INVESTMENT COMPANY INSTITUTE

MEMO# 17919

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DRAFT INSTITUTE COMMENT LETTER ON FASB PROPOSAL REGARDING FAIR VALUE MEASUREMENTS

[17919] August 24, 2004 TO: ACCOUNTING/TREASURERS COMMITTEE No. 27-04 CLOSED-END INVESTMENT COMPANY COMMITTEE No. 34-04 SEC RULES COMMITTEE No. 72-04 UNIT INVESTMENT TRUST COMMITTEE No. 23-04 RE: DRAFT INSTITUTE COMMENT LETTER ON FASB PROPOSAL REGARDING FAIR VALUE MEASUREMENTS As we previously advised you, the Financial Accounting Standards Board issued an exposure draft of a proposed accounting standard entitled Fair Value Measurements.1 If adopted the Exposure Draft would amend generally accepted accounting principles and would apply to all entities that prepare GAAP-based financial statements, including investment companies. The Exposure Draft would apply broadly to financial and non-financial assets and liabilities that are required to be measured at fair value under existing accounting standards. Attached is a draft comment letter on the proposal, which is briefly summarized below. Comments on the proposal are due to the FASB by September 7th. Please provide your comments on the draft letter to the undersigned no later than Wednesday, September 1 by phone (202/326-5851), fax (202/326-8314) or e-mail (smith@ici.org). The Institute's letter indicates that SEC registered investment companies are subject to extensive SEC regulation, including the manner in which they value their securities holdings, both for purposes of calculating daily net asset values and preparing financial statements. The letter goes on to state that, in certain instances the FASB proposal conflicts with SEC valuation requirements applicable to registered funds. The letter notes that if the Proposal is adopted in its current form, certain registered funds (depending on their security holdings) seemingly could not concurrently comply with both SEC valuation requirements and the FASB standard. The Institute's letter urges the Board to resolve these conflicts by conforming the proposal to SEC valuation requirements, or acknowledge that as to conflicts, registered funds should refer to applicable SEC standards. 1 See Institute Memorandum to Accounting/Treasurers Committee No. 22-04, Closed-end Investment Company Committee No. 23-04, SEC Rules Committee No. 57-04 and UIT Committee No. 14-04 [No. 17743], dated July 1, 2004. 2 Level 1 Reference Market The letter notes that the FASB proposal would seemingly require registered funds to consider last sale prices from regional exchanges (assuming they are active markets) and to use those prices if they are more advantageous than the last sale price from the exchange where the security is principally traded. The Institute's letter notes that, under SEC ASR 118, registered funds should designate a principal market for their securities and base value determinations on last sale trades from that market, irrespective of trades on other exchanges. Pricing in Active Dealer Markets Under the FASB proposal, securities traded in over-the-counter dealer markets, such as NASDAQ stocks and most fixed-income securities, would be

required to be valued at the bid price. The letter notes that during the past several months NASDAQ has made substantial improvements to its closing price reporting systems. These systems include the NASDAQ Closing Cross and the NASDAQ Official Closing Price. The Institute's letter urges the Board to permit NASDAQ traded stocks to be valued by reference to the last sale closing price. As to fixed-income securities, the draft letter notes that SEC ASR 118 permits a registered fund to "adopt a policy of using a mean of the bid prices, or of the bid and asked prices, or of the prices of a representative selection of broker-dealers quoting on a particular security; or it may use a valuation within the range of bid and asked prices considered best to represent value in the circumstances." Further, "any of these policies is acceptable if consistently applied." The Institute's letter indicates that ASR 118 appropriately affords the investment company discretion to apply the valuation methodology that best represents value in the particular circumstances. Measurement of Blocks The Institute's letter notes that registered funds are required to value their holdings by reference to readily available market quotes and that the SEC staff have indicated on several occasions that it would be inappropriate for registered funds to mark-up or mark-down a readily available market price for an unrestricted security solely because the company holds a large quantity of the outstanding shares of the issuer or holds an amount that is a significant portion of the security's average daily trading volume. The letter also notes that application of block discounts would reduce consistency and comparability, since it would cause different funds to apply different prices to the same security. The letter also states that mandated block discounts may be based on the mistaken assumption that funds are forced to accept reduced prices when they sell securities to meet redemption requests. Finally, the letter notes that block discounts are inconsistent with the "going-concern" assumption inherent in financial reporting. Gregory M. Smith Director – Operations/ Compliance & Fund Accounting Attachment (in .pdf format)
