MEMO# 26499

September 12, 2012

Draft ICI Comment Letter On FASB Liquidity Risk Disclosure Proposal; Comments Requested By September 20

[26499]

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TO: ACCOUNTING/TREASURERS COMMITTEE No. 12-12 RE: DRAFT ICI COMMENT LETTER ON FASB LIQUIDITY RISK DISCLOSURE PROPOSAL; COMMENTS REQUESTED BY SEPTEMBER 20

The Financial Accounting Standards Board recently released an exposure draft of a proposed accounting standards update that would amend ASC Topic 825 – Financial Instruments. [1] The Proposal would require all entities, including investment companies, to provide liquidity risk disclosures intended to inform financial statement users about the risk that the reporting organization may encounter difficulty when meeting its financial obligations. The proposed liquidity risk disclosures would require 1) a tabular presentation of cash flow obligations by class of financial instrument for specified time intervals, 2) a tabular presentation of available liquid funds and borrowing capacity, and 3) any additional quantitative and narrative disclosures necessary to provide financial statement users with an understanding of liquidity risks.

ICI has prepared the attached draft comment letter, which is summarized below. If you have comments on the draft letter please provide them to Greg Smith at 202/326-5851 or smith@ici.org by Thursday, September 20.

Available Liquid Funds Table

The draft letter indicates that SEC registered investment companies must include in their financial statements a comprehensive schedule of investments listing separately and describing each security held. The schedule of investments must also disclose a subtotal for each type or category of investment together with its percentage value compared to net assets. The letter argues that the detailed listing of investments by type provides fund investors with a complete understanding of available liquid funds and makes the proposed tabular disclosure redundant and unnecessary. The letter also describes how open-end funds can invest no more than 15% of their assets in illiquid securities and describes how money market funds are subject to even more stringent liquidity requirements. The letter recommends that an entity that provides substantially similar information elsewhere in its financial statements need not provide the proposed available liquid funds table.

Cash Flow Obligations Table

The draft letter indicates that for certain types of open-end funds, liabilities and cash flow obligations are very small relative to total net assets. For other funds, however, cash flow obligations may be significant. For example, funds may engage in strategies that give rise to cash flow obligations, such as short sales, derivatives transactions, and purchase of securities on a delayed delivery or when issued basis. The letter argues that funds with no material cash flow obligations should not be required to provide the proposed cash flow obligations tabular disclosure and recommends a framework for assessing materiality. The framework parallels the investment company exemption from the requirement to provide a statement of cash flows currently included in GAAP. In particular, a fund that meets the following conditions would not be required to provide the proposed cash flow obligations table:

1. During the period, substantially all of the entity's investments were highly liquid (for example, marketable securities, and other assets for which a market is readily available);
2. Substantially all of the entity's investments are carried at market value. Securities for which market value is determined using matrix pricing techniques would meet this condition. Other securities for which market value is not readily determinable and for which fair value must be determined in good faith by the board of directors would not;
3. The entity had little or no cash flow obligations, based on average cash flow obligations during the period, in relation to average total net assets. For the purposes of determining average cash flow obligations, obligations resulting from redemptions of shares by the entity, from unsettled purchases of securities or similar assets, or from covered options written generally may be excluded. However, any extension of credit by the seller that is not in accordance with standard industry practices for redeeming shares or for settling purchases of investments shall be included in average cash flow obligations; and
4. The entity provides a statement of changes in net assets.

Definition of Available Liquid Funds

Liquid funds as described in the Proposal include unencumbered cash, high-quality liquid assets, and borrowing availability. The draft letter indicates that funds may pledge cash or other portfolio securities as collateral with an exchange or derivative counterparty in order to ensure the exchange or counterparty that the fund will perform on its obligation. The letter questions why such pledged assets are excluded from the available liquid funds table. Such exclusion infers liquidity risk, where in fact no such risk exists. The letter recommends that where an entity has pledged cash or assets specifically to satisfy disclosed cash flow obligations, then the pledged assets should be able to be included in the liquid assets table (or the pledged assets should be shown as a contra item in the cash flow obligations table).

Gregory M. Smith
Senior Director of Fund Accounting and Compliance

Attachment

endnotes

[1] The exposure draft, Disclosures about Liquidity and Interest Rate Risk (Proposal) is available on the FASB website. For a summary of the Proposal, see ICI Memorandum No. 26282 (July 2, 2012).

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