressed in the form of "Risk Adjusted Yields". This in effect is the "premium" or consideration necessary to form a policy of insurance.

The unilateral nature of the contract requires the party to assess risks fully. To do otherwise is irresponsible financial underwriting. GICs and stable asset accounts are quasi "self- insured" or "massively co-insured" pools of assets designed to operate in tandem with each other within the context of a specific plan. So much emphasis is placed upon the maturity and bond features of these contracts that the presence of insurance is diminished. It should always be present in order to be carried at contract value.

Participant related insured events need to be discussed throughout the Statement. Certain sections such as A 1 do not even mention death, retirement or disability as event risks. This needs to be present in examples given. There is a lack of emphasis upon the insurance elements necessary to form part of the contract. This needs reinforcement throughout. Investment contracts with benefits provided pursuant to a plan should receive contract value accounting.

It is hoped that these comments are helpful in keeping the issues distinct. Insurance is supposed to be a promise. That promise is accepted by the insurer and it is transferred to financially responsible parties. Not all contracts conform to this principle.

It is our opinion that the Statement of Position will greatly clarify the issues. Distinguishing between risk events and securities has been greatly clouded by many issues. Please feel free to contact me with any questions you may have.

Sincerely,
QUALIFIED ANNUITY SERVICES/THE NEW YORK GIC EXCHANGE

Jack Bellersen

Joseph B. Bellersen, Jr.
President

JBB:gah

File: GIC Valuation - AICPA

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Price Waterhouse

December 15, 1993

Ms. Susan W. Hicks
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American Institute of Certified Public Accountants
1455 Pennsylvania Avenue, N.W.
Washington, D.C. 20004-1081

Re: **Reporting of Investment Contracts by Health and Welfare Benefit Plans and Defined-Contribution Pension Plans**
File Q-1-505

Dear Ms. Hicks:

We appreciate this opportunity to comment on the Exposure Draft of the above-captioned proposed SOP.

Specific comment was requested regarding a requirement to disclose a market rate of interest for fully benefit responsive contracts reported at contract value. We believe that such disclosure would be useful information for a plan participant and suggest that the U.S. Treasury Securities rate for similar maturities could be an appropriate benchmark.

We agree with the accounting and disclosure requirements of the proposed SOP; however, we offer the following suggestions which, if implemented, we believe would improve the document:

Address the accounting for investment contracts held by collective investment funds

Many banks and insurance companies sponsor funds that invest in investment contracts. Investment in these funds is restricted to defined contribution pension plans. These funds typically maintain some level of highly liquid securities, a liquidity buffer, to fund anticipated levels of benefit responsive withdrawals. The investment contracts in these funds are usually benefit responsive once the liquidity buffer is exhausted. The investment contract can be terminated without penalty for non-benefit responsive withdrawals, e.g. contract termination, if notification is given one year in advance.

We do not believe that a restriction of this nature is so significant as to disqualify the investment contract from reporting at contract value. However, due to the prevalence of this type of restriction, the proposed SOP should address it.

Use FASB Statement No. 5 terminology in paragraph A.2

In paragraph A.2 the proposed SOP states that contract termination penalties need not be considered "absent information that would indicate the plan's intent to terminate the contract". We believe that the wording should conform to FASB Statement No. 5 terminology, i.e., unless it is probable that the plan will terminate the contract.

Require disclosure of average yield only for periods for which a statement of changes in net assets available for benefit is presented

Paragraph 14 of the proposed SOP requires disclosure of the average yield for each period for which a statement of net assets available for benefits is presented. We believe that the disclosure of the average yield during a period should be required for each period for which a statement of changes in net assets available for benefits is presented.

* * * * * *

We would be pleased to discuss our comments with the Employee Benefit Plans Committee.

Very truly yours,

Price Waterhouse

FINANCIAL EXECUTIVES
INSTITUTE

Joseph A. Sciarrino
Vice President and Technical Director

December 10, 1993

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Technical Manager
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New York, NY 10036-8775

Dear Ms. Hicks:

The Committee on Corporate Reporting (CCR) of the Financial Executives Institute (FEI) is pleased to comment on the AICPA's September 15, 1993 proposed Statement of Position (SOP) entitled, "Reporting of Investment Contracts Held By Health and Welfare Plans and Defined-Contribution Pensions Plans."

Although CCR believes the proposed SOP represents an improvement to SOP 92-6 and the AICPA Audit and Accounting Guide, "Audits of Employee Benefit Plans," by expanding the circumstances under which reporting at contract value is appropriate beyond contracts with insurance companies, it opposes the requirement to report individual investment contracts contained in defined contribution plans at fair value. In assessing benefit responsiveness, the Committee believes the plan assets as a whole, including any guarantees, should be the criterion as opposed to individual investment contracts. In this regard, if a plan as a whole is determined to be "fully benefit responsive," individual contracts should be recorded at contract value.

Fair value reporting requirements for contracts not deemed to be fully responsive because of plan restrictions appear appropriate. However, we disagree with the "reasonable access" component of the definition of "fully responsive" contained in paragraph ten. If the plan provides that the benefits to be provided are at contract value, the plan should be reported at contract value regardless of the timing of the availability of those benefits to individual participants. It is not appropriate for an accounting standard to attempt to dictate the structure of a benefit plan by specifying how and when a participant may access his funds.

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If the final SOP continues to require application of fully benefit responsive criteria on an individual contract basis, the transition requirements should be modified to allow prospective application to investment contracts purchased (by defined contribution plans) after the SOP's effective date. Prospective treatment is necessary to prevent plan participants from incurring incremental costs that may result from modifying or selling existing non-benefit responsive contracts to make plans fully benefit responsive.

Paragraph four of the ED discusses the applicability of SFAS No. 5 on the reporting of investment contracts. CCR believes the proposed SOP should provide detailed examples of fully benefit responsive investment contracts that should be reported at less than contract value. Moreover, the example provided should be modified as follows . . . " or the reasonable probability of premature termination of the contract by the plan."

Finally, CCR opposes any requirement to disclose a market rate of interest for fully benefit responsive contracts that are reported at contract value. Any linkage between a market rate of interest and reporting at contract value is problematic and potentially misleading.

This response was developed by the AICPA Subcommittee of the CCR. The individual on the Subcommittee who prepared the response was Dave FitzPatrick of General Motors. Should you have any questions or comments, he can be reached at (313) 556-4167.

Sincerely,

J. A. Sciarrino

Joseph A. Sciarrino

JAS/afc

Metropolitan Life Insurance Company
One Madison Avenue, New York, NY 10010-3690

MetLife®

Fred P. Hauser, F.S.A.
Senior Vice-President and Controller

Ms. Susan W. Hicks
Technical Manager
Federal Government Division, File Q-1-505
American Institute of Certified Public Accountants
1455 Pennsylvania Avenue, N.W.
Washington, D.C. 20004-1081

Dear Ms. Hicks:

Metropolitan Life Insurance Company appreciates this opportunity to respond to the American Institute of Certified Public Accountants' (AICPA) Proposed Statement of Position, "Reporting of Investment Contracts Held by Health and Welfare Benefit Plans and Defined-Contribution Pension Plans." We strongly support the Committee's conclusion that defined-contribution plans should report investment contracts with fully benefit responsive features at contract value.

