FINANCIAL ACCOUNTING SERIES

EXPOSURE DRAFT

Proposed Accounting Standards Update

Issued: August 18, 2010
Comments Due: September 7, 2010

Plan Accounting—Defined Contribution Pension Plans (Topic 962)

Reporting Loans to Participants by Defined Contribution Pension Plans

a consensus of the FASB Emerging Issues Task Force

This Exposure Draft of a proposed Accounting Standards Update of Topic 962 is issued by the Board for public comment. Written comments should be addressed to:

Technical Director
File Reference No. EITF100C

Financial Accounting Standards Board
of the Financial Accounting Foundation

The *FASB Accounting Standards Codification*™ is the source of authoritative generally accepted accounting principles (GAAP) recognized by the FASB to be applied by nongovernmental entities. An Accounting Standards Update is not authoritative; rather, it is a document that communicates how the Accounting Standards Codification is being amended. It also provides other information to help a user of GAAP understand how and why GAAP is changing and when the changes will be effective.

Notice to Recipients of This Exposure Draft of a Proposed Accounting Standards Update

The Board invites individuals and organizations to send written comments on all matters in this Exposure Draft of a proposed Accounting Standards Update. Responses from those wishing to comment on the Exposure Draft must be received in writing by September 7, 2010. Interested parties should submit their comments by email to director@fasb.org, File Reference No. EITF100C. Those without email should send their comments to "Technical Director, File Reference No. EITF100C, FASB, 401 Merritt 7, PO Box 5116, Norwalk, CT 06856-5116." Do not send responses by fax.

All comments received constitute part of the FASB's public file. The FASB will make all comments publicly available by posting them to its website and by making them available in its public reference room in Norwalk, Connecticut.

An electronic copy of this Exposure Draft is available on the FASB's website.

Financial Accounting Standards Board
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Proposed Accounting Standards Update

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Summary and Questions for Respondents

Why Is the FASB Issuing This Proposed Accounting Standards Update (Update)?

The objective of this proposed Update is to clarify how loans to participants should be classified and measured by defined contribution pension benefit plans.

Participant loans are currently classified as an investment in accordance with the defined contribution pension plan guidance in paragraph 962-325-45-10. Subtopic 962-325 requires most investments held by a plan, including participant loans, to be presented at fair value. Topic 820, Fair Value Measurements and Disclosures, provides specific guidance on how fair value should be measured.

In practice, most participant loans are carried at their unpaid principal balance plus any accrued but unpaid interest, which was considered a good faith approximation of fair value. However, some stakeholders questioned whether that measurement conforms to Topic 820, which requires the use of observable and unobservable inputs such as market interest rates, borrower's credit risk, and historical default rates to estimate the fair value of participant loans. Other stakeholders have questioned whether the use of those assumptions would result in information that is decision useful.

Who Would Be Affected by the Amendments in This Proposed Update?

Any defined contribution pension plan that allows participant loans would be affected by the amendments in this proposed Update.

What Are the Main Provisions?

The amendments in this proposed Update would require that participant loans be classified as notes receivable from participants, which are segregated from plan investments and measured at their unpaid principal balance plus any accrued but unpaid interest.

How Would the Main Provisions Differ from Current U.S. Generally Accepted Accounting Principles (GAAP) and Why Would They Be an Improvement?

Existing guidance requires participant loans to be classified as plan investments, which are generally measured at fair value as required by paragraph 962-325-35-1. The proposed guidance requiring loans to participants to be classified as receivables would reduce the amount of time that plan administrators spend on estimating the fair value of participant loans using observable and unobservable inputs as defined under Topic 820. The classification of participant loans as receivables acknowledges that participant loans are unique from other investments in that a participant taking out such a loan essentially borrows against its own individual vested benefit balance.

The Task Force concluded that it is more meaningful to measure participant loans at their unpaid principal balance plus any accrued but unpaid interest, rather than at fair value. Participant loans cannot be sold by the plan. Furthermore, if a participant were to default, the participant's account would be reduced by the unpaid balance of the loan, and there would be no effect on the plan's investment returns or any other participant's account balance.

