PROPOSED FASB STAFF POSITION

No. AAG INV-a

Title: Reporting of Fully Benefit-Responsive Investment Contracts Held by Certain Investment Companies Subject to the AICPA Investment Company Guide

Comment Deadline: September 19, 2005

Introduction

1. The Board directed the FASB staff to issue this FASB Staff Position (FSP) to (a) describe the limited circumstances in which the net assets of an investment company (also referred to hereinafter as a fund) should reflect the contract value (which generally equals the principal balance plus accrued interest) of certain investments that it holds and (b) provide a definition of a fully benefit-responsive investment contract. This FSP also provides guidance with respect to the financial statement presentation and disclosure of fully benefit-responsive investment contracts.

2. The guidance in this FSP is applicable to investment companies subject to the AICPA Audit and Accounting Guide, *Investment Companies*. This FSP amends the guidance in AICPA Statement of Position 94-4, *Reporting of Investment Contracts Held by Health and Welfare Benefit Plans and Defined-Contribution Pension Plans,* with respect to the definition of *fully benefit-responsive* and the presentation and disclosure of fully benefit-responsive investment contracts. Amendments to SOP 94-4 will be reflected in the AICPA Audit and Accounting Guide, *Employee Benefit Plans*. This FSP also amends AICPA Statement of Position 92-6, *Accounting and Reporting by Health and Welfare Benefit Plans*. It also amends paragraph 10(h) of FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities,* to effectively remove the scope exception provided for fully benefit-responsive investment contracts reported at contract value in accordance with SOP 94-4. [Appendix B shows the amendments to SOPs 94-4 and SOP 92-6 and Statement 133.]

Background

3. Some employer-sponsored defined-contribution plans offer an investment alternative often referred to as a stable value fund. These funds primarily invest in guaranteed

investment contracts (GICs) issued by banks or insurance companies, referred to as "traditional GICs" and "synthetic GICs." The issuer of a traditional GIC takes a deposit from the fund and purchases investments that are held in the issuer's general account. The issuer is contractually obligated to repay the principal and specified interest guaranteed to the fund. In a synthetic GIC structure, the fund itself owns the underlying assets and purchases a wrapper contract, typically from a bank or insurance company. The issuer of the wrapper contract provides a guarantee that the crediting interest rate (which is the rate earned by participants in the fund for the wrapped portfolio) will never be negative (that is, that there will be no loss of principal or accrued interest). In most synthetic GIC structures, realized and unrealized gains and losses on the securities in the wrapped portfolio are not reflected immediately in the net assets of the fund, but rather are amortized over a multiyear period, usually either the time to maturity or the duration of the investments being wrapped, through adjustments to the future interest crediting rate. For purposes of this FSP, the term *investment contract* refers to a traditional GIC contract or a wrapper contract together with the underlying wrapped portfolio of individual investments.

4. Many of these employer-sponsored defined-contribution plans obtain beneficial ownership interests in bank or collective trust funds, allowing several smaller unaffiliated plans to gain the economies of scale necessary to participate in the stable value marketplace. These collective trust funds are required to issue separate standalone financial statements and are considered investment companies subject to the AICPA investment companies Guide, which requires all investment contracts to be reported at fair value.

5. SOP 94-4 currently requires that fully benefit-responsive investment contracts be reported at contract value in the defined-contribution plan's financial statements.

FASB Staff Position

6. *Question*—Under what circumstances should the net assets of an investment company reflect the contract value of certain investment contracts that it holds?

Answer—All investments (including derivative contracts) held by an investment company should be reported at fair value in accordance with the AICPA investment companies Guide. However, contract value is a relevant measurement attribute for that portion of the net assets of an investment company attributable to fully benefit-responsive investment contracts, provided that the investment company is established under a trust whereby the trust itself is adopted as part of one or more qualified[1] employer-sponsored defined-contribution[2] plans (including both health and welfare benefit plans and pension plans). Contract value is considered a relevant measurement attribute because that is the amount participants in the fund would receive if they were to initiate permitted transactions (for example, withdrawals) under the terms of the underlying defined-contribution plan.

7. *Question*—Under what circumstances should an investment contract be considered fully benefit-responsive?