MetLife suggests that the Committee reconsider the criteria for reasonable access at the plan level as a qualification for contracts to be deemed fully benefit responsive. We feel that the qualification for benefit responsiveness should remain at the contract level. The access in certain plans, such as money purchase plans, is restricted because of Internal Revenue Service regulations. Participants in such plans currently enjoy the same benefit guarantees under investment contracts as do participants in plans which have more liberal access provisions, and therefore need the same contract value information. We believe that the use of fair value for plans with more restrictive access provisions would create inconsistencies and inequalities with reporting financial information for contracts containing benefit responsive features.

Further, we believe that the proposed change to the last sentence of paragraph 7.37 of the AICPA Audit and Accounting Guide <u>Audits of Employee Benefit Plans</u> should be modified to state that "These contracts are unallocated and are to be included as plan assets at either their contract or fair values, as appropriate." This modification would reflect the Committee's view that contract value is the most meaningful information for participants in fully benefit responsive investment contracts. Similarly, we also believe that the proposed change to the third bullet of paragraph 7.39b of the AICPA Guide should be modified to state that the contract value, and not the fair value of funds invested in fully benefit responsive contracts should be confirmed.

We support the exclusion of a requirement for disclosure of a market rate of interest. The determination of such a market rate would be inherently arbitrary and subjective. It would also not be meaningful to fully benefit-responsive contractholders, who are guaranteed access at contract and not at market value.

The Committee has requested comment regarding the proposed effective date and transition. We feel that there is not sufficient time to implement this Statement of Position for plan years beginning after December 15, 1993, and therefore the effective date should be postponed.

We would be pleased to discuss our comments on the Proposal with the Committee or staff.

Sincerely,

Fred Hauser

Fred P. Hauser
Senior Vice-President and Controller

December 10, 1993

J. Michael Kelly
Vice President - Controller

GTE Corporation

One Stamford Forum
Stamford, CT 06904
203 965-2000

December 13, 1993

Ms. Susan W. Hicks
Technical Manager
Federal Government Division
File Q-1-505
AICPA
1455 Pennsylvania Avenue, N.W.
Washington, DC 20004-1081

Dear Ms. Hicks:

GTE is pleased to have the opportunity to comment on the AICPA's proposed Statement of Position, "Reporting of Investment Contracts Held by Health and Welfare Benefit Plans and Defined-Contribution Pension Plans". GTE is the largest U.S. based local-telephone company and the second-largest cellular-telephone company in the United States, based on the population of our market areas served. Other GTE businesses include telephone directories, government systems, satellite-based telecommunications and telecommunications products and services. GTE is a preparer of financial statements that include such contracts.

In general, we support the provisions of the proposed statement. In order to ensure that preparers have sufficient time to apply its provisions, however, we recommend that the effective date not occur until the year following the issuance of the final statement. We agree that the provisions of the statement, once finalized, should be adopted as of the beginning of the year and that restatement of prior years financial statements is not necessary.

We support the proposal to report benefit responsive contracts at contract value and non-benefit responsive contracts at fair market value. We also support the disclosures of:

- the average yield on benefit responsive investment contracts for each period for which a statement of net assets available for benefits is presented;
- any significant adverse change in the credit worthiness of the issuer of such a contract; and
- the amount of valuation reserves recorded against such contracts, if any.

In response to your question, we believe that the average yield on benefit responsive investment contracts is the most relevant interest rate related information to users of financial statements of this nature. The disclosure of the current market rate of interest for similar benefit responsive contracts or any other interest rate information is considered unnecessary. Users of financial statements have numerous sources of market information against which to evaluate returns on investment contracts.

GTE is pleased to have had the opportunity to express its opinions regarding the AICPA's proposed statement of position.

Very truly yours,

J. Michael Kelly

J. Michael Kelly

JMK:pb

Aetna

151 Farmington Avenue
Hartford, CT 06156

James A. Geyer
Vice President & Actuary
Guaranteed Products, YCC3
203-275-4514
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December 15, 1993

Ms. Susan W. Hicks
Technical Manager
Federal Government Division
File Q-1-505
AICPA
1455 Pennsylvania Avenue, N.W.
Washington, D.C. 20004-1081

RE: PROPOSED STATEMENT OF POSITION: REPORTING OF INVESTMENT CONTRACTS HELD BY HEALTH AND WELFARE BENEFIT PLANS AND DEFINED CONTRIBUTION PENSION PLANS

Dear Ms. Hicks:

I appreciate this opportunity to comment on the Exposure Draft. My comments reflect those of Aetna's large case pension business unit. You have received a separate letter from our Aetna Life Insurance and Annuity Company (ALIAC) business units, which market to smaller employers. Aetna decided to issue separate letters to give you a sense for the different issues and concerns that are present in the small vs. large case business units.

Overall, we found the Exposure Draft well thought out, with appropriate conclusions drawn that contract value reporting represents the most meaningful basis for the reporting of benefit responsive contracts. We have seen and participated in drafting the ACLI response to you, and agree with all of the comments being made there. To summarize these:

- "Reasonable Access" - potential for confusion in interpretation

- Effective date - too soon; should be 12/15/94.

- Transition Rules - there should be reasonable rules provided, for example, for existing fixed maturity contracts which represent a reasonably small percentage of a sponsor's total assets.

- Disclosure of market interest rate - too complex and unlikely to add meaningful or useful data.

- Proposed changes to 7-37 and 7-39 b - need to clarify that fair value disclosure is not needed for fully benefit responsive contracts.

Rather than expanding further on all these points, we will focus on several additional concerns not presented in the ACLI letter, plus address a few extra points on the "reasonable access" issue.

Definition of Fully Benefit Responsive

We believe the definition is too extreme, in that it suggests that any limitations on participant withdrawals or transfers in an investment contract, and perhaps even in the plan, will cause a contract to fail the definition. This appears to potentially contradict the fundamental principles you have laid out (which we fully support), namely,

- the objective of a plan's summary level reporting is to give users information regarding the plan's ability to pay benefits when due,

- values should be reported that are meaningful to financial statement users, and

- plan participants are the primary users for defined contribution plans.

Given this, we believe the two crucial tests for whether contract value reporting should be used are: (1) that participants' primary rights to their account balances under the plan are stated in terms of contract values, and (2) that the terms of the investment contract regarding benefit responsiveness are substantially aligned with participants' rights under the plan. Stated differently, if the plans' liability to participants is stated in contract value terms, and if the plans' assets (i.e., its investment contracts) support these contract value obligations to participants, then contract value reporting by the plan for both its assets and liabilities will provide the most meaningful information.

The proposed draft includes the guidance that "if access to funds is substantially restricted by plan provisions, investment contracts held by those plans may not be considered to be fully benefit responsive" (paragraph 10). This clause is inconsistent with the basic principles articulated above and will likely create much concern and confusion among plan sponsors and their auditors. Where does one draw the line for "substantially restricted"? Most plans do have restrictions on transfers by participants between the stable value fund option and "competing funds" such as money market funds, but allow transfers between the stable value option and all other plan funding options. I assume that this is not a "substantial restriction", since participants still have reasonable access to their funds, but I suspect that others may disagree.

The concept of "substantially restricted by plan provisions" does not fit with the basic principles presented. The more important concept should be that a plan's obligations to participants are defined in contract value terms, not whether participants can withdraw/transfer their funds at any time without restriction. The nature of stable value funds is that there must be reasonable restrictions on withdrawals and transfers to mitigate reinvestment and disintermediation risks; otherwise no one would be willing to write stable value benefit responsive contracts, except perhaps with very short term interest guarantees.

