



SUTHERLAND

December 5, 2016

VIA E-MAIL

Office of Regulations and Interpretations,
Employee Benefits Security Administration,
Attn: RIN 1210-AB63;
Annual Reporting and Disclosure, Room N-5655,
U.S. Department of Labor,
200 Constitution Avenue NW,
Washington, DC 20210

Re: RIN 1210-AB63 – Comments on Proposed Revision of
Annual Information Return/Reports (Form 5500)

Dear Sir or Madam:

We appreciate the opportunity to respond to the request for comments issued by the U.S. Department of Labor (the “Department”) regarding the proposed amendments and form revisions regarding the Form 5500 Annual Return/Report of Employee Benefit Plan and Form 5500-SF Short Form Annual Return/Report of Small Employee Benefit Plan (collectively, the “Form 5500 Proposal”). The Coalition of Collective Investment Trusts (the “Coalition”) is a group of fund sponsors and money managers active in the collective investment trust industry. With approximately 40 member companies, the Coalition collectively represents a sizeable presence in the industry.

The Form 5500 Proposal presents significant changes to the information that plans and their service providers will need to report and to the method of such reporting. As such, a number of industry groups have or can be expected to submit detailed comments to the Department suggesting how to modify or refine the Form 5500 Proposal to make it better coordinate with existing reporting regimes while still supporting the Department’s goals. In particular, the American Bankers Association (ABA) has submitted two sets of comments regarding the Form 5500 Proposal. We are writing today both to express our support for the comments offered by the ABA and to expand upon two specific aspects of the Form 5500

Proposal in the context of collective investment trusts (“CIT”s): (1) the definition of Hard-to-Value Assets, and (2) certain modifications to Schedule H. We would also ask the Department’s consideration of withdrawing the proposal and re-evaluating it in the context of anticipated regulatory reform which is likely to occur with the onset of the new administration.

We thank the Department for this opportunity to comment on the matters addressed in the Form 5500 Proposal and look forward to similar opportunities to provide substantive comments in the future.

Hard-to-Value Assets (HTVA)

One of the stated objectives of the Form 5500 Proposal is to modernize both financial and plan operation information gathering and reporting.¹ Regarding this overarching goal, the form revisions highlight the DOL’s emphasis on changes in reporting of investments that are considered hard-to-value assets.² For instance, the form revisions state that “[t]hese proposed changes to financial reporting are specifically designed to improve reporting of alternative investments, hard-to-value assets, and investments through collective investment vehicles and participant-directed brokerage accounts.” The Coalition submits that the revised Form 5500 will better accomplish these goals, and in a more cost-effective manner, with the following changes.

Clarification of the General Definition of HTVA

The proposed form revisions include a new definition for a HTVA.³ In part, HTVAs are defined as “assets that are not listed on any national exchanges or over-the-counter markets, or for which quoted market prices are not available from sources such as financial publications, the exchanges, or the National Association of Securities Dealers Automated Quotations System (NASDAQ).” This negative definition, which focuses on how assets may *not* be listed or quoted, creates a somewhat subjective standard, prone to differing interpretations. This will inevitably result in inconsistencies in reporting. Rather than promoting the Department’s goals of improving the reporting of such investments, the likely result is inconsistent reporting across plans and investment funds, thereby having the opposite effect on the Department’s goals.

We propose that the general definition of HTVA be tied to existing standards derived from accounting and other regulatory reporting requirements. For example, the Financial

¹ 81 Fed. Reg. 47497 & 47538.

² *Id.* at 47498 & 47541.

³ *Id.* at 47544.

Accounting Standards Board Statement of Financial Accounting Standards No. 157 (also called Accounting Standards Codification 820), the leading guidance on HTVA, has been updated over time, most recently in 2011 in Accounting Standards Update 2011-04, to align US GAAP with the International Financial Reporting Standards. The FASB guidance describes a hierarchy for fair valuation of assets as Level 1, 2 or 3, depending on how readily obtainable valuation data is with regard to the particular asset. Only level 3 assets are considered hard-to-value assets. Level 3 assets include those assets that cannot be valued by observable measures, such as market values or markets. In contrast, Level 1 and 2 assets are those considered more readily valued, with level 1 including any assets with observable quoted prices for identical assets or liabilities in active markets and Level 2 consisting of those assets that are readily valued based on market value but which are not publicly traded on an exchange.

The Coalition respectfully submits that the Department should adopt a more practical and common sense approach and provide a HTVA definition that correlates with the meaning of a Level 3 asset. This is a well-understood standard consistently under review by professional accountancy boards and used by the financial marketplace for classifying an asset as hard-to-value. This definition would better promote the Department's goals of transparency and modernization. It would facilitate having the information provided to plan sponsors in their plan's financial statements match the information reported in the Form 5500, thereby reducing confusion for plan sponsors and their consultants. There would be a consistent identification of a HTVA across the board. In addition, standardizing information collection and identification leads to efficiencies and helps to minimize costs associated with new reporting systems.

A CIT should not itself be deemed a HTVA simply by investing in a HTVA

In defining a HTVA, the Form 5500 Proposal further provides that certain pooled investment funds, including CITs "that are invested primarily in hard-to-value assets must themselves be identified as hard-to-value assets, regardless of whether they are valued at least annually."⁴ We support the Department's goal of developing a modernized information-gathering and reporting system; however we respectfully fail to see how labeling a CIT as a HTVA supports such goals. HTVA treatment would not generate any additional transparency or helpful information and would only serve to increase administrative costs.

