Comptroller of the Currency
Washington, DC 20219

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[*1]
This letter responds to your request n1 that the OCC change the valuation requirements for guaranteed and synthetic investment contracts ("GICs" and "SICs," respectively, and "GICs/SICs," collectively) held by national bank collective investment funds ("CIFs"). You initially requested an exemption under 12 C.F.R. § 9.18(c)(5) from OCC regulations that require CIF trustees to value GICs/SICs held by the CIFs at fair value. You specifically requested an exemption that would permit valuation of GICs/SICs, analogous to the method of valuation required under a recently issued American Institute of Certified Public Accounts Statement of Position ("SOP"). n2 You also requested that this exemption, if granted, (1) apply to all CIFs without the need for a separate written application by each CIF n3, (2) apply to CIFs consisting primarily of defined contribution plan assets and only a "de minimis" amount (five percent or less) of defined benefit plan assets, (3) apply to CIFs consisting of more than five percent defined benefit plan assets if those plans received the information necessary for calculating fair values, n4 and (4) permit all CIFs that are not included within the exemption to [*2] value GICs/SICs at contract value for a few years.

n1 Your proposal represents the concerns of several national banks and insurance companies.

n2 American Institute of Certified Public Accountants Statement of Position 94-4. Reporting of Investment Contracts Held by Health and Welfare Benefit Plans and Defined-Contribution Pension Plans (September 23, 1994) ("SOP 94-4").

n3 In the alternative, if the OCC requires each CIF to apply separately to value GICs/SICs at contract value, you ask that the OCC automatically approve separate applications within 30 days after submission, unless the OCC notifies the CIF to the contrary within that 30-day period.

n4 This requested exemption would allow each CIF consisting primarily of defined benefit plan assets to value fully benefit-responsive GICs/SICs at contract value. The CIF would need to provide the defined benefit plans with the information necessary for calculating fair values, since defined benefit plans must value GICs/SICs at fair value, not automatically at contract value.

The OCC will permit CIFs consisting *solely* of defined contribution plan assets invested only in fully benefit-responsive GICs/SICs and [*3] liquid, short term government securities and money market instruments to value GICs/SICs at contract value (i.e., principal balance plus accrued interest) without the need for a separate written application by each

CIF. We believe this exemption is consistent with the recent change in SOP's analogous accounting requirements. The OCC will not, however, extend this exemption to any CIFs consisting of defined benefit plan assets.

Background

National banks as fiduciaries may collectively invest funds held on behalf of retirement, pension, profit sharing, stock bonus or other trusts which are exempt from Federal income taxation under the Internal Revenue Code. 12 C.F.R. § 9.18(a)(2). Defined contribution plans and defined benefit plans, n5 among other things, may collectively invest assets in CIFs. In turn, CIFs may hold various assets, including GICs/SICs. GICs are individually negotiated investment contracts between insurance companies and investors. GICs resemble debt instruments that provide fixed returns over a period, usually less than ten years. SICs are individually negotiated investment contracts that provide cash flow protection for assets or pools of assets to investors [*4] who own those assets and who must sell those assets to pay plan-participants. SICs generally provide fixed returns over a period and are often issued by insurance companies. The fair value of GICs/SICs is not readily available from independent sources because they are not actively traded on a secondary market or exchange and do not have quoted market values.

n5 Defined benefit plans typically pay predetermined levels of benefits to employee-participants. Employers bear the risk and responsibility for funding those plans to meet those benefit levels. Defined contribution plans, in contrast, merely require employers to make fixed contributions. As a result, employees receive variable levels of benefits at retirement, depending on the success of plan investments.

GICs/SICs have almost no liquidity since the contracts usually prohibit their transfer. The only practicable means of liquidating GICs/SICs is to ask the issuers to redeem them. Issuers often issue puts on GICs/SICs that allow early redemption of an entire instrument at a discount from par or with lower stated rates of return, usually after one year's prior notice. Issuers also issue GICs/SICs with "fully benefit-responsive" [*5] features, which allow early withdrawal of a part of the instrument to pay employee benefits under an employer-sponsored plan. n6

n6 A "fully benefit-responsive" investment contract provides a liquidity guarantee at contract value for liquidations, transfers, loans, or hardship withdrawals rightfully initiated by any plan-participant. Participants would consider the contract value of a fully benefit-responsive investment contract to be the amount they would receive if they were to initiate transactions under the terms of the ongoing plan.

