

COMMENT LETTER

September 3, 2010

ICI Comment Letter on FASB Level 3 Measurement Uncertainty Analysis (pdf)

9/3/20109/3/20109/3/2010 VIA ELECTRONIC DELIVERY September 3, 2010 Mr. Russell G. Golden Technical Director Financial Accounting Standards Board 401 Merritt 7 P.O. Box 5116 Norwalk, CT 06856-5116 Re: Amendments for Common Fair Value Measurements and Disclosure Requirements in U.S. GAAP and IFRSs; File Reference No. 1830-100 Dear Mr. Golden: The Investment Company Institute¹ appreciates the opportunity to comment on the proposed accounting standards update Amendments for Common Fair Value Measurements and Disclosure Requirements in U.S. GAAP and IFRSs (Proposal or ASU). The Proposal would require issuers, including investment companies, to disclose the effects of alternative inputs on Level 3 fair value measurements through a measurement uncertainty analysis. The measurement uncertainty analysis is intended to provide readers of financial statements with information about the measurement uncertainty inherent in fair value measurements categorized within Level 3 of the fair value hierarchy at the measurement date. If changing one or more of the unobservable inputs used in a fair value measurement to a different amount that could have reasonably been used in the circumstances would have resulted in a significantly higher or lower fair value measurement, the issuer would be required to disclose the effect ¹ The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of \$11.66 trillion and serve almost 90 million shareholders. ² of using the alternative inputs and how it calculated that effect. The proposed disclosure would be provided by class of asset, rather than for individual security holdings. A separate Board proposal indicates that an issuer need not provide a measurement uncertainty analysis for unquoted equity instruments.² We see little benefit associated with application of the measurement uncertainty analysis to mutual funds. Indeed, we are concerned that the analysis may diminish fund investors' confidence in financial reporting and reported net asset value per share. We recommend that investment companies that are required to redeem their shares daily at their current fair value be excluded from the proposed requirement to provide a measurement uncertainty analysis. Benefits Lacking in Fund Context Paragraph BC of the ASU indicates that the Board decided, based on comments received on the exposure draft for Accounting Standards Update 2010-06, that disclosure of the measurement uncertainty inherent in a Level 3 fair value measurement would provide helpful information to users of financial statements. We agree investors in operating companies may find such disclosure useful in assessing earnings "quality" and the potential variability in earnings attributable to management's estimates of the fair value of Level 3

assets. The variability in earnings attributable to management's estimates may affect investors' assessment of the issuer and the price they are willing to pay for the issuer's shares. We see little benefit, however, with the proposed disclosure in the context of an open-end mutual fund that stands ready to redeem its shares each business day at their current fair value. Because a fund shareholder may redeem shares at their fair value, there is no need for, and little benefit associated with the proposed measurement uncertainty analysis. The sensitivity analysis amounts to a hypothetical exercise that has no bearing on the fund shareholder's actual experience in the fund, as measured by the change in the fund's net asset value per share over the reporting period and the related total return calculation. Indeed, we have concerns that the proposed measurement uncertainty analysis may cause investor confusion surrounding the fair value of the fund's shares and lessen confidence in the accuracy of the fund's net asset value per share and its reported returns.³ Instead, we believe providing the single best estimate of fair value based on the expertise and knowledge of fund management, under the supervision of the fund's board of directors, better serves fund shareholders.

² See paragraph 109 of proposed accounting standards update Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities (May 26, 2010).

³ We are also concerned that, should the reasonable alternative inputs occur in future periods, funds could find themselves subject to legal allegations that they miscalculated their NAVs by not adequately factoring those inputs into the fair value measurement process. While a fund that properly documents its valuation considerations should ultimately prevail against such allegations, the fact-based nature of such allegations could prevent them from being rejected as a matter of law, and could therefore result in substantial litigation costs.

3 Burden The proposed sensitivity analysis will entail potentially significant incremental cost and burden associated with preparing and auditing the disclosure of the effect of alternative inputs that reasonably could have been used. These costs may be incurred even where no disclosure is required so that a fund can demonstrate that the effects of the alternative inputs are not significant. Reporting entities will need to create a process and document their analyses and conclusions so that they are in a position to satisfy financial statement auditors. Ultimately, these costs will be borne by fund shareholders through increased administrative and audit fees charged to the fund.

Single Broker Quoted Securities Where a security does not trade regularly and independent pricing services do not provide an evaluated price due to lack of observable inputs, funds may obtain an indicative bid for the security from a broker-dealer. Funds may classify securities valued through reference to an indicative bid obtained from a broker-dealer as Level 3 holdings in fair value measurement disclosures. However, the fund likely would not know the valuation technique(s) or unobservable input(s) used by the broker-dealer in developing the indicative bid. Therefore, as a practical matter, the fund would not be able to perform the measurement uncertainty analysis called for in the ASU. We understand that some funds may use proprietary pricing models to validate indicative bids obtained from broker-dealers. In this circumstance, funds could decide to use their own proprietary pricing models to value the security (in lieu of obtaining bids from broker-dealers) and thus be in a position to develop the related sensitivity analysis. We are concerned that the proposed sensitivity analysis creates an incentive to internalize fair value measurements in the circumstance described above. Internalization would diminish the role of independent broker-dealers in the pricing process and create additional burdens on fund management.

Unquoted Equity Securities We support the exclusion of unquoted equity securities from the proposed measurement uncertainty analysis. Alternative inputs can be more readily applied to the contractual cash flows associated with fixed-income securities. In contrast, fair value measurements of unquoted equity securities are based on multiples of earnings, EBITDA or other less precise measures. We recommend that the exclusion be made a part of Topic

820, so that its effectiveness is not contingent upon adoption of the proposed amendments to Topic 815. 4 We appreciate the opportunity to comment on the proposed ASU and would be pleased to provide any additional information you may require. Please contact the undersigned at 202/326-5851 Sincerely, /s/ Gregory M. Smith Director – Operations/ Compliance & Fund Accounting cc: Richard F. Sennett Chief Accountant – Division of Investment Management U.S. Securities and Exchange Commission

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