The justification for this heightened reporting and information gathering status hinges on the premise that CITs and other pooled accounts are singularly difficult to value because of their

⁴ *Id.* at 47544 & 47631.

underlying investments and the view that they are not subject to adequate valuation rigor simply because not listed on national exchanges. This reflects a fundamental misunderstanding of how collective trusts are structured and valued in practice.

In terms of valuation, CITs follow practices that are, fundamentally, very similar to those employed by mutual funds. Structurally, both investment vehicles comprise pooled assets that are collectively invested with an established investment philosophy and objective. Furthermore, both vehicles provide frequent – in many cases daily – valuations of the vehicle and its units or shares. CITs are not subject to regulatory and reporting requirements under the SEC, however; that does not mean that they are exempt from meaningful regulatory and reporting controls. In fact, CITs are subject to reporting and valuation requirements under applicable bank regulations. A large number of CITs price their investments on a daily basis in order to provide daily unit values to facilitate daily plan and participant transactions.

In many cases, these investment valuations are performed by the same well-known asset managers and custodians that provide similar services to mutual funds, using very similar valuation practices. For that reason, any underlying investment in a CIT that fits the proposed definition of HTVA must be valued on a daily basis, most often using the FASB valuation practices described above. In addition, most CITs are subject to review by nationally known accounting firms through annual audits of the CIT bank sponsors and their CITs, which should create an additional level of assurance to the Department that the CIT is not hard to value. Thus, the underlying premise for imposing HTVA status on CITs and other collective accounts due to the opaque nature of their investments or valuation practices appears to fall short.

Finally, characterizing a CIT as a HTVA has consequences for small plans that wish to invest in such funds. Plans investing in HTVAs are ineligible to file Form 5500-SF.⁵ This means that a small plan would have to file a full Form 5500 if the CIT in which it invests determines to invest primarily in HTVAs. Such CITs do not present more risk or less transparency to the plan investors than mutual funds investing in the same assets, but the CIT investment is significantly disadvantaged by this treatment. This proposed requirement increases the costs and burdens to smaller plans which might otherwise be able to file the shortened 5500. Accordingly, such plans may feel constrained from choosing pooled investment options otherwise available to them and that were designed to enable smaller plans to broaden their retirement portfolio and diversify risks associated with relying too extensively on conventional stock and bond portfolios.

⁵ *Id.* at 47665.

Refinement of Schedule H

While the revisions to Schedule H were designed to develop a more modernized information-gathering and reporting system, the proposed form revisions reverse course by requiring a breakdown of all of the underlying assets of the CIT. At first glance, this break down would appear to increase transparency. If examined closely however, it can be seen to actually result in more confusion and less transparency due to the potentially voluminous reporting of unnecessary data.

Refining CIT Breakdown of Assets

The proposed break outs to Schedule H will generate a large amount of additional data by requiring a list of each asset in which a CIT invests, broken down on either a plan-by-plan basis on Schedule H, or in the case of a direct filing entity (“DFE”), on the DFE’s own Schedule H. CIT holdings information is already available to plans investing in the CIT through the CIT’s audited financial statement reporting and additional reporting made available throughout the year. Because Schedule H, as proposed, would require CIT sponsors to create an additional hierarchy and security breakdown for Form 5500 reporting, beyond what they routinely provide to plan investors, since the asset classes and sub-classes prescribed by the proposal are outside the norm for financial reporting. In this manner, the DOL would be disadvantaging CITs in the retirement market place by increasing costs and complexities for these investment vehicles, as compared to mutual funds. This is particularly unfortunate, since plan sponsors have begun to appreciate the lower costs and greater flexibility of investing in CITs.

- Many CITs have indexed investment strategies, such as S&P 500 funds. The revisions to Schedule H would require an index-based CIT to list all of the S’ & P 500 stocks and break down each plan’s proportionate interest in each of those stocks. This information does not appear to serve any real purpose; indeed a similar S&P 500 mutual fund would not be subject to this requirement. The result is an increase in the administrative costs to both the plan and the CIT for the collection and reporting of data that appears to be of limited utility to the DOL.
- In the case of CITs investing in alternative or hard-to-value funds, as a component of a target-date fund, for example, for the reasons described above they should be subject to the same limited Schedule H reporting requirements as are mutual funds.

Finally, in the event that the Department determines that a full breakdown of CIT assets would be required, the Department should look to provide consistency with respect to the form and format as used by mutual funds for SEC filings (e.g. Form N-PORT).

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Clarification of Certain Definitions

Finally, there are a number of additional clarifications that can be made to the Schedule H asset classes and specific definitions in the Form 5500 instructions. These changes will help ensure accurate and consistent reporting across plans and service providers, while at the same time improving efficiencies by conforming 5500 reporting items with data already being collected for other regulatory purposes. The Coalition encourages the DOL to consider the detailed recommendations from other industry organizations providing comment letters on this topic.

Sincerely,

A handwritten signature in blue ink that reads "Clifford Kirsch/ctm".

Clifford E. Kirsch

A handwritten signature in blue ink that reads "Carol McClarnon".

Carol T. McClarnon

CK/CTM