National banks market CIFs, which may hold GICs/SICs as assets, to both corporate defined benefit and defined contribution plans. CIFs, as well as issuers, generally find a much greater demand for GICs/SICs among defined contribution plans than among defined benefit plans, because defined contribution plans permit employee-participants to choose their investments, and many participants choose GICs/SICs.

Accounting Standards and OCC Regulations

OCC regulations currently require that CIF trustees value GICs/SIcs periodically, as they would any other asset, at market value or, in the absence of a market value, at fair value determined [*6] in good faith. See 12 C.F.R. §§ 9.18(b)(1) and (4). In a series of interpretive letters, the OCC has stated that, to make a good faith determination of fair value, a CIF trustee may not automatically assign contract value as a proxy in valuing GICs/SICs. n7 Automatically valuing CIF assets at contract or cost may harm current and future CIF plan-participants, and may expose national bank trustees to liability under the federal securities laws, common law fiduciary principles, or the Employee Retirement Income Security Act of 1974 ("ERISA"). For example, the unvarying use of contract value in a rising interest rate environment may result in the overstatement of CIF unit values. Fund participants may subsequently claim that they purchased units at inflated values and suffered damage due to the CIF trustee's improper asset aluations.

n7 See OCC Fiduciary Precedent 9.5012, Trust Interpretation No. 271 (Sept. 10, 1992); Trust Interpretation No. 268 (March 17, 1992); Trust Interpretation No. 265 (March 19, 1992); Trust Interpretation No. 181 (Oct. 18, 1988); and Trust Interpretation No. 67 (Dec. 12, 1986).

The OCC's interpretive letters on valuing CIF assets have interpreted [*7] sections 9.18(b)(1) and (4) consistently with analogous accounting industry requirements. For example, a Financial Accounting Standards Board Statement ("Statement"), n8 required defined benefit plans to value all investment contracts, including GICs/SICs, at fair value, not automatically at contract value. By its terms, the Statement applies only to defined benefit plans, not defined contribution plans or CIFs. Based on the Statement, the OCC denied a reuqest to allow valuations of GICs/SICs at contract value. See Trust Interpretation No. 271 (Sept. 10, 1992).

n8 Statement of Financial Accounting Standards No. 110 (Aug. 1992).

The American Institute of Certified Public Accountants recently issued the SOP, which requires defined contribution plans to value "fully benefit-responsive" investment contracts, which may include certain GICs/SICs, at contract value. n9 Conversely, the SOP also provides that defined contribution plans must value investment contracts that are not "fully benefit-responsive" at fair value. The SOP states that, for fully benefit-responsive contracts, contract value provides useful information to plan participants about the amount they would receive [*8] currently if they were to withdraw, borrow, or transfer funds under the terms of the plan. The SOP acknowledges, however, that contract value may or may not be equal to fair value. By its terms, the SOP does not apply to defined benefit plans or CIFs. Thus, CIF trustees that automatically value "fully benefit-responsive" GICs/SICs held for defined contribution plans at contract value think by analogy that they act consistently with generally accepted accounting principles, but still would not meet OCC requirements to value fund assets at "fair value."

n9 If a plan holds multiple contracts, each contract should be evaluated individually for benefit responsiveness.

Exemption Request

You have asserted that the SOP's accounting and valuation method is more appropriate than the Statement's method and should apply, by analogy, to CIF trustees valuing GICs/SICs. CIFs function similarly to defined contribution plans by providing benefits based on participants' pro rata share. You argued that, for fully benefit-responsive investment contracts, valuing GICs/SICs at contract provides the most meaningful information to employee-participants about the amount they would receive currently [*9] if they withdrew funds. Contract value is a useful proxy in valuing GICs/SICs because of the uniqueness of, and the lack of a secondary market for, these instruments.

You have requested an exemption, under 12 C.F.R. § 9.18(c)(5), from the valuation requirements of 12 C.F.R. §§ 9.18(b)(1) and (4) for all CIFs in light of the SOP. You suggested that the OCC extend and expand the guidance in the SOP to reach all CIFs, including those with defined benefit plan participants. You suggested that the OCC require CIF trustees that value GICs/SICs at contract value to adopt certain policies and procedures under which the trustee must:

. Diversify CIF assets, apply generally accepted accounting principles and applicable regulations to value CIF assets, and document the valuation results.

. Ensure that all CIF investments in GICs/SICs are of investment quality, transferable only with the issuers' prior consent, and not transferable on a secondary market.