Answer—An investment contract is considered fully benefit-responsive for purposes of this FSP, if *all* of the following criteria are met for that contract, analyzed on an individual basis:

a. The investment contract is negotiated directly between the fund and the issuer and prohibits the fund from assigning or selling the contract or its proceeds to another party without the consent of the issuer.

b. Either (1) the repayment of principal and interest credited to participants in the fund is guaranteed by the issuer of the investment contract or (2) the fund provides for prospective interest crediting rate adjustments to participants in the fund on a designated pool of investments held by the fund, provided that the terms of the agreement with participants in the fund specify that the crediting interest rate cannot be less than zero. Any potential for a decline in the interest crediting rate below zero must be transferred to a financially responsible third party through a contract generally referred to as a wrapper. If

[1]A *qualified* plan refers to a plan that qualifies under the U.S. Internal Revenue Code by allowing full or partial tax-deferred contributions and tax-deferred investment gains on those contributions.
[2]A *defined contribution plan* is defined in the AICPA employee benefit plans Guide as a plan that "requires an individual account for each participant and provides benefits based on (a) amounts contributed to the participant's account by the employer or employee, (b) investment experience on such amounts, (c) expenses, and (d) any forfeitures allocated to the account. In such plans, plan participants have a vested interest in monitoring the financial condition and operations of the plan since they bear investment risk under these plans, and plan transactions can directly affect their benefits (for example, investment mix, and risk and return)" [Sections 3.02 and 3.16].

an event has occurred that may affect the realization of full contract value for a particular investment contract (for example, a decline in creditworthiness of the contract issuer or wrapper provider), the investment contract shall no longer be considered fully benefit-responsive.

c. The terms of the investment contract require all permitted participant-initiated transactions with the fund to occur at contract value with no conditions, limits, or restrictions. Permitted participant-initiated transactions are those transactions allowed by the underlying defined-contribution plan, such as withdrawals for benefits, loans, or transfers to other funds within the plan.[3]

d. An event that limits the ability for the fund to transact at contract value with the issuer (for example, premature termination of the contracts by the plan, plant closings, layoffs, plan termination, bankruptcy, mergers, and early retirement incentives) must be probable of not occurring.[4]

e. The fund itself must allow participants reasonable access to their funds.[5]

Financial Statement Presentation and Disclosure Requirements

8. The following line items should be separately reported on the balance sheet with a parenthetical reference that such amounts are being reported at fair value:

a. Investments (including traditional GIC contracts)

b. Wrapper contracts.

9. The balance sheet of the fund should present amounts for (a) total assets, (b) total liabilities, (c) net assets at fair value, and (d) net assets. Amount (d)[6] represents the amount at which participants can transact with the fund. The amount representing the difference between (c) and (d) should be presented on the face of the balance sheet as a single amount, calculated as the sum of the amounts necessary to adjust the portion of net

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[3]An investment company registered under the Investment Company Act of 1940 (the Act) would not meet this requirement because Rule 22c-1 under the Act requires transactions between the investment company and its shareholders to be executed at current net asset value. Under Rule 2a-4 of the Act, current net asset value is computed using the fair value of the investment company's portfolio securities.

[4]The term *probable* is used in this FSP consistent with its use in FASB Statement No. 5, *Accounting for Contingencies*.

[5]Paragraph 11 of SOP 94-4 provides guidance for determining whether certain restrictions violate the provision that participants in the investment company have reasonable access to their funds.

[6]This net asset amount should be used for purposes of preparing the per-share disclosures required by sections 7.65 –7.70 of the AICPA investment companies Guide.

assets attributable to each fully benefit-responsive investment contract from fair value to contract value.

10. The following information should be disclosed in footnotes to the financial statements for each investment contract and should reconcile to corresponding line items on the balance sheet:

a. The fair value of the wrapper contract and the fair value of each of the corresponding underlying investments

b. Adjustment from fair value to contract value (if the investment contract is fully benefit-responsive)

c. Major credit ratings of the issuer or wrapper provider.

11. Investment companies subject to this FSP should disclose the following in connection with fully benefit-responsive investment contracts, in the aggregate:

a. A description of the nature of those investment contracts, how they operate, and the methodology for calculating the crediting interest rate, including the key factors that could influence future average crediting interest rates, the basis for and frequency of determining crediting interest-rate resets, and any minimum crediting interest rate under the terms of the contracts. This disclosure should explain the relationship between future crediting rates and the amount reported on the balance sheet representing the adjustment for the portion of net assets attributable to fully benefit-responsive investments from fair value to contract value.

b. A reconciliation between the beginning and ending balance of the amount presented on the balance sheet that represents the difference between net assets at fair value and net assets for each period in which a statement of changes in net assets is presented. This reconciliation should include (1) the net realized and unrealized gain or loss on all fully benefit-responsive investment contracts and (2) the increase or decrease due to changes in the fully benefit-responsive status of the fund's investment contracts.

