American Bankers Association
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Sherry Hazel
American Institute of Certified Public Accountants
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Re: Proposed Statement On Auditing Standards – *Forming An Opinion And Reporting On Financial Statements Of Employee Benefit Plans Subject To ERISA*

Dear Ms. Hazel:

The American Bankers Association (ABA[1]) appreciates the opportunity to comment on the Proposed Statement On Auditing Standards – *Forming An Opinion And Reporting On Financial Statements Of Employee Benefit Plans Subject To ERISA* (the Proposal). Many ABA members provide trust, custodial, and accounting services related to employee benefit plans (EBPs) for institutional clients. The Proposal, therefore, directly affects the nature and extent of many critical bank custodian services.

Under current audit requirements and within ERISA regulation, in certain circumstances, the EBP sponsor may instruct the auditor not to perform any auditing procedures with respect to investment information. The option is commonly referred to as a "limited scope audit." In these circumstances, qualified institutions (as plan custodians) generally certify as to the completeness and accuracy of investment information (the certification). The Proposal provides guidance to auditors for both limited and full scope audits and, as a result, emphasizes a greater understanding of responsibilities of the plan sponsor and of the custodian(s).

Since ERISA's enactment, custodial and trust duties and relationships have evolved alongside changes in the financial markets. For example, the manner in which plan assets are held has changed dramatically since 1974, as pointed out by the Department of Labor (DOL) Office of Inspector General's (OIG's) report in the audit of benefit plans, with the vast majority of most asset classes being no longer held in physical form but instead reflected as "books and records" holdings. Additionally, certain existing practices among custodians related to valuation of specific assets, such as limited partnerships, may not necessarily comply with the appropriate accounting framework (fair value).

While the Proposal brings clarity and focus as to when reliance on the certification to limit the scope of the audit is permissible, we request that the Auditing Standards Board (ASB) consider two issues that are integral to the Proposal's goals but which remain unaddressed:

1. The Proposal does not address the inherent gaps in the ERISA statutes which result in known limits of the certification, specifically: (a) no clear definitions or interpretations of "to hold"

[1] The American Bankers Association represents banks of all sizes and charters and is the voice for the nation's $17 trillion banking industry and its two million employees.

assets and to "execute investment transactions," and (b) the requirement to certify the completeness and accuracy of the investments, rather than to certify specifically as to their fair values.

2. The final standard should provide additional clarity and guidance on what action should be taken by the auditors and plan sponsors based on the known limits of the certification, particularly when complex assets are held by the plan. For example, the final standard should address how the auditor obtains reasonable assurance that the plan sponsor was able to make the determination that "the certified investment information is appropriately measured, presented, and disclosed in accordance with the applicable financial reporting framework."

Lastly, we strongly urge the ASB reconsider the requirement for an auditor to report findings of the audit over specific plan provisions. We see practical unintended consequences that are likely to occur, particularly given that findings will be attached to the Form 5500 and, along with the auditor's report, be made publicly available. We believe that there is high likelihood that those who gain access to these reports will misinterpret the findings, especially considering the definition of "findings" and "clearly inconsequential" are not well defined. Further, communications between the auditor, the plan sponsor, and the custodian may then deteriorate for fear that findings will be reported, even when the related issue is first identified by the plan sponsor. The costs of addressing this likelihood will certainly not exceed any perceived benefits and, in certain cases, this requirement could actually cause more harm than help.

On the attached Appendix, we have detailed comments to specific aspects of the Proposal related particularly to the certification. Thank you for your attention to this matter and for considering our request. The ABA membership would welcome the opportunity to actively participate in clarifying or reaching consensus on the open items outlined in the Appendix.

Please feel free to contact me (mgullette@aba.com; 202-663-4986) if you would like to discuss this further.

Sincerely,

Michael L. Gullette

Appendix: Comments to Specific Issues within the Proposal

Defining "Hold" and "Execute" within the Limited Scope Audit

While the majority of EBPs hold assets that have readily-available fair values with straight-forward servicing related to them, certain assets in some ERISA trusts are more complicated, requiring sub-custodians, or they may be invested in commingled funds, funds-of-funds, or funds organized into other similar structures. The Proposal clarifies that plan sponsors provide written representation to the auditor that the certification was received from a qualified institution meeting the requirements under ERISA, including the requirement that the institution both "holds the investments and executes investment transactions."