. Ensure that all CIF investments in GICs/SICs are fully benefit-responsive.

. Disclose Certain information about CIF assets and operations to plan-participants who, in turn, must make disclosures to their employee-participants [*10] about: CIF investment quality and diversification standards, the CIF's valuation procedures, the fact that GICs/SICs would be reported at contract value, the consequences of a departure from contract value reporting, CIF yields and returns net of fees or other expenses, and the fact that GICs/SICs would be reported at contract value, the consequences of a departure from contract value reporting, CIF yields nd returns net of fees or other expenses, and the fact that GICs/SICs are not bank deposits or obligations, or U.S. government or FDIC obligations.

You also requested that this exemption, if granted, (1) apply to all eligible CIFs without the need for a separate written application by each CIF, n10 (2) apply to CIFs consisting primarily of defined contribution plan assets and only a "de mininis" amount (five percent or less) of defined benefit plan assets, (3) apply to CIFs consisting of more than five percent defined benefit plan assets if those plans received the information necessary for calculating fair values, n11 and (4) permit all CIFs that are not included within the exemption to value GICs/SICs at contract value for a few years.

n10 Or, in the alternative, if the OCC requires each CIF to apply separately to value GICs/SICs at contract value, you asked that the OCC automatically approve separate applications within 30 days after submission, unless the OCC notifies the CIF to the contrary within that 30-day period.

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n11 The CIFs would provide those plans with information necessary for calculating fair value, because defined benefit plans must disclose the fair value of GICs/SICs to plan-participants. Thus, those defined benefit plans would calculate fair value, instead of the CIFs investing in GICs/SICs.

Discussion

CIF trustees should generally value GICs/SICs on days the CIFs allow admissions or withdrawals, as they would any other asset, at market value or, in the absence of a market value, at fair value determined in good faith. Market value provides useful information to plan participants about the current value of their CIF investments. Market value reduces the potential harm to current and future CIF plan-participants from overstated or understated unit values. Market value may be more difficult to calculate than contract value, and CIFs that automatically value GICs/SICs at contract value may be criticized for transferring to their participants the problems associated with calculating the fair value of GICs/SICs.

The OCC will, however, grant an exception to permit trustees for CIFs consisting solely of defined contribution plan assets invested only in fully benefit-responsive [*12] GICs/SICs and liquid, short term government securities and money market instruments to value GICs/SICs at contract value, in accordance with the SOP. Contract value (i.e., principal balance plus accrued interest) provides useful information about fully benefit-responsive contracts held by CIFs consisting solely of defined contribution plans, because contract value reflects the amount employee-participants would receive if they were to withdraw, borrow, or transfer funds under the terms of those plans. SOP 94-4 at 7, PP 8-9. In addition, contract value for fully benefit-responsive contracts provides the appropriate valuation for CIFs, because the defined contribution plan participants must disclose contract value to their employee-participants.

Contract valuation may be used by CIFs consisting solely of defined contribution plan assets only where this valuation is consistent with the SOP, and a national bank's fiduciary duty under common law, 12 C.F.R. Part 9, and the ERISA. For example, the SOP states that, if management is aware of an event that may affect the value of the contract, it may be appropriate to disclose the event or report the investment at less than contract value. [*13] CIF trustees should be mindful that valuing GICs/SICs that no longer pay interest or that were issued by now-bankrupt companies at contract value may not meet the standards of the SOP or other legal requirements.

Conclusion

The OCC will grant your request in part for an exemption under 12 C.F.R. § 9.18(c)(5) of the valuation requirements of 12 C.F.R. §§ 9.18(b)(1) and (4) for GICs/SICs by permitting CIFs consisting solely of defined contribution plan assets invested only in fully benefit-responsive GICs/SICs and liquid, short term government securities and money market instruments to GICs/SICs at contract value. The OCC will apply this exemption to all CIFs without the need for separate applications. n12 We believe this exemption is consistent with the analogous requirements of the SOP.

n12 Although the OCC has generally only approved exemption requests under 12 C.F.R. § 9.18(c)(5) following an individual request from each CIF, subsection (c)(5) does not limit OCC approval to an individual CIF.

The OCC will continue to require CIFs consisting of any defined benefit plan assets and all CIFs holding GICs/SICs that are not benefit-responsive to value those contracts [*14] at fair value.

Very truly yours,

Susan F. Krause
Senior Deputy Comptroller for Bank Supervision Policy