c. The average yield earned by the fund (irrespective of the interest rate credited to participants in the fund) for each period for which a balance sheet is presented.

d. A schedule of the average historical interest rate credited to participants in the fund (by reset date) covering each period for which a balance sheet is presented.

e. Two sensitivity analyses:

(1) The effect on the average crediting interest rates calculated at the latest balance sheet date and the next four reset dates, under two or more scenarios where there is an immediate hypothetical increase or decrease in interest rates, with no change to the duration of the underlying investment portfolio and no contributions or withdrawals. These scenarios should include, at a minimum, immediate hypothetical changes in interest rates equal to one-quarter and one-half of the current interest rate.

(2) The effect on the average crediting interest rates calculated at the latest balance sheet date and the next four reset dates, under two or more scenarios where there are the same immediate hypothetical changes in interest rates in the first analysis, combined with an immediate hypothetical 15 percent decrease in the net assets of the fund due to participant transfers, with no change to the duration of the portfolio.

f. A description of the events which limit the ability of the fund to transact at contract value with the issuer (for example, premature termination of the contracts by the plan, plant closings, layoffs, plan termination, bankruptcy, mergers, and early retirement incentives), including a statement that the occurrence of such events is not probable.

g. A description of the events and circumstances that would allow issuers to terminate fully benefit-responsive investment contracts with the fund.

Effective Date and Transition

12. The guidance in this FSP, considering the special transition guidance outlined in paragraph 13, is effective for financial statements for annual periods ending after December 15, 2005. Earlier application is permitted. If comparative financial statements are presented, the guidance in this FSP shall be applied retroactively to all prior periods presented.

13. To be considered within the scope of the guidance in this FSP as of the effective date, all, or essentially all, of the investment company's net assets must be held by participants in one or more qualified employer-sponsored defined-contribution plans. In order to be considered within the scope of the guidance in this FSP after the effective date, any portion of the net assets of the investment company that is not held by participants in qualified employer-sponsored defined-contribution plans as of the

effective date is not permitted to increase due to gross contributions, loan repayments, or transfers into the fund.

Appendix A

Example of Financial Statement Presentation and Disclosure

A1. The following is an example of a financial statement presentation and disclosure prepared in accordance with paragraphs 8–10 of this FSP:

Example Balance Sheet Presentation

Investments (at fair value)	$8,800,000
Wrapper contracts (at fair value)	100,000
Total assets	$8,900,000
Total liabilities	200,000
Net assets at fair value	$8,700,000
Adjustment from fair value to contract value for fully benefit-responsive investment contracts	1,100,000
Net assets	$9,800,000

Related Footnote Disclosure

	Major Credit Ratings	Investments at Fair Value	Wrapper Contracts at Fair Value	Adjustment to Contract Value
Traditional GIC A	AAA/Aaa	$1,600,000	—	$ 400,000
Traditional GIC B	AA/Aa1	1,800,000	—	$ 200,000
Wrapped portfolio A:				
Bond #1		850,000	—	—
Bond #2		910,000	—	—
Wrapper		—	40,000	—
Total wrapped portfolio A	AAA/Aa2	1,760,000	40,000	200,000
Wrapped portfolio B:				
Bond #1		850,000	—	—
Bond fund #1		860,000	—	—
Bond #2		930,000	—	—
Wrapper		—	60,000	—
Total wrapped portfolio B	AA-/Aa3	2,640,000	60,000	300,000
Short-term investments	AAA/Aaa	1,000,000	—	—
Total		$8,800,000	$100,000	$1,100,000

Appendix B

Proposed Amendment to SOP 94-4

B1. AICPA Statement of Position 94-4, *Reporting of Investment Contracts Held by Health and Welfare Benefit Plans and Defined-Contribution Pension Plans*, is amended as follows: [Added text is underscored and deleted text is ~~struck out~~.] (Amendments to SOP 94-4 effectively amend corresponding sections of the AICPA Audit and Accounting Guide, *Employee Benefit Plans,* as originally amended by SOP 94-4.)

a. Note:

NOTE

Statements of Position (SOPs) of the Accounting Standards Division present the conclusions of at least two-thirds of the Accounting Standards Executive Committee, which is the senior technical body of the Institute authorized to speak for the Institute in the areas of financial accounting and reporting. Statement on Auditing Standards No. 69, *The Meaning of* Present Fairly in Conformity With Generally Accepted Accounting Principles, identifies AICPA SOPs as sources of established accounting principles that an AICPA member should consider if the accounting treatment of a transaction or event is not specified by a pronouncement covered by Rule 203 of the AICPA Code of Professional Conduct. In such circumstances, the accounting treatment specified by this SOP should be used, or the member should be prepared to justify a conclusion that another treatment better presents the substance of the transaction in the circumstances.