When Would the Amendments Be Effective?

The amendments in this proposed Update would be applied retrospectively to all prior periods presented. The effective date will be determined after the Task Force considers the feedback on the proposed Update. Early adoption would be permitted.

How Do the Proposed Provisions Compare with International Financial Reporting Standards (IFRS)?

Participant loans are not as commonly observed outside the United States and IAS 26, *Accounting and Reporting by Retirement Benefit Plans*, does not specifically provide accounting guidance for participant loans. However, IAS 26 acknowledges that there may be some situations in which fair value may not be the most meaningful measurement attribute for plan investments, such as when securities that have a fixed redemption value are acquired to match the obligations of the plan or specific parts of the plan. It also states that estimates of fair value may not be possible in certain situations. IAS 26 does not explicitly require a specific classification of the loans to participants as investments or receivable separately from investments. However, participant loans are generally carried at amortized cost by a plan applying IFRS.

Questions for Respondents

The Board invites individuals and organizations to comment on all matters in this proposed Update, particularly on the issues and questions below. Comments are requested from those who agree with the proposed guidance as well as from those who do not agree. Comments are most helpful if they identify and clearly explain the issue or question to which they relate. Those who disagree with the proposed guidance are asked to describe their suggested alternatives, supported by specific reasoning.

Question 1: Do you agree that participant loans should be classified by defined contribution pension plans as notes receivable from participants, separately from plan investments? If not, why not? What alternative classification would you prefer and why?

Question 2: Do you agree that participant loans should be measured at their unpaid principal balance plus any accrued but unpaid interest? If not, why not? What alternative measurement would you prefer and why?

Question 3: The Task Force concluded that no additional disclosures specific to participant loans would be required as part of the amendments in this proposed Update. Do you agree? If not, what additional disclosure do you believe would be necessary?

Question 4: Do you agree that the amendments in this proposed Update should be applied retrospectively, with early adoption allowed? If not, why not?

Question 5: How much time do you believe would be necessary for you to efficiently implement the amendments in this proposed Update?

Amendments to the *FASB Accounting Standards Codification*™

Introduction

1. The Accounting Standards Codification is amended as described in paragraphs 2–9. Terms from the Master Glossary are in **bold** type. Added text is <u>underlined</u>, and deleted text is ~~struck out~~.

Amendments to Subtopic 962-310

2. Add paragraph 962-310-35-2 and its related heading, with a link to transition paragraph 962-310-65-1, as follows:

Plan Accounting—Defined Contribution Pension Plans—Receivables

Subsequent Measurement

<u>> Participant Loans</u>

<u>**962-310-35-2** Participant loans shall be measured at their unpaid principal balance plus any accrued but unpaid interest.</u>

3. Add paragraph 962-310-45-2 and its related heading, with a link to transition paragraph 962-310-65-1, as follows:

<u>Other Presentation Matters</u>

<u>> Participant Loans</u>

<u>**962-310-45-2** For reporting purposes, participant loans shall be classified as notes receivable.</u>

4. Add paragraph 962-310-50-1, with a link to transition paragraph 962-310-65-1, and its related heading as follows:

Disclosure

> Participant Loans

962-310-50-1 The disclosures about fair value prescribed in paragraphs 825-10-50-10 through 50-16 are not required for participant loans.

5. Add paragraph 962-310-65-1 and its related heading as follows:

> Transition Related to Accounting Standards Update No. 2010-XX, *Plan Accounting—Defined Contribution Pension Plans (Topic 962): Reporting Loans to Participants by Defined Contribution Pension Plans*

962-310-65-1 The following represents the transition and effective date information related to Accounting Standards Update No. 2010-XX, *Plan Accounting—Defined Contribution Pension Plans (Topic 962): Reporting Loans to Participants by Defined Contribution Pension Plans:*

a. The pending content that links to this paragraph shall be effective for fiscal years beginning after *TBD*.
b. An entity shall apply retrospectively the pending content that links to this paragraph.
c. Early application of the pending content that links to this paragraph is permitted.
d. The disclosures in paragraphs 250-10-50-1 through 50-3 shall be provided in the period an entity adopts the pending content that links to this paragraph.

