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Disclosure as driving force

FASB: Corporate funds should give details on asset mix

By **Barry B. Burr**

Posted: February 18, 2008, 6:01 AM EST

NORWALK, Conn. — A new pension accounting proposed rule might drive corporate pension funds away from illiquid and risky investments such as hedge funds, some experts believe.

The Financial Accounting Standards Board, Norwalk, last week approved issuing a proposal to require a more detailed breakout of corporate pension fund asset allocations, including derivatives, hedge funds and other alternative investments, to obtain a better assessment of concentrations of risk.

FASB officials expect to issue the proposal, an amendment to Financial Accounting Standard 132 (revised), by March 7, followed by a 45-day public comment period.

"We are rewriting the rule to make it clearer how asset categories should be disclosed," said Philip R. Hood, an assistant project manager overseeing the proposal. "It would give more clarity to the types of investments held in the plan."

Current asset allocation categories are equity, debt, real estate and other, and are disclosed in a note to the financial statements in corporate annual reports.

But some experts worry that increased disclosure will constrain corporate executives' willingness to use alternative investments.

"It further narrows the ability of plans to effectively manage long term vs. short term," said Cynthia Steer, managing director and chief research strategist at Rogerscasey Inc., Darien, Conn.

If adopted, the proposal could lead to corporate pension funds investing more conservatively to reduce exposure to risky or illiquid assets, Ms. Steer said.

Diane Garnick, investment strategist in New York for Invesco Ltd., said the proposal also would require more heavily prescribed valuation rules. These range from publicly traded securities that can be valued by daily market prices to estimating prices for less

frequently traded public securities or for private assets, whose values are more uncertain, Ms. Garnick said.

Some motivation

Plan sponsors, for example, often don't get the information transparency from their hedge funds to report in detail under the proposal, Ms. Garnick said. This will give plan sponsors some motivation to invest more with traditional managers, who give them transparency, and to reduce exposure to hedge funds, Ms. Garnick said.

Yet Boeing Co. and a few other companies that voluntarily disclose detailed pension fund asset allocation don't appear to be deterred from investing in alternatives.

Michael W. Peskin, managing director, Morgan Stanley Asset Management, New York, doubts more disclosure would be a deterrent. He thinks the FASB proposal, if adopted, won't necessarily cause corporations to invest pension assets more conservatively to steer away from risk reporting.

"Changes in the funding rule and changes in the accounting rule on reporting (pension funding level) on balance sheets are much bigger drivers" that might cause plans to invest more conservatively, Mr. Peskin said.

FASB's Mr. Hood said greater disclosure is necessary. "Currently, the disclosure we see as to the types of assets in a pension plan are broad," Mr. Hood said. "Typically we see lots of companies lumping a lot of different types of investments into 'other' ... and 'debt.'"

The proposed changes would allow investors to see the extent a company invests in risky or speculative assets, Mr. Hood said. "It is alerting investors to the potential risks or concentrations of risk in plan assets.

"If a company invests a lot in CDOs (collateralized debt obligations) and CDO prices fall, a company would have to make more contributions to the pension plan," Mr. Hood said. "If a company doesn't invest well, it would affect cash flow" of the corporation.

The proposal, which also would apply to retiree medical and other post-employment benefit funds, would take effect for annual reports for the year ending 2008, Mr. Hood said. The more detailed disclosure would appear in a note to the financial statements, in the same place asset disclosure appears now, he said.

William F. Quinn, chairman, American Beacon Advisors Inc., which oversees the \$9.1 billion pension fund of American Airlines Inc., Fort Worth, Texas, said, "An investor of pension funds getting more disclosure is good.

"Generally, disclosure doesn't hurt as long as it's not a real burden," Mr. Quinn said. "We disclose more than the standard breakout. We probably meet the spirit of what they are trying to accomplish."

In its annual report last year, American Airlines' parent company, AMR Corp., listed the pension fund allocation as 37% long-duration bonds, 30% U.S. stocks, 21% international stocks, 6% emerging markets stocks and bonds, and 6% alternative (private) investments. Plus, it noted the use of currency overlay managers and other information about its investment strategy.

But the FASB proposal appears to require more detailed disclosure.

Boeing officials declined to comment on the proposal, said Todd Blecher, spokesman, but the Chicago-based company's 10-K, filed Feb. 15, discloses details of the pension fund's asset mix. The report shows an allocation of 3% hedge funds, 4% private equity, 5% global strategies, 4% real estate and real assets, 46% debt and 38% equity. The report includes details on the use of currency management and derivatives, giving their notional allocation, as well as types of hedge fund strategies.

Mr. Quinn, who also is chairman of the Committee on Investment of Employee Benefit Assets, said CIEBA officials haven't had time yet to review to proposal.

"For investors, more information is useful," Mr. Quinn said. "The corporate side may have a different view."

Likely to fight

Added Invesco's Ms. Garnick: "I think they (corporations) are likely to fight it (more disclosure), but they are likely to lose."

Keith P. Ambachtsheer, president, KPA Advisory Services Ltd., a Toronto-based pension consulting firm, said, "Ideally, the discussion should be about mismatch risk on the balance sheet ... a single metric that represents mismatch risk on the balance sheet. Unfortunately no such metric exist."

"I interpret this proposal as a very clumsy and awkward way of getting at that (mismatch risk)," Mr. Ambachtsheer said.

Morgan Stanley's Mr. Peskin agreed. "The only risk that counts is mismatch risk" between pension assets and liabilities. "I think FASB is missing this."

Companies could use swaps to hedge pension liabilities and appear to have a leveraged position in fixed income in terms of asset disclosure, Mr. Peskin said. "These assets could go down a lot, showing an increase in asset risk but not a decrease in asset/liability risk."

"It would be misleading to pick up the asset risk, but not a reduction in the asset/liability risk," Mr. Peskin said. "Until they get more detail on the liability side, it's premature to dig deeper on the asset side."

Mr. Hood said the FASB discussed requiring greater disclosure of liabilities when statement 132 was under consideration. But the board rejected it because "it would provide minimal information about the amount and timing of benefit payments," Mr. Hood said. "It would not allow users to assess the degree to which plan assets and liability cash flows are aligned."

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