SOP 94-4 is amended by SOP 99-3, *Accounting for and Reporting of Certain Defined Contribution Plan Investments and Other Disclosure Matters.* SOP 99-3 is effective for financial statements for plan years ending after December 15, 1999. Earlier application is encouraged for fiscal years for which annual financial statements have not been issued. If the previously required "by fund" disclosures are eliminated, the reclassification of comparative amounts in financial statements for earlier periods is required.

SOP 94-4 is amended by FASB Staff Position AAG INV-a, “Reporting of Fully Benefit-Responsive Investment Contracts Held by Certain Investment Companies Subject to the AICPA Investment Company Guide.” FSP AAG INV-a is effective for financial statements for plan years ending after December 15, 2005. Earlier application is permitted for fiscal years in which annual financial statements have not been issued. If comparative financial statements are presented, the guidance in this FSP should be applied retroactively to all prior periods presented.

b. Paragraph .03:

This SOP provides guidance on the reporting of investment and insurance contracts held by health and welfare benefit plans and defined-contribution pension plans. It applies to all health and welfare benefit plans and defined-contribution pension plans. The Appendix [paragraph .20] provides guidance for determining whether contract value accounting is appropriate for ~~the values of~~ investment contracts held by defined-contribution plans, including both health and welfare, and pension plans~~;~~ .~~however, certain~~Certain examples may also be useful in determining the fair value of investment contracts held by other types of plans.

c. Paragraph .04:

Defined-benefit health and welfare benefit plans should report investment contracts at fair value. Defined-contribution plans, including both health and welfare and pension plans, should report all ~~fully benefit-responsive investment contracts~~ investments (including derivative contracts) at fair value. However, contract value is a relevant measurement attribute for that portion of the net assets available for benefits of a defined-contribution plan attributable to fully benefit-responsive investment contracts.~~at contract value, which may or may not be equal to fair value, and all other investment contracts at fair value. If, however, plan management is aware that an event has occurred that may affect the value of a fully benefit-responsive contract (for example, a decline in the creditworthiness of the contract issuer or third-party guarantor—if different from the contract issuer—or the possibility of premature termination of the contract by the plan), pursuant to FASB Statement No. 5,~~ ~~*Accounting for Contingencies*~~~~, disclosure of the event or reporting the investment at less than contract value may be appropriate.~~

d. Paragraph .09:

Consistent with the objective of a defined-contribution plan's financial statements, ~~plan~~net assets available for benefits of defined-contribution plans should be measured and reported at values that are meaningful to financial statement users. 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.

e. Paragraph .10:

~~A fully benefit-responsive investment contract (whether with an insurance enterprise or other entity) provides a liquidity 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. From the perspective of the participants, the contract value of a fully benefit-responsive investment contract held by a plan is~~

~~the amount they would receive if they were to initiate transactions under the terms of the ongoing plan.~~

f. Paragraph .11:

An investment contract is considered fully benefit-responsive for purposes of this SOP, if all of the following criteria are met for that contract, analyzed on an individual basis:

a. The investment contract is negotiated directly between the fund and the issuer and prohibits the fund from assigning or selling the contract or its proceeds to another party without the consent of the issuer.

b. Either (1) the repayment of principal and interest credited to participants in the plan is guaranteed by the issuer of the investment contract or (2) the plan provides for prospective interest crediting rate adjustments to participants in the plan on a designated pool of investments held by the plan, provided that the terms of the agreement with participants of the plan specifies that the crediting interest rate cannot be less than zero. Any potential for a decline in the interest crediting rate below zero must be transferred to a financially responsible third party through a contract generally referred to as a wrapper. If an event has occurred that may affect the realization of full contract value for a particular investment contract (for example, a decline in creditworthiness of the contract issuer or wrapper provider), the investment contract shall no longer be considered fully benefit-responsive.

c. The terms of the investment contract require all permitted participant-initiated transactions with the plan to occur at contract value with no conditions, limits, or restrictions. Permitted participant-initiated transactions are those transactions allowed by the plan, such as withdrawals for benefits, loans, or transfers to other funds within the plan.

d. An event that limits the ability for the plan to transact at contract value with the issuer (for example, premature termination of the contracts by the plan, plant closings, layoffs, plan termination, bankruptcy, mergers, and early retirement incentives) must be probable of not occurring.

e. The plan itself must allow participants reasonable access to their funds.