My second crucial test suggested was a need to have contract restrictions aligned with plan restrictions. The draft appears to recognize this with the words "investment contracts must...provide for all participants-initiated transactions <u>permitted by an ongoing plan</u> and contract value with no conditions, limits, or restrictions" (paragraph 10; emphasis added). I believe your intent is that investment contracts can have "conditions, limitations, or restrictions", as long as those restrictions are aligned with restrictions in the plan. Unfortunately, as presented, these words are already causing much confusion; several plan sponsors have contacted us to express their concerns that restrictions in our contracts and their plans will cause problems.

The words "no conditions, no limits, or restrictions" appear more absolute than intended. The examples in A.8.a. and A.8.b indicate that plan termination, plan spin-off, plan amendment, and layoff restrictions do not invalidate contract value reporting. You seem to be on the right track, but using the absolute words in the text and then these examples in the back will cause confusion as to what restrictions are OK vs. not OK. We suggest adding a principle in the text that contract restrictions that refer to events that are out-of-the-ordinary and not anticipated at the time the financial statements are prepared, such as plan termination, etc., do not invalidate contract value reporting.

<u>Use of the Word "Guarantee"</u>

The definition of fully benefit-responsive contracts in the AICPA draft includes the wording "provides a guarantee by a financially responsible third party of principal and previously accrued interest...". This wording is potentially confusing. First, some might read "third party" as being other than the insurer who wrote the benefit responsive GIC or similar contract. Some parts of the financial community associate the word "guarantee" with coverages that only financial guarantee insurance companies can offer, and thus could conclude that they need to purchase an additional "wrap" to qualify for contract value accounting.

This (inappropriate) view could be reinforced by reference to paragraph 4, where the SOP speaks of "a decline in the credit worthiness of the contract issuer <u>or</u> third party guarantor" this potential confusion could be cleared up by adding "(if different from contract issuer)" after the word "guarantor".

GIC Pools

The SOP may adversely affect GIC pooled products. GIC pools are generally trusts or insurance company separate accounts that purchase GICs from multiple other insurers; defined contribution plans buy into the pool and share in the underlying GICs. The GICs are written to provide full benefit responsiveness to the plans participating in the pool and all transactions between the plan sponsor and the pool are at contract value.

GIC pools have become very popular investment vehicles for defined contribution plans. In fact, according to an article in the November 29, 1993 issue of Pensions and Investments, there were $15.5 billion invested in GIC pools at 9/30/93, up $4.3 billion from 9/30/92.

The potential problem with the draft arises from the last sentence in paragraph 10, i.e., that "contracts that provide for prospective interest adjustments may still be fully benefit responsive provided that the terms of the contract specify that the crediting interest rate cannot be less than 0" (emphasis added).

A GIC pool contract might be viewed as one that provides for "prospective interest adjustments" since interest earned is a function of the investment income the pool realizes on all of the GIC contracts. Interest rates for the life of the contract or even the next accounting period are not set in advance; instead, investment earnings are determined at the end of each accounting period. However, the GIC pool contract itself does not provide or "specify" any explicit guarantee, even 0%, to the plan sponsor. However, each plan sponsor does implicitly share in the guarantees of the underlying GICs and their benefit responsiveness.

Most GIC pool providers would not want to issue a 0% guarantee, since doing so would expose them to credit risk. However, this should not invalidate contract value reporting, just as regular GIC purchases are OK unless there has been a material decline in the creditworthiness of a contract issuer (as noted in paragraph 4).

We believe contract value is clearly appropriate for GIC pool contracts, since the true substance of benefit responsiveness is no different for a plan that purchases multiple benefit responsive GIC contracts itself vs. a plan that invests in a GIC pool which in turn invests in multiple benefit responsive GICs. To eliminate any possible confusion on this point, we suggest changing the last sentence to "still be fully benefit responsive provided that the crediting rate cannot be less than zero." This recognizes the implicit guarantees that are present through the underlying GICs, but does not require an explicit guarantee in the GIC

pool contract itself. If credit problems develop which could threaten the 0%, these should be handled as in paragraph 4.

Thank you again for this opportunity to comment. If I can be of any assistance, or if you would like any further explanation regarding the points made above, please do not hesitate to call (203-275-4514).

Sincerely,

J. A. Geyer

James A. Geyer

jag845:cmd

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ITT

ITT Corporation

World Headquarters

Merlin L. Alper
Vice President and
Deputy Controller

December 20, 1993

Ms. Susan W. Hicks
Technical Manager, Federal Government Division
File Q-1-505
American Institute of Certified Public Accountants
1455 Pennsylvania Avenue, NW
Washington, D.C. 2004-1081

Subject: Draft SOP: Reporting of Investment Contracts Held by Health and Welfare Benefit and Defined-Contribution Pension Plans ("Plans")

Thank you for the opportunity to comment on the draft SOP ("ED"), which specifies that "fully benefit responsive" investment contracts held by the Plans are to be reported at contract values, and that Plans report other investment contracts at fair value. We support the general objective to measure and report at "values that are meaningful to financial statement users" (ED paragraph 8), but it appears to us that the ED defines too narrowly circumstances for which contract values are the most relevant measures.

The ED proposals for choosing between contract-value and fair-value accounting are presented in the context of SFAS No. 110, which (a) required that defined benefit pension plans report investment contracts at fair value, and (b) asked the AICPA to review valuation for defined-contribution plans.

Reporting at fair value for defined benefit plans in Statement No. 110 was adopted as most relevant to "the plan's ability to pay benefits." The FASB considered and rejected the argument that defined benefit plans receive contract value at maturity of investment contracts and should report on that basis.

Subsequently, however, the FASB issued Statement No. 115, which includes reporting held-to-maturity debt securities at amortized cost. While Statement No. 115 literally does not cover "investment contracts," debt securities and investment contracts seem to be nearly identical in substance. In fact, in Statement No. 97, the FASB said that "... accounting for investment contracts issued by insurance enterprises should be consistent with the accounting for interest-bearing and other financial instruments" (cited in SFAS No. 110 as part of the rationale for reporting investment contracts at fair value).

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Telephone (212) 258-1808

It is not clear to us that Statements No's. 97, 110, and 115 provide a clear context necessitating fair-value reporting for some of the circumstances in the scope of the ED. We do not see reasons for the conclusion in ED paragraph 10 that if members' access to plan funds is available only upon termination of their participation (thereby failing the "reasonable access to funds" criterion proposed in the ED), then contract value reporting would not be permitted. We believe that it is more reasonable and more consistent with analogous situations in GAAP for defined contribution plans to report investment contracts at contract value unless the contract is impaired or will not be held to maturity. (Incidentally, comments on draft SOP's would be helped substantially by inclusion of "basis for conclusions" section to explain the ED's underlying rationale.)

There will be a disconnect between (a) contract value commitments to participants in technically not-fully-benefit responsive contracts, and (b) fair-value reports that participants will receive. The proposed reporting will not be meaningful to such participants.

The ED asked for respondents' views on requiring disclosures of market rates of interest for contracts reported at contract value. We believe that such disclosure would be unnecessary, confusing to users/plan participants, and difficult to implement.

We think that the proposed application for plan years beginning after December 15, 1993, provides too little time for plans to convert to the new reporting basis, whatever that might be; plans that perform monthly valuations would need to convert to the new basis for the end of the next month. We suggest application for plan years beginning after December 15, 1994.

