August 15, 2014

Mr. David R. Bean
Director of Research and Technical Activities
Project No. 26-5E
Governmental Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Dear Mr. Bean:

The California State Teachers’ Retirement System (“CalSTRS” or “we”) has reviewed the Governmental Accounting Standards Board’s (“GASB”) Exposure Draft (“ED”), Fair Value Measurement and Application, and is pleased to offer our comments.

As background, CalSTRS is the largest educator-only pension fund in the world with a net position of $189 billion as of June 30, 2014. CalSTRS administers a hybrid retirement system consisting of a cost-sharing multiple-employer defined benefit plan, two defined contributions plans, and another postemployment benefit plan. CalSTRS provides pension benefit for California’s 868,000 public school educators and their beneficiaries. The Teachers' Retirement Law (California Education Code Section 22000 et seq.), as enacted and amended by the California Legislature, established these plans and CalSTRS as the administrator. The participating employers in CalSTRS are school districts and other related educational entities (collectively, “employers”) within the State of California; the State of California is the plan sponsor. All employers in California are statutorily required to participate in CalSTRS’ pension plans for certain classes of employees. Legal statutes dictate the amounts that employers, employees, and the plan sponsor must contribute to the plan. Additionally, the sponsor, not the employers, has the primary legal obligation for benefits that cannot be paid from plan assets.

Our Mission: Securing the Financial Future and Sustaining the Trust of California’s Educators
SUMMARY
We agree with many of the positions in the ED, especially those that result in more consistency in the measurement of investments among governmental entities. However, we have significant concerns about the effective date of certain of the provisions of the standard. Specifically, we recommend the Board consider a phased implementation approach for the disclosure requirements to help ease the implementation burden on governmental entities. Additionally, we have included below other comments and recommendations related to certain aspects of the measurement, presentation and disclosure provisions proposed in the ED. We also encourage the Board to hold an additional public hearing before finalizing the proposed standard.

MEASUREMENT OF INVESTMENTS
• We are concerned that ambiguity in the proposed guidance regarding the application of the NAV practical expedient may cause further diversity in practice. For example, public pension funds often own real estate for which there is a general partner holding a 1% interest with the fund holding the remaining 99%. We do not think the ED provides clear guidance as to whether this type of situation would qualify for the NAV practical expedient as a non-governmental entity. We recommend that such investments (as described above) should fall under the NAV practical expedient.
• Additionally, the ED is not clear if mutual funds, REITs and other traded securities that are priced at NAV would fall under the NAV practical expedient, given the proposed criteria. We recommend that the investments described above be excluded from all NAV related disclosures, even if they qualify for the NAV practical expedient.
• We understand that Paragraph B42 intends to clarify that the definition of investments does not apply to liabilities, but we would like clarification on whether an asset that has moved into a liability position should continue to be considered under the proposed standard’s definition of an investment. For instance, if a derivative moves into a liability position, would it be appropriate to reclassify the derivative as a liability?

PRESENTATION
• We agree with the Board’s proposed treatment of transaction costs when valuing an investment, which is to treat these costs as period costs, when incurred, rather than a reduction of an investment’s fair value at the time of acquisition. However, the ED
continues to remain silent on the treatment of costs incurred when purchasing an investment. We encourage the GASB to provide guidance on whether or not the costs to purchase an investment should be included in net appreciation of the fair value of investments or expensed in the period of acquisition. We recommend that the Board require acquisition costs be recorded as direct investment expense, to the extent these costs are readily identifiable, to be consistent with other period expenses. We think this would provide additional clarity for users and preparers.

- We recommend the GASB clarify how unrealized gains and losses should be reported for forward contracts, and whether unrealized gains and losses would be considered investments.

- We also would like to continue to note that inconsistency exists today in regards to the presentation of investments on the face of governmental entities’ financial statements as well as in the footnote disclosures. We note the lack of guidance regarding short term investment positions has created some diversity in practice. In addition, some governmental entities, specifically pension plans, will categorize investments by asset class and some will categorize investments by investment type, which creates a lack of comparability for users of governmental financial statements. The GASB should consider adding a schedule of investments to make classification of these investments more understandable.

- Additionally, GASB 40 *Deposits and Investment Risk Disclosures* and GASB 53 *Derivatives*, have not provided guidance for categorizing investments and the ED does not give the impression that the GASB intends to provide that guidance with this proposed standard. We urge the GASB to consider providing presentation guidance to aid in the consistency and comparability of governmental financial statements. This additional presentation guidance would not only be helpful to users of governmental financial statements, but would also allow for better benchmarking between similar governmental entities.

**DISCLOSURES**

- We continue to emphatically urge the GASB to consider a phased approach for the disclosure requirements to allow for gradual assimilation and to help ease the implementation burden on governmental entities, similar to the FASB’s approach to the disclosure requirements for Accounting Standards Codification 820 *Fair Value Measurement*. Governmental entities will bear a significant burden in validating inputs.
and especially in evaluating Level 3 investments. We recommend that all disclosures related to securities that fall under the NAV practical expedient should be delayed.

- We recommend the GASB clarify the definition of “type” regarding the NAV disclosures that should be applied to each “type of investment” to better understand the level of grouping that will be permitted for these disclosures.
- We support the GASB’s decision to remove from the ED the proposed disclosures relating to the sensitivity analysis as the cost of providing this information would outweigh the benefit to our users.
- We also support the GASB’s decision to remove from the ED the proposed disclosure of quantitative information about the significant unobservable inputs used in the fair value measurements of Level 3 investments as the cost of providing this information would outweigh the benefit to our users.

CLOSING

- CalSTRS appreciates the opportunity to comment on the Fair Value Measurement and Application ED. We would like to reiterate our concerns surrounding the cost-benefit of this proposed guidance and feel that our participation in the field study further supported this concern. Our interactions with our custodians during the field study confirmed that they will bear a significant cost as well, particularly the additional time and effort required to implement the disclosure requirements. While information from custodians will help in the process of implementing the proposed guidance, governmental entities will still bear a significant burden in validating inputs and especially in evaluating Level 3 investments. During our field test of the Preliminary Views Document, we estimated the size of the burden for the initial year (implementation of the proposed standard) would be $2,000,000 in non-staff (vendor) cost and 6,570 staff hours. Estimated fixed costs in subsequent years were approximately $100,000 of non-staff cost and 3,916 staff hours. These estimates do not include additional external audit fees associated with the review of the significantly augmented disclosures.
- At June 30, 2014, CalSTRS held approximately 14,000 total unique securities, 2,000 of which will require significant additional research to assign the appropriate level within the fair value hierarchy. Approximately 600 of our securities are predicted to qualify for the NAV practical expedient, as we understand the proposed guidance. We are primarily concerned about the value of NAV disclosures to our readers given the large volume of our securities.
- Given the volume of work required to implement the proposed standard we do not recommend retrospective application.
- Given the significance of the guidance for certain government entities, we also urge the GASB to conduct an additional public hearing to discuss these concerns before finalizing the standard.

Sincerely,

Lieu Nguyen
On behalf of Robin Madsen
Chief Financial Officer, Financial Services