~~For purposes of this SOP, benefit responsiveness is defined as the extent to which a contract's terms or related agreement and the plan itself 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 frequently are negotiated directly between the plan and the issuer and generally prohibit assignment of the contracts or their proceeds to another party. 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. The plan itself must also 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. 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. However, in plans with a single investment fund that allow reasonable access to assets by inactive participants, restrictions on access to assets by active participants consistent with the objective of the plan (for example, retirement or health and welfare benefits) will not affect the benefit responsiveness of the investment contracts held by those single-fund plans. Also, if a plan limits participants' access to their account balances to certain specified times during the plan 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. In addition, administrative provisions that place short-term restrictions (for example, three or six months) on transfers to competing fixed-rate investment options to limit arbitrage among those investment options (*equity wash* provisions) would not affect a contract's benefit responsiveness.

g. Paragraph .12:

If a plan holds multiple contracts, each contract should be evaluated individually for benefit responsiveness. If a plan invests in pooled funds that hold investment contracts, each contract in the pooled fund should be evaluated individually for benefit responsiveness. However, if the pooled fund places any restrictions on access to funds for the payment of benefits, the underlying investment contracts would not be considered fully benefit-responsive. Contracts that provide for prospective interest adjustments may still be fully benefit-responsive provided that the terms of the contracts specify that the crediting interest rate cannot be less than zero. The Appendix [paragraph .20] to this SOP includes examples of the application of ~~fair value and contract value reporting~~<u>the definition of fully benefit-responsive</u> for defined-contribution plan investments.

a. Paragraph .15 and the heading preceding it:

Financial Statement Presentation and Disclosure Requirements

The statement of net assets available for benefits of the plan should present amounts for (1) total assets, (2) total liabilities, (3) net assets at fair value, and (4) net assets available for benefits. The amount representing the difference between (3) and (4) should be presented on the face of the statement of net assets available for benefits as a single amount, calculated as the sum of the amounts necessary to adjust the portion of net assets attributable to each fully benefit-responsive investment contract from fair value to contract value.

Defined-contribution plans, including both health and welfare, and pension plans, should disclose the following in connection with fully benefit-responsive investment contracts, in the aggregate:

a. A description of the nature of those investment contracts, how they operate, and the methodology for calculating the crediting interest rate, including the key factors that could influence future average crediting interest rates, the basis for and frequency of determining crediting interest-rate resets, and any minimum crediting interest rate under the terms of the contracts. This disclosure should explain the relationship between future crediting rates and the amount reported on the statement of net assets available for benefits representing the adjustment for the portion of net assets attributable to fully benefit-responsive investments from fair value to contract value.

b. The average yield earned by the plan (irrespective of the interest rate credited to participants in the plan) for each period for which a statement of net assets available for benefits is presented.

c. A schedule of the average historical interest rate credited to participants in the plan (by reset date) covering each period for which a statement of net assets available for benefits is presented.

d. A description of the events that limit the ability of the plan to transact at contract value with the issuer (for example, premature termination of the contracts by the plan, plant closings, layoffs, plan termination, bankruptcy, mergers, and early retirement incentives), including a statement that the occurrence of such events is not probable. [The term *probable* is used in this Statement consistent with its use in FASB Statement No. 5, *Accounting for Contingencies*.]

e. A description of the events and circumstances that would allow issuers to terminate fully benefit-responsive investment contracts with the plan.

~~Defined-contribution plans, including both health and welfare, and pension plans, should disclose the following in connection with fully benefit-responsive investment contracts in the aggregate:~~

~~*a*. The average yield for each period for which a statement of net assets available for benefits is presented~~

~~*b*. The crediting interest rate as of the date of each statement of net assets available for benefits presented~~

~~*c*. The amount of valuation reserves recorded to adjust contract amounts (for example, due to problems with the creditworthiness of the contract issuer or third-party guarantor)~~

~~*d*. The fair value of investment contracts reported at contract value, in accordance with FASB Statement No. 107, *Disclosures about Fair Value of Financial Instruments*.~~

~~Those plans should also provide 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 contracts 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). [As amended, effective for financial statements for plan years ending after December 15, 1999, by Statement of Position 99-3.]~~

i. Paragraph A.1:

<u>Defined-contribution plans, including both health and welfare, and pension plans, should report all investments (including derivative contracts) at fair value. However, contract value is a relevant measurement attribute for that portion of the net assets available for benefits of a defined-contribution plan attributable to fully benefit-responsive investment contracts.</u> ~~Fully benefit-responsive investment contracts held by defined-contribution plans, including both health and welfare, and pension plans that provide a liquidity guarantee by a financially responsible third party of principal and previously accrued interest for participant-initiated liquidations, transfers, loans, or hardship withdrawals under the terms of the ongoing plan, should be reported at contract value, which may or may not be equal to fair value.~~ 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. ~~Other investment contracts should generally be reported at fair value.~~

j. Paragraph A.2:

Investment contracts ~~that do not provide a liquidity guarantee as discussed in paragraph A.1~~ may be valued by discounting the related cash flows based on current yields of similar investments with comparable durations. 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 unless it is probable that the plan intends to terminate the contract.

k. Paragraph A.5:

Because guaranteed proceeds from the bond are not available for benefit withdrawals or transfers prior to maturity, the contract is not fully benefit-responsive and, therefore, net assets available for benefits should reflect the fair value for such investment contracts.~~the contract should be valued at fair value.~~ Fair value may be determined as the amount at which the bond could be exchanged in a current transaction between parties, other than in a forced or liquidation sale, considering the guaranteed fixed value of the bond at the end of three years.

l. Paragraph A.7:

~~The contract should be reported at contract value~~The net assets available for benefits should reflect the contract value for such investment contracts, because the plan will receive such value and only such value if the contract is accessed to pay participant benefits or transfers.

m. Paragraph A.8:

The contract described in the preceding paragraph would be viewed as fully benefit-responsive. Examples of some variations on this contract, and their impact on the valuation, follow.

a. *Liquidity at contract value is not guaranteed for benefits that are attributable to termination of the plan, a plan spin-off to a new employer plan, or amendments to plan provisions.* Net assets available for benefits should reflect the contract value for such investment contracts,~~The contract should be reported at contract value~~ unless it is probable that the plan will be terminated, spun off, or amended.

b. *Liquidity at contract value is not guaranteed for benefits that are attributable to the layoff of a large group of workers or an early retirement program.* Net assets available for benefits should reflect the contract value for such investment contracts,~~The contract should be reported at contract value~~ unless it is probable that termination of the employment of a significant number of employees will occur.

c. *The contract will pay for benefits of up to 30 percent of the contract at contract value, and any excess benefits will be at some adjusted value.* Net assets available for benefits should reflect the fair value for such investment contracts because they are not fully benefit-responsive.~~The contract should be reported at fair value.~~ Fair value may be determined as the guaranteed amount plus the estimated discounted cash flows related to the amount in excess of 30 percent of the contract value.

d. *The contract will pay benefits at contract value, but only if the issuer of the contract determines that there is sufficient liquidity in the portfolio of assets that backs the contract.* Because the third party has not guaranteed liquidity for participant-initiated withdrawals, net assets available for benefits should reflect the fair value for such investment contracts because they are not fully benefit-responsive.~~the contract should be reported at fair value.~~

e. *The contract will not pay benefits at contract value if benefits are due to participant transfers to another fixed income investment option, unless the funds are invested in an equity option for at least three months (*equity wash *provisions).* Net assets available for benefits should reflect the contract value for such investment contracts because the contracts would be considered fully benefit-responsive.~~ The contract should be reported at contract value.~~

n. Paragraph A.9:

Net assets available for benefits should reflect the fair value for such investment~~The~~ contracts ~~should be reported at fair value ~~because there is no guarantee of liquidity at contract value. Fair value would be determined in the same manner as for an illiquid bond. Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards No. 107, *Disclosures about Fair Value of Financial Instruments,* includes a discussion of methods used to determine the fair values of illiquid instruments.

o. Paragraph A.11:

~~The~~Net assets available for benefits should reflect the contract value for such investment contracts~~contract should be reported at contract value~~ because participants are guaranteed return of principal and accrued interest.

p. Paragraph A.13:

Net assets available for benefits should reflect the contract value for such investment contracts~~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, the trust assets and the wrapper contract should be reported at the wrapper contract value~~ because participants are guaranteed return of principal and accrued interest.

q. Paragraph A.14:

Under this 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 contract issuer, and the issuer is obligated to buy the bond. The transaction price is defined under the contract (for example, amortized cost). ~~The issuer is not obligated, however, to purchase securities that are in default.~~

r. Paragraph A.15:

Net assets available for benefits should reflect the contract value for such investment contracts~~The contract, when considered together with the bond, should be reported at contract value (refer to paragraph A.13) absent impairment of the value of the securities due to credit risk~~ because return of principal and accrued interest has been guaranteed to participants.

s. Paragraph A.16:

If the contract provided only an *option* for the sponsor to sell the bond to the issuer, rather than an obligation to do so, reflecting net assets available for benefits at contract value for such investment contracts would ~~only~~also 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.~~

Proposed Amendment to SOP 92-6

B2. AICPA Statement of Position 92-6, *Accounting and Reporting by Health and Welfare Benefit Plans,* is amended as follows: [Added text is underscored and deleted text is ~~struck out~~.]

a. Note:

NOTE

Statements of Position (SOPs) of the Accounting Standards Division present the conclusions of at least a majority of the Accounting Standards Executive Committee, which is the senior technical body of the Institute authorized to speak for the Institute in the areas of financial accounting and reporting. Statement on Auditing Standards No. 69, The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles, identifies AICPA SOPs as sources of established accounting principles that an AICPA member should consider if the accounting treatment of a transaction or event is not specified by a pronouncement covered by Rule 203 of the AICPA Code of Professional Conduct. In such circumstances, the accounting treatment specified by this SOP should be used or the member should be prepared to justify a conclusion that another treatment better presents the substance of the transaction in the circumstances.

SOP 92-6 is amended by SOP 94-4, *Reporting of Investment Contracts Held by Health and Welfare Benefit Plans and Defined-Contribution Pension Plans*. SOP 94-4 is effective for financial statements for plan years beginning after December 15, 1994, except that the application of SOP 94-4 to investment contracts entered into before December 15, 1993, is delayed to plan years beginning after December 15, 1995. Earlier application of SOP 94-4 is encouraged. Accounting changes adopted to conform to the provisions of SOP 94-4 should be made as of the beginning of the year in which the change is adopted. The effect of initially applying SOP 94-4 should be reported in a manner similar to the cumulative effect of a change in accounting principle (APB Opinion No. 20, *Accounting Changes*, paragraph 20). Pro forma effects of retroactive application (APB Opinion No. 20, paragraph 21) are not required. Restatement of financial statements of prior years is not permitted.

SOP 92-6 is also amended by SOP 99-3, *Accounting for and Reporting of Certain Defined Contribution Plan Investments and Other Disclosure Matters*. SOP 99-3 is effective for financial statements for plan years ending after December 15, 1999. Earlier application is encouraged for fiscal years for which annual financial statements have not been issued. If the previously required "by fund" disclosures are eliminated, the reclassification of comparative amounts in financial statements for earlier periods is required.

SOP 92-6 is also amended by SOP 01-2, *Accounting and Reporting by Health and Welfare Benefit Plans*. SOP 01-2 is effective for financial statements for plan years beginning after December 15, 2000. Earlier application is encouraged. Financial statements presented for prior plan years are required to be restated to comply with the provisions of this SOP. The effect of restating the beginning balance of benefit obligations for the earliest year presented should be disclosed.

<u>SOP 92-6 is also amended by FASB Staff Position AAG INV-a, "Reporting of Fully Benefit-Responsive Investment Contracts Held by Certain Investment Companies Subject to the AICPA Investment Company Guide." FSP AAG INV-a is effective for financial statements for plan years ending after December 15, 2005. Earlier application is permitted for fiscal years in which annual financial statements have not been issued. If comparative financial statements are presented, the guidance in this FSP should be applied retroactively to all prior periods presented.</u>

b. Paragraph .25:

Plan investments, whether they are in the form of equity or debt securities, real estate, or other investments (excluding insurance contracts ~~and fully benefit-responsive investment contracts held by defined-contribution health and welfare plans~~), should be reported at their fair value at the financial statement date. The fair value of an investment is the amount that the plan could reasonably expect to receive for it in a current sale between a willing buyer and a willing seller, that is, other than in a forced or liquidation sale. Fair value should be measured by the market price if there is an active market for the investment. If there is no active market for the investment but there is a market for similar investments, selling prices in that market may be helpful in estimating fair value. If a market price is not available, a forecast of expected cash flows, discounted at a rate commensurate with the risk involved, may be used to estimate fair value. [As amended, effective for financial statements for plan years beginning after December 15, 1994, by Statement of Position 94-4. Revised, June 2004, to reflect conforming changes necessary due to the issuance of recent authoritative literature.]

c. Paragraph .29:

Plan assets of defined-contribution health and welfare benefit plans should be measured and reported at values that are meaningful to financial statement users including plan participants. The contract value of a *fully benefit-responsive* investment contract held by a defined-contribution health and welfare benefit plan is the amount a participant would receive if he or she were to initiate transactions under the terms of the ongoing plan. Defined-contribution health and welfare benefit plans should report fully benefit-responsive investment contracts <u>(including derivative contracts) at fair value. However, contract value is a relevant measurement attribute for that portion of the net assets available for benefits of a defined-contribution health and welfare benefit plan attributable to fully benefit-responsive investment contracts.</u>~~at contract value, which may or may not be equal to fair value. If, however, plan management is aware that an event has occurred that may affect the value of the contract (for example, a decline in~~

~~the creditworthiness of the contract issuer or third-party guarantor if different from the contract issuer or the possibility of premature termination of the contract by the plan), pursuant to FASB Statement No. 5, *Accounting for Contingencies*, disclosure of the event or reporting the investment at less than contract value may be appropriate.~~ [Paragraph added, effective for financial statements for plan years beginning after December 15, 1994, by Statement of Position 94-4.]

d. Paragraph .30:

<u>An investment contract is considered fully benefit-responsive for purposes of this SOP, if all of the following criteria are met for that contract, analyzed on an individual basis:</u>

a. <u>The investment contract is negotiated directly between the fund and the issuer and prohibits the fund from assigning or selling the contract or its proceeds to another party without the consent of the issuer.</u>

b. <u>Either (1) the repayment of principal and interest credited to participants in the plan is guaranteed by the issuer of the investment contract or (2) the plan provides for prospective interest crediting rate adjustments to participants in the plan on a designated pool of investments held by the plan, provided that the terms of the agreement with participants of the plan specifies that the crediting interest rate cannot be less than zero. Any potential for a decline in the interest crediting rate below zero must be transferred to a financially responsible third party through a contract generally referred to as a wrapper. If an event has occurred that may affect the realization of full contract value for a particular investment contract (for example, a decline in creditworthiness of the contract issuer or wrapper provider), the investment contract shall no longer be considered fully benefit-responsive.</u>

c. <u>The terms of the investment contract require all permitted participant-initiated transactions with the plan to occur at contract value with no conditions, limits, or restrictions. Permitted participant-initiated transactions are those transactions allowed by the plan, such as withdrawals for benefits, loans, or transfers to other funds within the plan.</u>

d. <u>An event that limits the ability for the plan to transact at contract value with the issuer (for example, premature termination of the contracts by the plan, plant closings, layoffs, plan termination, bankruptcy, mergers, and early retirement incentives) must be probable of not occurring.</u>

e. <u>The plan itself must allow participants reasonable access to their funds.</u>

~~*Benefit responsiveness* is the extent to which a contract's terms 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~~

~~frequently are negotiated directly between the plan and the issuer and generally prohibit assignment of contracts or their proceeds to another party. Investment contracts must transfer the risk of principal and accrued interest 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. The plan itself must also 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. 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. However, in plans with a single investment fund that allow reasonable access to assets by inactive participants, restrictions on access to assets by active participants consistent with the objective of the plan (for example, retirement or health and welfare benefits) will not affect the benefit responsiveness of the investment contracts held by those single-fund plans. Also, if a plan limits participants' access to their account balances to certain specified times during the plan 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. In addition, administrative provisions that place short-term restrictions (for example, three or six months) on transfers to competing fixed income investment options to limit arbitrage among those investment options (*equity wash* provisions) would not affect a contract's benefit responsiveness. [Paragraph added, effective for financial statements for plan years beginning after December 15, 1994, by Statement of Position 94-4.]

Proposed Amendment to Statement 133

B3. FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities,* is amended as follows:

a. Paragraph 10(h):

> *Certain investment contracts.* A contract that is accounted for under either paragraph 4 of FASB Statement No. 110, *Reporting by Defined Benefit Pension Plans of Investment Contracts*, or paragraph 12 of FASB Statement No. 35, *Accounting and Reporting by Defined Benefit Pension Plans*, as amended by Statement 110, is not subject to this Statement. ~~Similarly, a contract that is accounted for under either paragraph 4 or paragraph 5 of AICPA Statement of Position 94-4, *Reporting of Investment Contracts Held by Health and Welfare Benefit Plans and Defined-Contribution Pension Plans*, is not subject to this Statement.~~ Th~~ose~~is exception~~s~~ appl~~y~~ies only to the party that accounts for the contract under Statement 35~~,~~ or Statement 110~~, or SOP 94-4~~.