Sincerely,

M. L. Alper

FLORIDA INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

325 WEST COLLEGE AVENUE • P.O. BOX 5437 • TALLAHASSEE, FLORIDA 32314
TELEPHONE (904) 224-2727

November 15, 1993

Susan W. Hicks, Technical Manager
Federal Government Division
American Institute of Certified Public Accountants
1455 Pennsylvania Avenue, N.W.
Washington, D.C. 20004-1081

RE: File Q-1-505

Dear Ms. Hicks:

This comment letter sets forth the views of the Accounting Principles and Auditing Standards Committee of the Florida Institute of Certified Public Accountants (the "FICPA Committee") on the AICPA's Proposed Statement of Position, "Reporting of Investment Contracts Held by Health and Welfare Benefit Plans and Defined-Contribution Pension Plans."

The comments in this letter were derived from a discussion of the SOP in a recent meeting attended by ten members of the FICPA Committee. The members who participated in this discussion collectively possess a broad knowledge of health and welfare benefit plans and defined-contribution pension plans.

GENERAL COMMENTS

In general, the Committee endorses the proposed statement of position, believing that is a reasonable follow-up to Financial Accounting Standard No. 110 and will provide greater consistency of financial reporting among various types of benefit plans.

SPECIFIC COMMENTS

With respect to specific comments solicited by the AICPA, we have the following responses:

- The FICPA Committee believes the effective date of this Statement of Position should be for plan years beginning after the date of final adoption of such a statement of position. (Paragraph 17).

- Although the FICPA Committee believes that some statement of rate disclosure may be useful to the financial statement user, we were unable to determine how to define a rate that would be a reasonable disclosure.

- The FICPA Committee is not aware of any ERISA or Internal Revenue Code issues that would conflict with this proposed statement of position.

CONCLUSION

In conclusion, we believe that this proposed statement of position is a reasonable approach to accounting for investment contracts by defined-contribution and health and welfare benefit plans and could be issued in its present form with the exception of pushing back the effective date as discussed above.

We appreciate the opportunity to provide this response to the Exposure Draft. Representatives of this Committee are available to discuss the contents of this letter with the AICPA.

Sincerely,

Stephen H. Kattell, C.P.A., M.B.A.
Chairman
(904)468-5340
Committee on Accounting Principles and Auditing Standards
Florida Institute of Certified Public Accountants

Response Coordinated by Audrey W. Lewis

MORLEY
CAPITAL
MANAGEMENT, INC.

December 14, 1993

Ms. Susan W. Hicks
Technical Manager
Federal Government Division, File Q-1-505
AICPA
1455 Pennsylvania Avenue, N.W.
Washington, D.C. 20004-1081

Re: Exposure Draft - Proposed Statement of Position on Reporting of Investment Contracts Held by Health & Welfare Benefit Plans and Defined-Contribution Pension Plans.

Dear Ms. Hicks:

Morley Capital Management was the first stable asset manager to become a registered investment advisor. Founded in 1982, we presently manage over $6 billion in stable assets, 65% in separate client portfolios and 35% in open-ended stable asset pooled funds. Our clients (representative list attached) represent a broad spectrum of institutional stable asset investors.

On behalf of these clients, we are submitting comments on the AICPA's September 15, 1993 Exposure Draft entitled "Proposed Statement of Position on Reporting of Investment Contracts Held by Health & Welfare Benefit Plans and Defined-Contribution Pension Plans." The following is our response and you will note is almost identical to that which was submitted by the GIC Association valuation committee. Our firm actively participated in this committee and we believe this response reflects the opinions of the clients we serve.

In general, we support the proposed Statement of Position and believe this standard in many ways will improve current practice.

In response to your specific request for comments, we would like to submit the following input.

1. Timing of Implementation: Page 16 - Paragraph 17
We recommend that the effective date of this SOP be for financial statements with plan years beginning after December 15, 1994. We believe this is reasonable because there will not be enough time between the comment period ending December 15, 1993 for the AICPA to review comments, issue the SOP, and have plan fiduciaries comply with the SOP between December 15, 1993 and January 1, 1994.

In addition, we recommend a transition period for contracts -- presently held in health & welfare and defined contribution pension plans and purchased prior to September 15, 1993 -- that do not presently meet all of the proposed requirements to be considered "fully benefit responsive." This would be consistent with the FAS No. 110 which grandfathered DAs and IPGs issued prior to the date of the exposure draft.

We believe these contracts should continue to be valued at contract value until plan years beginning after December 15, 1998. We make this recommendation because the present contracts were purchased on behalf of plan participants with the understanding that they would be carried at

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contract value. To change the valuation methodology on existing contracts could cause undue concern about the meaningful value of the account statement balances and/or financial damage to the plan participants. Fair valuation of existing contracts resulting in a premium or a discount would create a bias against participants entering or exiting the fund, and create significant confusion regarding appropriate valuation of actual benefit payments.

Should plan sponsors wish to maintain a stable value portfolio as an investment option for their participants, this transition period would enable them to restructure the type of contracts purchased to comply with the "fully benefit responsive" provisions of this proposal. Requiring immediate compliance for previously placed contracts might result in a significant cost to plan participants, either through unexpected wrap charges or lower yield if contract provisions were renegotiated. For many contracts this might not even be possible.

The proposed transition period would also limit the difficulty and expense inherent in trying to value partially benefit responsive contracts.

2. Inclusion of Market Interest Rate: SOP Cover Letter
Relating to the issue of reporting a "market rate of interest for fully benefit responsive contracts," we suggest that the current SOP without this requirement is appropriate. Market values are only appropriate in certain circumstances such as: when there is an active secondary market, the issuer is financially unsound, the contract is not fully benefit responsive, or a triggering event has occurred which will result in premature termination. Otherwise, contract value is the only appropriate valuation that should be reported. The main issue is: "What can the participant expect to receive at the present point in time if the account is accessed?" Any valuation or interest-rate scenario that differs from the value that would be received would, at best, confuse the primary users of the financial statements and, in the worse case, mislead these plan participants.

3. Valuation Implications Due to Plan Restrictions: SOP Cover Letter
We are not currently aware of any ERISA or IRS Codes implications that, by definition, will arise from a plan restriction causing a contract to be valued at other than contract value. It is not a matter that has been extensively researched by our organization. This issue should be specifically addressed to the Department of Labor and the IRS.

We are concerned that the plan not be required to create a situation in which it would increase its fiduciary liability exposure. This might occur if a plan is required to report contracts at fair value when they are unable to deliver fair value to participants when contracts held in the portfolio are accessed.

Each plan sponsor must comply with its fiduciary responsibility to disclose any material items that will impact the plan participant and the value of plan assets. This is done through many means in addition to plan financial statements: SPDs, participant communications, mandated education -ala DOL 404(c)- and periodic participant statements. Disclosure should include: restrictions that will impact contract valuation, liquidity provisions, access restrictions, rates of return, penalties on any withdrawal or transfer and any significant event that will affect the value of plan assets. However, we believe that each plan fiduciary should have the discretion to determine the best means to fulfill its responsibility to disclose financial information to plan participants.

Therefore, no further disclosure should be required in the SOP other than fulfillment of current fiduciary reporting responsibility.

4. Types of Plans Covered: Page 8-9 - Paragraph 10; Page 11 - Paragraph #15(e)(3.18); Page 13 - Paragraph #15(i)(4.14); Page 15-16 - Paragraph #16(c)(30)
We recommend that full benefit responsiveness be defined as it was in the 2/17/93 draft SOP. This prior SOP defined full benefit responsiveness as permitting all participant-initiated requests permitted by the plan to be withdrawn at contract value.