Amendments to Subtopic 962-325

6. Amend paragraph 962-325-35-2, with a link to transition paragraph 962-310-65-1, as follows:

Plan Accounting—Defined Contribution Pension Plans—Investments—Other

Subsequent Measurement

962-325-35-2 Some plan investments may not have market quotations and, therefore, will need to be valued in good faith. Examples include all of the following:

a. Real estate
b. Mortgages or other loans (~~including~~ excluding loans to participants ~~of a 401(k) plan~~)

c. Limited partnerships
d. Restricted securities
e. Unregistered securities
f. Securities for which the market is thin
g. Nontransferable investment contracts.

7. Amend paragraph 962-325-45-5, with a link to transition paragraph 962-310-65-1, as follows:

Other Presentation Matters

> Non-Participant-Directed Investments

962-325-45-5 The presentation of non-participant-directed investments in the statement of net assets available for benefits or in the notes shall be detailed by general type, such as the following:

a. Registered investment companies (for example, mutual funds)
b. Government securities
c. Common-collective trusts
d. Pooled separate accounts
e. Short-term securities
f. Corporate bonds
g. Common stocks
h. Mortgages
i. Subparagraph superseded by Accounting Standards Update 2010-XX.~~Loans to participants~~
j. Real estate.

8. Supersede paragraph 962-325-45-10 and its related heading, with a link to transition paragraph 962-325-65-1, as follows:

~~**> Participant Loans**~~

962-325-45-10 Paragraph superseded by Accounting Standards Update 2010-XX.~~For reporting purposes, participant loans shall be classified as investments.~~

9. Amend paragraph 962-325-55-16, with a link to transition paragraph 962-310-65-1, as follows:

Implementation Guidance and Illustrations

> Illustrations

> > Example 1: Illustrative Financial Statements and Disclosures of a Defined Contribution Plan with Participant-Directed and Non-Participant-Directed Investment Programs

962-325-55-16 This Example illustrates certain applications of the provisions of this Subtopic to the annual financial statements of a defined contribution plan with participant-directed and non-participant-directed investments. The following are illustrative financial statements and disclosures.

	December 31,	
	20X1	**20X0**
Assets:		
~~Investments (See Note C)~~	~~$ 9,177,000~~	~~$ 7,995,000~~
Investments (See Note C)	$ 9,107,000	$ 7,980,000
Receivables:		
Employer contribution	14,000	10,000
Participant contributions	52,000	50,000
Participant loans	70,000	15,000
~~Total receivables~~	~~66,000~~	~~60,000~~
Total receivables	136,000	75,000
Total assets	9,243,000	8,055,000
Liabilities:		
Accounts payable	10,000	20,000
Accrued expenses	15,000	-
Total liabilities	25,000	20,000
Net assets available for benefits	$ 9,218,000	$ 8,035,000

See accompanying notes to the financial statements.

[For ease of use, the remainder of this paragraph, which is unaffected by the amendments in this Update, has been omitted.]

The amendments in this proposed Update were approved for publication by the unanimous vote of the five members of the Financial Accounting Standards Board:

Robert H. Herz, *Chairman*
Thomas J. Linsmeier
Leslie F. Seidman
Marc A. Siegel
Lawrence W. Smith

Background Information and Basis for Conclusions

Introduction

BC1. The following summarizes the Task Force's considerations in reaching the consensus in this proposed Update. It includes the Board's basis for ratifying the Task Force consensus when needed to supplement the Task Force's considerations. It also includes reasons for accepting certain approaches and rejecting others. Individual Task Force and Board members gave greater weight to some factors than to others.