We appreciate the ASB's desire to provide clarification that management of the plan sponsor must determine whether the certifying institution "holds" the assets and "executes investment transactions" included in the certification. However, the meaning of these terms is unclear and therefore does not assist with this determination. This is because most securities and other assets no longer exist in physical form, but are instead reflected as "books and records" holdings with one or more central depositories, clearing corporations, sub-custodians, transfer agents, or similar entities. The depositories and clearing houses, like the Federal Reserve and Depository Trust and Clearing Corporation (DTCC), actually maintain the official record of the holdings. The banks reflect these holdings on their books.

Most custodians consider "holding" an asset to be equivalent to having "custody" of the asset. For non-physical assets, this generally means that the ownership of the asset is reflected through book-entry in the name of the trust for which the certifying entity serves as trustee, or in the name of the certifying entity itself (or its duly appointed nominee or other agent), acting on behalf of its customer(s). This includes assets the custodian "holds" with a domestic or foreign sub-custodian and/or depository (such as the Federal Reserve, in the case of U.S. government and agency securities held in book entry form) in an account that is identified as belonging to the custodian for the benefit of its customers. In other words, the essential element for "holding" an asset is generally understood as maintaining the evidence of ownership of the asset in the custodian's (or its duly appointed nominee's or other agent's) name, or in the name of the trust, for the benefit of one or more of its customers.

Recognizing that it is outside of the ASB's purview to establish legal interpretations of ERISA, it would nonetheless be useful for the ASB to affirm that, for purposes of management's determination, "holding the investments and executing investment transactions" includes the following scenarios, which are commonly recognized as constituting "custody" of an asset:

- Non-physical assets "held" in the following manner:
    - As trustee, where title is in the name of the certifying entity as trustee for the plan.
    - As custodian, where title is in the name of the plan or trust.

This also includes hedge funds and limited partnerships, where the issuer reflects the plan or trust as owner and the custodian is involved in numerous aspects of the investment activity, including payment for purchases and receipt of redemptions and other proceeds, processing of capital calls, and receipt of statements.

- Assets held by sub-custodians and/or depositories
- Assets for which the certifying entity's evidence of ownership can be established in accordance with standard industry practice and for which the certifying entity handles the settlement of funds associated with trading or other activity, such as:
    - Pooled separate accounts, guaranteed annuity contracts, or other insurance products.

      Further guidance should address when plan sponsors should expect that these investments would be covered by a separate certification from the insurance carrier, or whether they would meet the definition of "held" by the custodian, and, therefore, not need to be carved out of the custodian's certification.
    - Collateral held by the counterparty, agent bank securities lending arrangements, as well as third-party lending arrangements where the collateral and/or assets on loan may be held elsewhere.
    - Participant loans held within defined contribution plans, where the record-keeper maintains the official books and records of loans by participants.

The ASB as well as the DOL should clarify that so long as the certifying institution serves as primary or "master" custodian, the use of sub-custodian agents, nominees, depositories, and other forms of book-entry does not prevent management from making a determination that the investments are "held" by the certifying entity. Without clarifying this, plan sponsors are likely to get inconsistent responses from custodians about which assets are covered by their certification.

If the DOL or ASB considers the broader range of assets listed above as being "not held", and which therefore should be carved out or otherwise excluded from certification, custodians would have to make changes to the certified reports provided today, as well as to the process for certifying. This would require lead time in order to integrate the changes into custodian and auditor processes and, of course, likely result in additional cost that would be passed on to the plan sponsors.

These comments also apply to the DOL's proposed Form 5500 Modernization project, which requires custodians to flag or carve out assets that are not "held" or are not otherwise presented at fair value. We strongly encourage the ASB to collaborate with the DOL to bring more clarity to the definitions that are integral to driving consistency and completeness in certifications issued by qualified institutions. ABA members would welcome the opportunity to participate in a collaboration between the ASB and the DOL in this effort.

It may be helpful to consider how other regulatory entities have more specifically defined the manner in which assets are held. Any opportunity to align the understanding, and where appropriate the definitions, across regulators and required filings (such as FBAR filings), related to the manner held would be beneficial to plan sponsors, preparers, and users of financial and regulatory reports.

Bridging the Gap between "Complete & Accurate" Market Values and GAAP-Compliant Fair Value

ERISA requires certifying entities to certify to the "completeness" and "accuracy" of the investment-related information reported as part of their "ordinary business records", which has not traditionally extended to certifying to fair value (for reasons outlined below). Requiring banks that are holding ERISA assets to certify to completeness & accuracy of investment-related holdings and activity is entirely appropriate, given that settling trades, collecting income and other transactions, holding assets, securing prices and producing valuation reports are integral to the custodial functions performed by banks. These functions are reviewed by regulators and external auditors, and covered within SOC 1 examinations (Systems and Organization Controls report). Providing fair value estimates, however, falls well outside this scope.

