Public Pension Financial Forum
c/o Colorado PERA
1300 Logan Street
Denver, CO 80203

October 31, 2007

Director of Research and Technical Activities
Governmental Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, Connecticut 06856-5116

Subject: Project No. 26-4

Dear Board and Staff:

The Public Pension Financial Forum (P2F2) is pleased to have the opportunity to respond to the Government Accounting Standards Board (GASB) Project No. 26-4, Exposure Draft document on Accounting and Financial Reporting for Derivatives.

P2F2 was formed in 2004. The purpose of this organization is to promote excellence in public pension plan financial operations, provide educational programs of current interest to membership, promote the exchange of ideas concerning financial operations and reporting between public pension plans, and to foster sound principles, procedures and practices in the field of public pensions related to the financial operations of such plans. Membership is open to any finance employee of a public pension who supports the purposes of P2F2. The organization currently has 180 members representing 85 plans.

We would like to thank GASB for the changes that have been made from the initial preliminary views document and for the use of a field test on one of our member plans. We feel a number of the more problematic issues have been considered and changed; however we do have further issues with the exposure draft as will be detailed in this response.

External investment pools (direct holdings vs. indirect)

Pension trust funds invest heavily in external investment pools and commingled funds which may use derivatives. It is generally assumed that investments within these external investment pools are excluded from this statement. We are concerned with this assumption and feel that this should be explicitly stated. If the exposure draft required reporting and disclosing the underlying holdings within these types of external pools and commingled funds, we do not feel we can provide the required information on a timely basis, if at all.

We are also concerned with the comparability between plans when one plan uses external pools heavily and one does not. We suggest that the disclosures include the total amount of assets held directly as compared to those held in external pools which have been excluded from the disclosure.

Hedge Accounting

We strongly agree with paragraph 17 that derivative instruments associated with assets and liabilities measured at fair value are not eligible for hedge accounting. We understand this to mean that all derivatives within a pension trust fund would not be subject to any hedge accounting even if the purpose of the derivative was to hedge some investment risk such as foreign currency risk. We do feel that the final statement should explicitly state that pension trust funds are excluded from hedge accounting.

Hybrid Instruments – Paragraph 54

We feel we need more definition and need to understand the impact of the definition in Paragraph 54 as it relates to fixed income securities held as investments. Many fixed income securities include embedded options or exotic structures that our investment staffs and custodial banks don’t consider derivatives but may fall under the definition in Paragraph 54.

Summary Information - Paragraph 60

We agree with the Board (Paragraph 126) that the Statement should focus on end-of-period fair values of derivative investments summarized by type with disclosures of notional values. However, we are concerned about the breakdown of the changes in fair value during the reporting period by category of derivative instrument and do not feel this is useful information to our readers.

A derivative category or strategy could be devised that may produce a loss but still work successfully. A simple example would be the use of futures to get into a foreign market. The use of futures might be the most cost effective way to gain exposure to a market. If the market drops, a loss is generated as expected. However, due to the sensitive nature of derivatives, our readers may be alarmed about a loss in derivatives. Pension trust funds can also use derivatives in many more complex arrangements and the gain or loss on those derivatives may not communicate that the strategy of that investment was achieved.

The overall investment results and returns of our plans are of utmost concern to our constituents and we feel the disclosure of changes in fair value by derivative investment type will focus attention on the wrong area and could misinform the reader about the use of derivatives.

Disclosure of Fair Value Pricing Methods and Significant Assumptions – Paragraph 60(c)

We agree that the pricing method should be disclosed in a summary manner, but we are concerned about the level of detail that might be required when disclosing significant assumptions on the methods used on estimates. This information is currently not being captured at the level of detail required by this exposure draft and it would be time consuming to gather this data. We are also concerned about the potential amount of detail that might be needed to explain the methods and assumptions used when describing an estimation method, particularly when a pension trust fund uses a large number of complex derivatives instruments. Additional illustrations should be included within the final statement to guide us in fulfilling this disclosure requirement in a concise manner.

Credit Risk Disclosures - Paragraph 67(a) and 64(a)

We are very concerned about the availability of the information required in paragraph 64(a) and feel more definition and field testing is required to fulfill these disclosure requirements. The credit risk disclosure includes significant details that have not previously been summarized or accumulated. Also, we would like assistance on fulfilling this disclosure requirement on exchange-traded derivatives.

Separate Statement for Fiduciary Funds and Need for Expanded Illustrations

Pension trust funds are by far the largest governmental users of derivatives. Pension trust funds can typically trade derivatives on a daily basis and can at any one time hold hundreds or even thousands of derivative positions. However, we feel this statement was not written and designed for governments whose primary use of derivatives is for investment purposes.

Pensions can use derivatives in a number of different strategies, some of which are listed below:

- Asset allocation rebalancing
- Substitute for physical securities
- Currency exposure management – hedged or active
- Active fixed income management – including managing duration
- Risk reduction
- Incremental return
- Leverage in hedge funds
- Cash overlay strategies
- Portable alpha strategies
- Active commodity investment management
- Strategies to match benefit liability cash flows

We feel pension trust funds use derivatives in a unique manner, as compared to other governments. If GASB wants to expand disclosures for these instruments, they should be designed specifically for pension trust funds and should deliver value and usefulness to our financial statement readers. We believe that any possible further disclosures should continue to be tested at several large pension trust funds and useful illustrations should be included to highlight the proper disclosures for some of the particular scenarios shown above.

Again, P2F2 appreciates the opportunity to comment on this project. Should you have any additional questions regarding these comments, please feel free to contact our organization.

Sincerely,

Karl Greve, President