Background Information and Conclusions

BC2. Participants in a defined contribution plan can direct the investment of their plan account balance into an investment in a loan to themselves if the plan allows for participant loans. Although participant loans are by their nature receivables, for reporting purposes, participant loans are considered a plan investment. Before the issuance of FASB Statement No. 157, *Fair Value Measurements* (codified as Topic 820), fair value of a plan investment was defined as the amount that the plan could reasonably expect to receive in a current sale of assets and was required to be measured by quoted market prices when available. In practice, most participant loans were carried at their amortized cost, which was considered a good-faith approximation of the fair value using that definition. According to Topic 820, fair value of a plan investment is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Under Topic 820, plans can no longer assume that the outstanding principal balance of a loan approximates its fair value and, so, the valuation principles of Topic 820 should be applied. Stakeholders have questioned whether reporting participant loans at fair value as determined under Topic 820 would result in information that is decision useful.

BC3. The Task Force concluded that participant loans are unique plan assets that should be classified as notes receivable from participants. The Task Force believes that classification of participant loans as receivables acknowledges that participant loans are essentially a participant borrowing against their own individual account. Furthermore, Task Force members believe that this classification best reflects the legal nature of the asset, which is a loan from the plan to the participant.

BC4. The Task Force concluded that it would be more meaningful to report participant loans at their unpaid principal balance plus any accrued but unpaid interest than at fair value. Any individual credit risk is mitigated by the fact that the loans are secured by the participant's vested balance. In addition, if the participant is currently an employee, loan repayments are generally withheld by the employer from that employee's payroll check, thereby minimizing the risk that the loan will default. If a participant were to default, the participant's account would be reduced by the unpaid balance of the loan and the participant would be subject to a penalty and additional taxes. An individual default would have no effect on the other plan participants' investment balances. The Task Force also noted that a participant loan is not necessarily issued at fair value at the inception of the loan because an individual’s credit risk is not considered in determining the loan terms, which are preestablished for all participants in the Plan Document.

BC5. Some Task Force members indicated that they believe that participant loans are more accurately reflected as distributions. Those Task Force members noted that the borrower is not legally obligated to pay back the loan to the plan. However, other Task Force members noted that nonrepayment of loans is generally remote because of the severe penalties imposed upon default.

BC6. The Task Force also discussed that the Department of Labor requires participant loans to be included as an investment on the supplemental schedule of assets held (measured as the unpaid principal balance plus any accrued but unpaid interest) to be included with the audited financial statements. The Task Force believes that although for purposes of the supplemental schedule participant loans will still be reported as investments, the current value included on the supplemental schedule for the participant loans will now be consistent with the measurement requirements in GAAP.

Effective Date and Transition

BC7. The effective date will be determined after the Task Force considers the feedback on the proposed Update.

BC8. The Task Force decided that the provisions of this proposed Update would be applied retrospectively upon adoption. The Task Force believes that retrospective application would be possible and cost effective because plan sponsors have the necessary historical information to reclassify participant loans from investments to notes receivable from participants separately from investments. Furthermore, the Task Force believes that the application of the amendments in this proposed Update would generally not result in a change to how participant loans are being measured in practice.

Benefits and Costs

BC9. The objective of financial reporting is to provide information that is useful to present and potential investors, creditors, donors, and other capital market participants in making rational investment, credit, and similar resource allocation decisions. However, the benefits of providing information for that purpose should justify the related costs. Present and potential investors, creditors, donors, and other users of financial information benefit from improvements in financial reporting, while the costs to implement new guidance are borne primarily by present investors. The Task Force's assessment of the costs and benefits of issuing new guidance is unavoidably more qualitative than quantitative because there is no method to objectively measure the costs to implement new guidance or to quantify the value of improved information in financial statements.

BC10. The Task Force does not anticipate that entities would incur significant costs as a result of the amendments in this proposed Update. The Task Force expects that the proposed measurement of participant loans is currently used in practice and that information to apply the guidance in this proposed Update on a retrospective basis would be readily available.

Amendments to the XBRL Taxonomy

There are no proposed amendments to the XBRL taxonomy as a result of the amendments in this proposed Update.