If this recommendation were adopted, it would entail deleting the following section in each of the above listed paragraphs:

"For example, if plan participants are allowed access at contract value to all or a portion of their account balances only upon termination of their participation in the plan, it would not be considered reasonable access and, therefore, investment contracts held by that plan would generally not be deemed to be fully benefit responsive. If however, a plan limits participants' access to their account balances to certain specified times during the year (for example, semiannually or quarterly) to control the administrative costs of the plan, that limitation generally would not affect the benefit responsiveness of the investment contracts held by that plan."

As currently written, the proposed SOP and its definition of fully benefit responsive contracts addresses issues relating primarily to 401(k)-type plans. There are other defined contribution plans, such as many multi-employer (Taft-Hartley) annuity plans, and some Section 457 and profit sharing plans which currently have benefit responsive contracts that will not meet the proposed "access" standards defined in the SOP. The contracts within these plans still transfer the risk of benefit payments, as designed by the plan, to a financially responsible third party. The participants of these plans are still the main users of the financial statements and bear the investment risk of the portfolio. Selection of a contract-valued asset by the plan fiduciary was made specifically to provide a stable return for conservative plan participants. Any adjustment in value from contract value will create significant concern among these plan participants and might force them to invest in shorter-term, lower-yielding assets to provide stable valuation. In the long run, this would significantly impact the retirement benefits of millions of participants.

If necessary, reasonable access examples might be contained in the "Application of Fair Value & Contract Value Reporting For Defined-Contribution Plan Investments" attached to the SOP. In our Attachment A, we have included examples of reasonable access for the different types of plans, both Health & Welfare and Defined-Contribution Pension Funds.

In conclusion, the SOP will be a positive event for investors in stable asset investments. There are a number of significant issues that should be clarified, and we hope this brief commentary will be useful in defining the outstanding issues.

Thank you for the opportunity to present our views. We look forward to the issuance of the final SOP. Please feel free to contact me with any questions.

Cordially

Harold H. Morley

Harold H. Morley
President/CEO

enc.

ATTACHMENT A

Example #1: Benefit responsive contracts in a participant elected deferred compensation plan, such as a 401(k) plan.

For participant directed deferred compensation plans, it would not be considered reasonable access to plan assets if plan participants are only allowed access at contract value to all or a portion of their account balances upon termination of their participation in the plan. Therefore, investment contracts held by this type of plan would generally not be deemed to be fully benefit responsive. If, however, a plan limits participants' access to their account balances to certain specified times during the year (for example, semiannually or quarterly) to control the administrative costs of the plan, that limitation generally would not affect the benefit responsiveness of the investment contracts held by that plan.

Example #2: Contracts in a health & welfare plans (e.g. medical, vacation, strike fund, training funds, etc.)

Investment contracts in a health & welfare fund may be deemed to be fully benefit responsive if all participant initiated events allowed under the plan can be paid at contract value. These events may be either voluntary (e.g. taking accrued vacation & applying for training programs) or involuntary (e.g. applying for strike benefits & medical payments due to claims.) Should 100% of the benefits allowed under each plan not be covered under the benefit responsive provisions, the contracts would generally not be deemed to be fully benefit responsive and should be carried at fair value for any portion of the contract that will not cover plan allowed benefits.

Example # 3: Contracts held in Taft-Hartley annuity plans or some non-participant directed Section 457 plans.

In these plans, reasonable access is determined by the purpose of the plan and is contained within the collective bargaining agreement which establishes and supports the plan. Each negotiating cycle, official representatives of the plan participants and employers are able to negotiate on the issue of reasonable access in the specified plan. Since the participants of these plans are the primary users of the financial statements, bear the investment risk of their accounts, and participate in the definition of the benefits allowed under the plan, all investment contracts which cover 100% of the benefits due under the plan can be considered benefit responsive. Contracts which do not cover 100% of the benefits of the plan generally would not be deemed to be fully benefit responsive and should be carried at fair value for any portion of the contract that will not cover allowed benefits.

Example # 4: Contracts held in Employer Directed Profit Sharing plans.

In these plans also, reasonable access is determined by the purpose of the plan. Plans which contain provisions that allow withdrawals, at no penalty, prior to termination from the plan should also be deemed to have granted reasonable access. The participants of these plans are the primary users of the financial statements, bear the investment risk of their accounts, and can determine the timing of withdrawals. All investment contracts which cover 100% of the benefits due under the plan can be considered benefit responsive. Contracts which do not cover 100% of the benefits of the plan generally would not be deemed to be fully benefit responsive and should be carried at fair value for any portion of the contract that will not cover allowed benefits.

MORLEY CAPITAL MANAGEMENT
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SBS Trust Company
State of California Deferred Compensation Plan
Stone Container Corporation
Tektronix, Inc.

Taft-Hartley Clients

Hotel & Restaurant Employees International Union Pension Fund
IBEW-NECA (Over 70 local unions and chapters participating)
Indiana State Council of Plasterers & Cement Masons Pension Fund
Indiana State Council of Carpenters Pension Fund
Intermountain Iron Workers Tax Deferral Plan
Joint Industry Board of the Electrical Industry
Kansas Construction Trades Open End Pension Trust Fund
National Asbestos Workers Pension Fund
No. California Retail Clerks Pension & Individual Account Funds
Roofers 195 Annuity & Pension Funds
Southern California Lumber Retirement Trust Fund
Telephone Workers Savings & Security Plan
Timber Operators Council, Inc., International Woodworkers of America

THE NORTHERN TRUST COMPANY
FIFTY SOUTH LA SALLE STREET
CHICAGO, ILLINOIS 60675

TELEPHONE (312) 630-6000

December 15, 1993

Ms. Susan W. Hicks,
Technical Manager
Federal Government Division, File Q-1-505
AICPA
1455 Pennsylvania Ave., N.W.
Washington, D.C. 20004 - 1081

Dear Ms. Hicks:

The following is our response to the Exposure Draft on the Proposed Statement of Position, "Reporting of Investment contracts Held by Health and Welfare Benefit Plans and Defined-Contribution Plans," dated September 15, 1993.

As trustee and/or custodian for the assets of a number of Defined Contribution and Health and Welfare Benefit plans, changing the valuation requirements for investment contracts held by such plans will require a degree of lead time to develop the necessary operational processes of receiving such values from a different party. Until now, such values were derived from statements provided by the GIC issuer. In addition, moving from this current environment will also require a degree of communication with our client base so as to inform them of the new operational manner in which we will be receiving values for their GIC investments.

Rather than an effective date for plan years beginning after December 15, 1993, we would strongly urge that the AICPA change this requirement to begin for plan years beginning after December 15, 1994.

We will be looking forward to the final issuance of your Statement of Position.

Respectfully,

Carlos Hernandez

Carlos Hernandez
Trust Officer

The University
of Alabama
System

Office of Internal Audit - UAH
Madison Hall 212
Huntsville, AL 35899
Phone: (205) 895-6037
Fax: (205) 895-6187
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MEMORANDUM

TO: Jim Robertson, Chair
ASCPA Audit Standards & Procedures Committee

FROM: Sylvia L. Ayers, CPA S L Ayers
Director of Internal Auditing, UAH

SUBJECT: Response to Proposed SOP
"Reporting of Investment Contracts Held by Health and Welfare Benefit Plans and Defined-Contribution Pension Plans"

DATE: November 15, 1993

Effective Date and Transition
Appears reasonable.