Plan sponsors, nonetheless, are tasked with determining whether the certifications reflect the fair value. Within paragraph 22 of the Proposal, it is stated that the auditor should request various written representations from management, including:

> "when management imposes an ERISA-permitted audit scope limitation, acknowledgement that management is responsible for the financial statements, and for […] determining whether the certified investment information is appropriately measured, presented and disclosed in accordance with the applicable financial reporting framework."

While we believe the wording in the Proposal is technically appropriate, in context of the reliance on the custodian during a limited scope audit, it may lead a plan sponsor to expect certified information from a custodian to already have the characteristics of being "appropriately measured" according to the applicable financial reporting framework (e.g. all values represent fair value). This may not always be the case, as certain values supplied by the custodian may represent "best available" values that do not conform to the fair value definition. Further, some of the values (both fair values and best available values) may represent those estimated by third-party specialists hired by the plan sponsor.

While the bank exercises appropriate control over the safekeeping and reporting of plan assets, including the pricing of those assets, these standard custody functions are not designed nor intended as a substitute for the rigorous valuation processes and controls normally expected under FASB's fair valuation measurement standard. Without performing these steps, it would be inappropriate for custodians to certify to fair value.

Responsibilities of the Plan Sponsor Related to Fair Values

It is the plan sponsor's responsibility to determine whether the values provided by the custodian are measured at fair value and, if not, to adjust the values appropriately. With the advent of the fair value measurement and presentation guidance under Accounting Standards Codification (ASC) Topic 820, custodians have provided improved transparency and clarity around the basis of the prices reflected in the trust statements. This has enabled their custody clients (including plan sponsors) to make better judgements as to whether the valuation of any particular asset provided by the custodian is reflective of fair value. We support the proposed audit guidance that focuses on procedures to examine the extent to which the plan sponsor utilized the custodian's (or third-party's) pricing transparency reports to assess whether the certified investment information has appropriately reflected plan investments in accordance with the accounting framework.

For non-marketable securities, such as limited partnerships, hedge funds, and other commingled funds, FASB's guidance under Accounting Standards Update (ASU) 2009-12, ASU 2015-07, and ASU 2015-10 provides very specific practices on the considerations and analyses that should be performed by reporting entities in order to rely on net asset value (NAV) as a practical expedient for reporting fair value. These steps include determining whether the fund meets the definition of or has attributes of an investment company or follows accounting and reporting guidance within or consistent with ASC Topic 946, Financial Services —Investment Companies.

The depth of analysis and level of documentation to support the assertion that a fund NAV qualifies as the practical expedient is clearly outside the realm of a custodian's 'ordinary business records'. The practices set forth by FASB related to investments valued at NAV should be considered additive to the custodian's reporting of market values in the certified statement. In other words, the issuance of a certification is not a replacement for performing these steps. Only after performing the procedures to determine whether the fund prices qualify as the practical expedient would the plan sponsor be in a position to determine whether the values certified by the custodian were appropriately measured.

We recommend that the final standard reiterate that these steps are expected to be performed by the reporting entity (the plan sponsor in this case), whether the plan is subject to a full scope or a limited scope audit.

Auditor's Role in Addressing the Inherent Gap in the ERISA Language

We recognize that the ASB must work within the constraints of the statutes, and cannot proffer a legal interpretation, nor an expansion of the ERISA language related to the clauses that describe the certifying entity's responsibility. To the extent that the final standard does not or cannot change the current mandate to provide certification to the "completeness and accuracy" of the investment data reported by the custodian, the burden will continue to lie with the plan sponsor to determine whether the certification is sufficient.

However, it is less clear in the Proposal as to what steps the auditor is expected to perform over the plan sponsor's valuation process in a limited scope scenario. Beyond simply receiving management's written representation, it would be helpful if the final standard includes specific audit steps intended to gain assurance that management has satisfactorily performed the steps needed to present fair value in accordance with GAAP.

Depending on the how the final standard clarifies certification carve-outs, as well as the audit of the plan sponsor's valuation procedures related to fair value measurement that are not covered by the certification, significant additional work could be required of the custodian, plan sponsor, and the auditor. This could be a significant cost-benefit issue that may warrant additional consideration.