MINUTES

Financial Accounting Standards Board

To: Board Members

From: Mike Kramer, ext. 273

Subject: Minutes of the February 9, 2004 Board Meeting **Date:** March 2, 2005

cc: Bielstein, L. Smith, Golden, Petrone, Leisenring, Wilkins, Lott, E. Smith, Laurenzano, Belcher, Thompson, Gabriele, Sutay, FASB Intranet

Topics: Potential FSP: Accounting for fully benefit-responsive investment contracts by certain investment companies

Basis for Discussion: Board memorandum dated February 3, 2005.

Length of Discussion: 10:00 a.m. to 10:45 a.m.

Attendance:

Board members present:	Herz, Batavick, Crooch, Seidman, Trott, and Young
IASB Board/Staff present:	None
Board members absent:	Schipper
Staff in charge of topics:	Belcher
Other Staff at Board table:	L. Smith, Golden, Laurenzano, and Kramer
Outside Participants:	None

Summary of Decisions Reached:

The Board provided direction for the FASB staff in drafting a proposed FASB Staff Position (FSP) to address issues related to the accounting for certain fully benefit-responsive investment contracts held by certain investment companies. The Board reconfirmed that fair value is the appropriate amount at which to measure all investments and derivatives of an investment company. However, the Board was supportive of contract value accounting being appropriate for fully benefit-responsive investment contracts held by certain entities in limited circumstances coupled with enhanced disclosure of the investment contracts. The Board asked the staff to prepare a draft of the proposed FSP for discussion at a future Board meeting that includes the following:

1. The criteria and limited circumstances under which contract value accounting treatment would be appropriate
2. A description of the enhanced quantitative and qualitative disclosures required if contract value is used.

The Board recommended that the staff utilize guidance in AICPA Statement of Position 94-4, *Reporting of Investment Contracts Held by Health and Welfare Plans and Defined-Contribution Pension Plans*, in drafting the proposed FSP.

Objective of the Meeting:

The objective of the meeting was to ask the Board for guidance on drafting a proposed FSP to address issues related to the accounting for certain fully benefit-responsive investment contracts held by investment companies. The objective of this meeting was met.

Matters Discussed and Decisions Reached:

1. Mr. Belcher opened the meeting by providing background and an introduction. The purpose of the meeting was to ask the Board for guidance on the direction the staff should take in drafting an FSP to address issues related to the accounting for certain fully benefit-responsive investment contracts held by certain investment companies. This issue was brought to the attention of the

staff by a letter dated November 30, 2004 from the AICPA's Accounting Standards Executive Committee (AcSEC) and the AICPA's Investment Companies Expert Panel.

2. This issue centers around the accounting for investments in Stable Value Funds, which are primarily offered by defined contribution plans as a conservative investment alternative for its participants. Stable Value Funds have been a popular investment alternative for retirement fund investors over the past decade because they offer competitive returns and provide for safety of principal, as plan participants must transact in the fund at book value or contract value, regardless of changes in the fair value of the underlying securities in the fund. The fund is able to accomplish this by transferring the risk of principal and accrued interest to a financially responsible third party (usually by purchasing a guarantee from an insurance company, called a "wrap" or "wrapper" contract). The mechanics of how a typical wrapper contract operates are included in the audience handout.

3. AICPA Statement of Position 94-4 requires that defined contribution plans report fully benefit-responsive investment contracts at contract value in the overall plan's financial statements, recognizing that this amount may not equal fair value. Stable value funds are available in different legal forms depending on the size of the underlying benefit plan. The larger defined contribution plans have the economies of scale to establish individual account stable value funds that are managed in a separate trust account for the benefit of a single plan. These funds are considered part of the overall benefit plan and account for fully-benefit responsive investment contracts at contract value in accordance with SOP 94-4.

4. Many small and medium-sized plans, however, obtain beneficial ownership interests in bank or collective trust stable value funds by pooling their money with several smaller unaffiliated plans to gain the economies of scale necessary to participate in the stable value marketplace. These bank or collective trust funds are generally required to issue audited stand-alone financial statements as nonregistered investment companies, subject to the accounting and reporting requirements of the AIPCA Investment Company Guide, which requires all investments be reported at fair value. Currently, however, these entities report fully benefit-responsive investment contracts at contract value either by analogy to and upon reliance on guidance in SOP 94-

4 or upon reliance on federal bank regulation which allows contract value for regulatory reporting purposes.