Disclosure Requirements
In the AICPA letter accompanying the proposed SOP, it was noted that the AICPA Employee Benefit Plans Committee had considered requiring disclosure of a market rate of interest for fully benefit responsive contracts reported at contract value. I also agree that this additional information would be beneficial to the users of the financial statements, particularly to plan participants. The market interest rate should be based on similar contracts with similar maturity dates and similar quality/media investment features.

Reporting of Contracts
Concur with valuing non-fully benefit responsive contracts at fair value when there are plan restrictions.

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CIGNA Corporation

Hartford, CT 06152
(203) 726-4630

Gary A. Swords
Vice President and
Chief Accounting Officer

December 21, 1993

American Institute of Certified Public Accountants
Federal Government Division
1455 Pennsylvania Avenue, N.W.
Washington, D.C. 20004-1081

RE: File No. Q-1-505

Dear Ms. Hicks:

CIGNA, as a leading provider of benefit plan products and services, has been actively following the development of the Proposed Statement of Position (SOP), "Reporting of Investment Contracts Held By Health and Welfare Benefit Plans and Defined-Contribution Pension Plans," and is pleased to provide comments thereon. We support the proposed SOP's conclusions concerning the importance of reporting relevant information to plan participants and agree that the information useful to plan participants 1.) includes the amounts they would receive currently if they were to withdraw, borrow or transfer funds under plan terms and 2.) is determined by considering whether plan investments provide for payment of benefits to plan participants in accordance with plan terms (fully benefit responsive). However, we strongly believe that significant changes are required to meet the SOP's objectives.

By requiring that plan terms allow a participant reasonable access to funds, we believe that the proposed SOP's definition (in paragraph 10) of a fully benefit responsive contract is inappropriate. We believe that an investment contract's benefit responsiveness should be determined based on a plan participant's access to funds under the plan terms, not the specific terms of such access. As long as the contract is benefit responsive under the plan terms, contract value reporting to plan participants represents the amounts that plan participants would receive under plan terms. If however, a benefit responsive contract is limited by plan terms to paying benefits only after retirement or death, reporting for such a contract at market value, because plan terms limit participant access to funds, would not provide useful information to plan participants. If the contract provides benefits at retirement or death at contract value, versus an alternative plan investment such as a stock fund that pays benefits at market value, then the pertinent information to a plan participant is contract value, regardless of the date that benefits can be received.

The Department of Labor, in fact, requires that the statements of account balances provided by plan sponsors to participants reflect amounts that participants are actually eligible to receive under the terms of the plan. In the case of an investment contract that is benefit responsive under the terms of the plan, but fails to meet the proposed SOP's definition of full benefit responsiveness, application of the proposed SOP would result in a difference between the values in plan financial statements and the amounts shown on the participants' statements of account balances. We believe this disjoint is not useful to plan participants, resulting in plan financial statements that are confusing at best, and potentially misleading.

Paragraph four of the proposed SOP provides examples of an event that may affect the value of a fully benefit responsive contract, including, "...the possibility of premature termination of the contract by the plan." Because this event would be evaluated under the special disclosure requirements of SFAS 5, "Accounting for Contingencies," we believe this language should refer to "... the <u>reasonable</u> possibility of premature termination of the contract by the plan." In addition, we believe that the proposed SOP should provide examples of a fully benefit responsive investment contract that should be reported at less than contract value, such as a probable premature termination of the contract by the plan which would result in a payment to the plan that is less than the contract value.

Paragraph 14 requires disclosures for benefit responsive investment contracts that describe interest crediting rates and terms along with any limitations on guarantees. Because this information is superfluous if the investment contract is carried at fair value, the requirements should be limited to fully benefit responsive contracts carried at contract value.

Finally, the proposed transition requirements should be conformed to paragraphs 8 and 9 of SFAS 110, "Reporting by Defined Benefit Pension Plans of Investment Contracts," as follows:

- Accounting changes to conform to the provisions of the proposed SOP must be implemented by restating the beginning balance of net assets available for plan benefits for the earliest period presented. Allowing implementation at a date other than the beginning of the first plan year presented would reduce the comparability of financial information and its usefulness to plan participants.

- For practical reasons, deposit administration funds purchased by defined benefit healthcare welfare benefit plans prior to the issuance of this proposal should be "grandfathered" and reported at contract value.

In closing, we support the proposed SOP's focus on providing relevant financial information to the primary users of defined contribution plan financial statements but believe that the changes noted above are essential in meeting the objective. We would be happy to provide clarification or additional assistance if necessary.

Very truly yours,

Gary A Swords

Gary A. Swords

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Kwasha Lipton

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December 21, 1993

Ms. Susan W. Hicks
Technical Manager
Federal Government Division
File Q-1-505
AICPA
1455 Pennsylvania Avenue, N.W.
Washington, DC 20004-1081

Re:
AICPA Proposed Statement
Of Position

Dear Ms. Hicks:

The purpose of this letter is to provide you with our comments in regard to the exposure draft of an AICPA proposed Statement of Position (SOP), *Reporting of Investment Contracts Held by Health and Welfare Benefit Plans and Defined-Contribution Pension Plans.* Kwasha Lipton is an employee benefits consulting firm and serves as the recordkeeper for over 160 defined-contribution pension plans covering over 700,000 participants. In addition, Kwasha Lipton has served as the investment consultant for approximately 25 defined contribution pension plans which have in total close to $1 billion in investment contract assets.

Our comments are specifically addressed to defined-contribution pension plans and relate primarily to the requirement to value at fair value those investment contracts that are deemed not to be fully benefit responsive because of plan restrictions. This requirement is contained in paragraph 10 of the proposed SOP. It is not uncommon for an employer to have a retirement plan that imposes certain restrictions on all or a portion of the plan accounts. These restrictions are in place solely for purposes of benefit design; are entirely independent of the plan's investment vehicles; and are in no way controlled by any contract issuer.

Two common plan structures of this type are:

1. Money purchase pension plans which provide for an annual employer contribution to the individual accounts of plan participants. Although plans of this type are defined contribution plans, they are qualified under IRS rules as pension plans. As such, distributions to participants prior to their termination of employment are not allowed. Typically, money purchase plans do not have alternate investment funds which allow for transfers of accumulated balances, nor do they have loan features. It is not uncommon for money purchase plans to be invested partially or fully in investment contract assets.

2. Retirement savings plans which typically incorporate a 401(k) feature that allows for participant contributions to be made on a pre-tax basis. Common plan provisions include company matching contributions, a variety of investment options, the ability to transfer funds among the investment options, in-service withdrawals, and loan provisions. By law, pre-tax contributions may not be withdrawn during employment and prior to age 59-1/2, except under hardship. In addition, some retirement savings plans have provisions that restrict the participant's access to a portion of their funds. For example, some plans mandate that the company matching contributions may not be withdrawn during employment, and must be invested in a "fixed income fund" which, at some times, may be comprised entirely of investment contracts. Upon termination of employment, the full amount of the participant's vested account balance will be available.

In general, we concur with the recommendation that only benefit responsive investment contracts should be reported at contract value. However, we believe that benefit responsiveness should be judged solely on the basis of the terms of the contract and not on the basis of plan provisions that do not directly relate to such contracts.

In determining whether contract value reporting is appropriate, the fact that a participant is not permitted under the plan to make in-service withdrawals or transfers between investment options should not be the controlling factor. Rather, contract value reporting is appropriate so long as the participant is permitted to make contract value withdrawals and transfers whenever such withdrawals or transfers are permitted under the plan, and so long as any plan restrictions do not explicitly reference amounts held in investment contracts. We believe that paragraph 10 of the proposed SOP (and all other references that define "benefit responsiveness") should be changed accordingly.

If this change were made, and if the accounts to which restrictions apply (e.g, pre-tax amounts or money purchase contributions) happen to be invested in an investment contract, that contract could still be considered fully benefit responsive -- for example, where the contract provides that, if every plan participant were to terminate employment on the same day, each participant would receive full payment of his/her account balance with accumulated contract interest.

We believe that this suggested change to the proposed SOP would allow contract value to continue to be used in the majority of situations and would therefore eliminate a great deal of confusion and misunderstanding that will arise on the part of plan participants if fair value is mandated.

In order to avoid even more confusion and misunderstanding we further believe that, wherever fair value is required, it should only be used for purposes of reporting and disclosure for the plan as a whole. Fair value should not be required in the reporting of participant account values, except under extraordinary circumstances, under which FASB Statement No. 5 would so require (for example, a significant decline in the creditworthiness of the contract issuer). This is because the individual investment contracts which comprise the fixed income fund of the retirement savings plan or the money purchase plan are generally structured to provide all amounts on a contract value basis. Typically, each year, a new investment contract is negotiated to accept all participant and company contributions and to pay all plan benefits on a contract value basis. Each contract has a specified maturity date and a guaranteed interest rate for the term of the contract.

Under such a structure, assume a participant has a $100 contribution credited to his account during 1994. Under the terms of the plan's underlying investment contracts, when this participant terminates employment he will receive exactly $100 plus contractual interest earnings. If prevailing interest rates have declined since the underlying investment contract was negotiated, the participant will not receive any more than the $100 principal plus contractual interest earnings. Likewise, if prevailing interest rates have risen since the underlying investment contract was negotiated, the participant will not receive any less than the $100 principal plus contractual interest earnings.

Therefore, except under extraordinary circumstances, reporting fair value for any portion of a participant's account balance would, in our opinion, provide no useful information to the participant, and in many cases will be misleading. The only useful and proper information about an individual participant's account is its current value on a contract value basis, since this is the only basis on which the participant will be able to receive a distribution.

We appreciate the opportunity to provide these comments on the proposed SOP. If you have any questions or would like additional information, please do not hesitate to call.

Respectfully submitted,

R B Root

Randolph B. Root, F.S.A
Partner

Lawrence J. Sher, F.S.A.
Partner

RBR/LJS:wp

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nysscpa

December 15, 1993

Ms. Susan W. Hicks
Technical Manager
Federal Government Division
File Q-1-505
American Institute of CPAs
1455 Pennsylvania Avenue, N.W.
Washington, DC 20004-1081

Re: Proposed Statement of Position Titled "Reporting of Investment Contracts Held by Health and Welfare Benefit Plans and Defined-Contribution Pension Plans

Dear Ms. Hicks:

The New York State Society of Certified Public Accountants is pleased to submit its comments on the subject exposure draft. The comments represent the views of the Society's Financial Accounting Standards Committee.

The Committee basically agreed with the proposed amendment, but would suggest that an effort be made to further clarify the definition of a "fully benefit responsive investment contract" found in paragraphs 9 and 10. For example, what is the degree of "financial responsibility" required of a third party? Is an investment contract fully or not fully benefit responsive if a plan participant has taken retirement at age 55 but is permitted access to the funds only after age 59 1/2? Because of the elusiveness of this newly coined expression in paragraph 9, such clarifications are needed.

The Committee also gave consideration to the issue of requiring disclosure of a market rate of interest for fully benefit responsive contracts reported at contract value. Unfortunately, similar to the experience of the Employee Benefit Plans Committee, the Society's Committee could not reach a consensus on what the market rate should represent.

If you wish to further pursue the comments herein, please let us know and we will arrange for someone from the Committee to contact you.

Sincerely,

Robert Kawa

Robert Kawa, CPA
Chairman, Financial Accounting Standards Committee

Walter M. Primoff

Walter M. Primoff, CPA
Director, Professional Programs

RK/WMP/jz
cc: Financial Accounting Standards Committee
Accounting & Auditing Chairmen
John Burke, CPA

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ALUMINUM COMPANY OF AMERICA
ALCOA BUILDING
PITTSBURGH, PENNSYLVANIA 15219
[illegible]

[illegible]
[illegible]

December 21, 1993

Ms. Susan W. Hicks
Technical Manager, Federal Government Division
American Institute of Certified Public Accountants
1455 Pennsylvania Avenue, N.W.
Washington, DC 20004-1081

RE: File Q-1-505
Reporting of Investment Contracts Held by Health and Welfare Benefit Plans and Defined-Contribution Pension Plans

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Dear Ms. Hicks,

The Aluminum Company of America (Alcoa) appreciates the opportunity to express its views on the AICPA's proposed Statement of Position, "Reporting of Investment Contracts Held by Health and Welfare Benefit Plans and Defined-Contribution Pension Plans". Alcoa generally does not support the position taken by the AICPA in the Exposure Draft. This viewpoint is consistent with Alcoa's response submitted to the Financial Accounting Standards Board on the Exposure Draft of FASB Statement No. 110, "Reporting by Defined Benefit Pension Plans of Investment Contracts".

The exposure draft requirements appear to be based upon the following:

1) FASB Statement No. 110, which requires that defined-benefit pension plans report investment contracts issued by either an insurance entity or other entity at fair value.

2) Fair value provides the most meaningful measure of a defined-contribution plan's present and future ability to pay benefits when due.

3) Defined Contribution Plan participants, the primary users of the financial statements have an interest in monitoring the financial condition of the Plan since they incur the investment risk.

Alcoa agrees "that the primary objective of a defined-contribution plan's financial statements is to provide information that is useful in assessing the plans's present and future ability to pay benefits when due".

Although Alcoa agrees with the intent of the proposed amendment, we disagree that fair value provides the most meaningful measure of a defined contribution plan's ability to pay benefits when due. The amendment would allow "Fully Benefit Responsive" investment contracts to be valued at contract value (which may or may not be fair value), and "other contracts" to be valued at fair value. The result would be inconsistent methods to value these similar contracts. The remainder of this discussion will focus on our belief that all investment contracts issued by insurance companies (referred to as Guaranteed Investment Contracts or GIC's) be valued at contract value. Contract value provides the most meaningful measure of these contracts to the users of the Plan's financial statements.

GIC's are nontradeable financial instruments and therefore the Plan will recognize cash flows according to the terms of the contract. As interest rates move in the market place, the value the these GIC's would fluctuate - if they were tradeable securities and if there was an established market. Since there is no secondary market, recording GIC's at fair value would either overstate or understate the plan's ability to meet present or future benefit payments. Plan participants, the primary users of the financial statements, place their money in GIC options precisely for this reason - to avoid investments such as stocks and bonds, that would expose them to market volatility.

The cost of implementing fair value as the measure of the value of GIC's would be significant without providing the added benefit of a more accurate and reliable means of valuation. Since there is not a secondary market for the contracts, there would be two primary means of measuring fair value.

1) The market value of similar investments with similar terms.

2) The present value of estimated future cash flows of the GIC using a discount rate commensurate with the risks involved.

Both of the fair value methods seem to be deficient in providing an accurate and reliable method of measuring the value of a GIC due to the subjectivity of selecting a similar financial instrument or a discount rate commensurate with the risk of the contract.