5. The staff was seeking guidance from the Board on whether contract value accounting should be extended in certain circumstances to the bank collective trust funds that are not directly subject to SOP 94-4. Under Alternative A, it is not appropriate for entities subject to the AICPA Investment Company Guide to analogize to SOP 94-4 under any circumstances. Under Alternative B, fair value is the appropriate amount at which to measure all investments and derivatives of an investment company. However, certain entities in limited circumstances will be allowed to account for fully benefit-responsive investment contracts at contract value in accordance with SOP 94-4 if they meet certain criteria. This alternative would require enhanced fair value disclosures for all guaranteed investment contracts (GICs) and synthetic GICs and enhanced disclosures regarding how synthetic GICs affect current and future crediting rates for the fund.

6. Mr. Trott provided some background on SOP 94-4, which was issued when he and Mr. Crooch were members of AcSEC. SOP 94-4 only deals with health and welfare plans. FASB Statement No. 110, *Reporting by Defined Benefit Pension Plans of Investment Contracts*, deals with defined benefit plans and requires the use of fair value. SOP 94-4 is more limited in scope and does not deal with all GICs. Mr. Trott believes that the appropriate accounting is fair value, but is sufficiently concerned about practical concerns to support Alternative B. He stated that he can only support Alternative B if the staff can appropriately determine and define which limited entities will qualify and what additional disclosures will be required.

7. Ms. Seidman said that she reviewed SOP 94-4 and Statement 110 to determine why AcSEC decided to depart from fair value. The basis for conclusions clearly states that contract value is the most useful information for plan participants. Ms. Seidman said that she supports pursuing Alternative B because it clearly defined what would be the most useful information in both the financial statements and the additional disclosures and who would find this information most useful.

8. Mr. Batavick supports Alternative B. Contract value is more relevant information to current and prospective plan participants. Mr. Batavick is sensitive to defining an appropriate scope to determine what types of

arrangements would qualify for contract value. He also agrees with strong, prominent disclosure.

9. Mr. Young has a strong preference for fair value measurement in general. However, the investment vehicles in question provide a lot of value. Mr. Young would support Alternative B if it can be tested to see if these stable value investment vehicles can truly support heavy market strains and still guarantee contract value. If he could be more comfortable with the guaranteed nature of these investments, he would fully support Alternative B.

10. Mr. Crooch believes that the most important information to a participant is how much money is in their fund and how much they will be able to access, even if they are not able to fully withdraw it immediately. If these assets have a stable value, this would be the most useful information.

11. Mr. Belcher explained that participant statements are provided at contract value on a regular basis. However, if plan participants were interested in checking the balance of their accounts, they would look to the plan financial statements. If those statements were provided at fair value, investors may be unclear as to their ability to legally contract with the fund at contract value. The administrative burden is much lower using all contract value.

12. Mr. Golden added that although the plan participant transacts only at contract value, a sophisticated investor would consider market interest rates as well as the current difference between contract value and fair value when determining whether to remain in the plan. This is an example of how fair value disclosures would be most beneficial to plan participants.

13. Mr. Trott added that a plan could list plan assets at fair value and then recognize the deficiency between contract value and fair value as a liability, which could be reconciled and used to determine the direction of future credit rates. He believes that this would be very useful in the disclosures.

14. Mr. Herz mentioned that investors would want to know how investment performance would affect credit rates. Some sort of sensitivity analysis or “stress test” would be useful information. Mr. Herz supports Alternative B.

15. The Board agreed with Alternative B. The Board asked the staff to prepare a draft of the proposed FSP for discussion at a future Board meeting that includes the following:

1. The criteria and limited circumstances under which contract value accounting treatment would be appropriate
2. A description of the enhanced quantitative and qualitative disclosures required if contract value is used.

The Board recommended that the staff utilize guidance in AICPA Statement of Position 94-4, *Reporting of Investment Contracts Held by Health and Welfare Plans and Defined-Contribution Pension Plans*, in drafting the proposed FSP.

16. Mr. Belcher introduced a second issue. The staff was seeking guidance on whether this treatment should also be extended to other stable value investment vehicles, such as IRS Section 529 Savings Plans and/or registered IRA mutual funds.
17. The Board directed the staff to do additional research regarding other stable value investment vehicles in the context of their preparation of the proposed FSP.

Follow-up Items:

None

General Announcements:

None