Pursuant to FASB Statement No. 5, Accounting for Contingencies, if Plan Management is aware that an event has occurred that may affect the value of a GIC (i.e., decline in creditworthiness of the contract issuer or third party guarantor or possible premature termination of the contract by the Plan), disclosure of the event or reporting the GIC at less than contract value may be appropriate. Under either the fair value or contract value method, the issuer's credit quality would be evaluated when preparing the financial statements. Therefore, we believe that reporting fair value at the time of the event is appropriate.

In summary, we believe that measuring and reporting investment contracts with insurance companies that are held by defined-contribution plans at contract value provides the primary users of the financial statements with the most meaningful information upon which to base their decisions. Our opinion is based upon the following points:

1) Contract value most accurately reflects the plan's ability to meet present and future benefit payments.

2) It is a cost effective method of measurement.

3) The credit quality of the issuer would need to be evaluated under either the fair value or contract value method.

4) Fair value does not provide a realistic interim valuation of a GIC since a GIC is a nontradeable financial instrument in which the holder can only recognize cash flows according to the terms of the contract.

Again, thank you for providing us with this opportunity to respond.

Sincerely,

Earnest J. Edwards

EJE:gpw

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ERNST & YOUNG

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New York, New York 10019

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December 21, 1993

Ms. Susan W. Hicks
Technical Manager
Federal Government Division, File Q-1-505
American Institute of Certified Public Accountants
1455 Pennsylvania Avenue, N.W.
Washington, DC 20004-1081

Proposed Statement of Position "Reporting of Investment Contracts Held by Health and Welfare Benefit Plans and Defined - Contribution Pension Plans"

Dear Ms. Hicks:

We are pleased to provide our comments on the proposed amendment to the AICPA Audit and Accounting Guide, *Audits of Employee Benefit Plans* (the "Audit Guide"), and SOP 92-6, *Accounting and Reporting by Health and Welfare Benefit Plans* referred to above.

We support the conclusion in the proposed SOP that defined contribution plans should report at contract value only those investment contracts with fully benefit responsive features and that other investment contracts should be reported at fair value. We also would accept accounting for *all* investment contracts held by defined contribution plans at contract value, given current practice and the potential disruption the change to fair value might cause for some plans. However, the Financial Accounting Standards Board in Statement 110, *Reporting by Defined Benefit Pension Plans of Investment Contracts,* established the use of fair value in accounting for investment contracts. Accordingly, we believe that, the proposed SOP appropriately recognizes the distinct features of investment contracts that are fully benefit responsive.

We agree with the conclusion in the proposal that disclosure of a market rate of interest for fully benefit responsive contracts should not be required. Given the variety of rates and the variety of investment contract and plan provisions available in the marketplace, we do not believe that such a disclosure would be useful to and or fully understood by plan participants.

Finally, given the expected timing of the release of the final SOP, we believe the effective date should be delayed by one year to years beginning after December 15, 1994.

We appreciate the opportunity to present our comments and would be pleased to discuss any aspect of this letter with the AICPA staff at your convenience.

Very truly yours,

Ernst + Young

APPWP
Association of Private Pension and Welfare Plans

Lynn D. Dudley
Director of
Retirement Policy

December 29, 1993

Susan W. Hicks
Technical Manager
Federal Government Division
File Q-1-505
AICPA
1455 Pennsylvania Avenue, N.W.
Washington, D.C. 20004-1081

Re: AICPA Proposed Statement of Position, Reporting of Investment Contracts Held by Health and Welfare Benefit Plans and Defined Contribution Pension Plans

Dear Ms. Hicks:

The American Institute of Certified Public Accountants ("AICPA") published an exposure draft of the above-captioned proposed Statement of Position ("SOP") dated September 15, 1993. The SOP would allow investment contracts to be reported at contract (book) value provided that certain conditions are satisfied.

The Association of Private Pension and Welfare Plans ("APPWP") membership includes a substantial number of defined contribution plan sponsors, insurance companies and investment firms extremely interested in issues involving investment contracts. The APPWP thus welcomes the opportunity to comment on the AICPA exposure draft on behalf of its membership.

We want to commend the AICPA committee for its efforts in preparing the basic framework proposed for the accounting treatment of investment contracts purchased by qualified defined contribution plans. The focus on the "benefit responsive" features of such contracts provides an appropriate measure of value for plans which define benefits payable to participants in terms of a current lump sum account balance. In addition, the SOP would properly apply the same treatment to similar contracts regardless of whether the issuer is an insurance company, a bank, or another type of financial institution.

The following discussion is intended to respond to the AICPA's solicitation of comments on several issues and to ask for clarification with respect to several aspects of the definition of a benefit responsive investment contract.

(1) Market Rate of Interest Disclosure:

The AICPA letter which accompanied the publication of the exposure draft invited comments whether the SOP should require disclosure of a "market rate" of interest for investment contracts reported at contract value. The basic intent appears to be the creation of an objective benchmark for use by participants making investment decisions.

It is not surprising that the AICPA committee was unable to reach a consensus on this issue. It is even more doubtful that a consensus could be developed in the retirement industry in general regarding a proper benchmark, because the question is actually rather subjective in nature.

Our major concern, however, is that such information may confuse rather than assist participants in terms of what it represents. Plan administrators may well conclude that they must spend more attention on clarifying what the benchmark does not represent than on what the description does represent.

(2) Reasonable Access Requirement:

The AICPA cover letter also asked for comments with respect to the SOP requirement that in order for the contract value standard to apply, the defined contribution plan in question must provide plan participants with "reasonable access" to their plan accounts. The SOP only refers to permissible restrictions based on frequency of access. However, plans restrict access for various reasons:

- A qualified money purchase pension plan may not allow the withdrawal of employer contributions prior to the termination of service.

- Some profit sharing (401(k)) plans retain the account balances of retirees (or employees relatively close to retirement) in the investment contract(s) to avoid investment volatility.

- The investment contract(s) balance may be "frozen" during the period that the investment contract is phased out as an investment option under the plan.

Provided that the investment contract parallels the availability provisions of the plan, and the participant is entitled to contract value whenever he or she has access to the account, contract value appears to provide the only meaningful financial measure of value. Otherwise, the financial statements would provide a different value from that used to determine distributions and exchanges.

(3) Contract Descriptions:

The SOP would require financial statements to provide a general description of rules for changing the contract interest rate and any contract limitations on book value withdrawals. Presumably, the disclosure may be provided for a plan's investment contract portfolio in general terms. Attempting a contract-by-contract narrative for portfolios with a number of contracts would be an exhaustive task at best, and no participant would read such a lengthy document.

In addition, the SOP would require disclosure of the average yield and current interest rate in the aggregate by investment option for each reporting period. It is not clear whether this information would be required on a monthly or quarterly basis. If that is so, the information is not available under current procedures used by most plans.

(4) Contract Termination Provisions:

The examples provided in the SOP Appendix are extremely helpful. We would suggest clarification whether a contract that ceases participant withdrawals/exchanges during the termination phase of the contract would cease to qualify for contract value treatment during the termination period. For example, some "participating" contracts operate in this fashion during a 5-year installment payout period.

(5) Effective Date:

Finally, we suggest that the effective date be deferred until the first plan year beginning after the issuance of the SOP in final form. Only at that time will plans know for sure what information will be required for reporting purposes.

****

We would be pleased to provide any additional information or clarification on these comments or on any other issue which the AICPA may deem useful in putting the SOP into final form.

Sincerely,

Lynn D. Dudley

Lynn D. Dudley
Director of Retirement Policy