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Ms. Suzanne Bielstein Director - Major Projects and Technical Activities Financial Accounting Standards Board 401 Merritt 7, P.O. Box 5116 Norwalk, CT 06856-5116

File Reference No. 1201-100

Dear Ms. Bielstein:

Fidelity Management & Research Company, the investment adviser to the Fidelity Investments group of funds, appreciates the opportunity to provide comments on the Exposure Draft - Proposed Statement of Financial Accounting Standards: Fair Value Measurements (the "Exposure Draft").

The proposals set forth in the Exposure Draft would have a significant impact on the investment management industry, most notably on SEC registered investment companies ("Registered Funds"). Registered Funds are subject to extensive regulation found in the Investment Company Act of 1940, ("1940 Act"). In governing investment company operations, the 1940 Act places significant focus on the manner in which securities are valued, both for purposes of calculating daily net asset values ("NAVs") and for financial reporting. The SEC has also issued several Accounting Series Releases, and various staff letters addressing funds' security valuation obligations. Under the 1940 Act, securities for which market quotations are readily available are to be valued at market value, and all other securities are to be valued at fair value as determined in good faith by the board of directors.² SEC Accounting Series Release No. 118 instructs Registered Funds to use the last quoted sales price as of the time of valuation.³ When there is no quoted sales information, ASR 118 contemplates the use of bid and asked prices quoted by broker dealers. In

¹ Fidelity Investments is one of the world's largest providers of financial services, with custodied assets of \$1.9 trillion, including managed assets of \$1.0 trillion as of July 31, 2004. Fidelity offers investment management, retirement planning, brokerage, human resources and benefits outsourcing services to 21 million individuals and institutions as well as through 5,500 financial intermediaries. The firm is the largest mutual fund company in the United States, the No. 1 provider of workplace retirement savings plans, one of the largest mutual fund supermarkets and a leading online brokerage firm.

² Section 2(a)(41) of the 1940 Act.

³Accounting Series Release No. 118, Investment Company Act Release No. 6295, (December 23, 1970) ("ASR 118").

the absence of readily available market quotations, funds must employ fair value methodologies to estimate the value of securities.

The mutual fund industry has come under intense scrutiny during the past year due, in part, to market timing abuses that have been widely reported in the mainstream press. The SEC has responded to concerns regarding various mutual fund scandals by requiring additional disclosure relating to "Fair Value Pricing" techniques and rule making. Given indications that additional guidance from the SEC in the area of valuation is forthcoming, we are concerned that the FASB's proposals to modify existing GAAP, some of which conflict with current regulatory guidance, may cause confusion and inconsistencies in financial reporting by Registered Funds.

As a firm that manages approximately 300 Registered Funds and many more other investment products, we determine the values of more than 40,000 financial assets every day and have had over 50 years of experience doing it. Fidelity has spent considerable time reviewing the Exposure Draft and while we agree the goals of providing a uniform standard for measurement of fair value, we have identified a number of proposals that cause us concern.

If the Exposure Draft is adopted as proposed, certain Registered Funds seemingly could not comply with both existing SEC valuation requirements and the new FASB requirements. The SEC has not proposed to revise or repeal ASR 118 and we believe Registered Funds would be required to continue to comply with it, notwithstanding adoption of the Exposure Draft by the FASB. We have outlined in four sections below those aspects of the Exposure Draft that we believe would inappropriately treat financial instruments like other assets and deserve significant consideration by the Board.

Section I: Active Market

Issue 3: This proposed Statement would clarify that valuation techniques used to estimate fair value should emphasize market inputs, including those derived from active markets. In this proposed Statement, active markets are those in which quoted prices are readily and regularly available; readily available means that pricing information is currently accessible and regularly available means that transactions occur with sufficient frequency to provide pricing information on an ongoing basis. Is that guidance sufficient? If not, what additional guidance is needed?

When considering financial instruments, we are concerned that the proposed definition of "active markets" does not address the intricacies of fixed-income markets. We are concerned that some may interpret the Exposure Draft to mean that the determination of value for most fixed-income instruments would require Level 2 or Level 3 estimates. If so, we believe this would cause preparers of financial statements to consider additional unneeded estimates under the income and cost approach.⁴ For many types of fixed-income instruments, including

⁴ The Proposal indicates that valuation techniques consistent with the market approach, income approach, <u>and</u> cost approach shall be considered for all estimates of fair value. The proposal concedes that the results of other valuation techniques may not provide significant additional information for estimates that are developed using quoted market prices in active markets.

investment grade instruments like Treasury, government, corporate and municipal securities, trading information for specific instruments may not be readily or regularly available from the dealer market and, therefore, it is virtually impossible to make an assessment as to whether the market is an "active market". However, in the fixed-income markets, there is a high correlation between price movements in similar investment grade instruments. It is common for Registered Funds to obtain prices for such instruments from brokers or pricing services that reflect indicative bids. Nevertheless, we would consider the markets in which many of these instruments trade to be "active markets". In fact, Registered Funds are required to maintain highly liquid portfolios under the Investment Company Act in order to stand ready to redeem their shares at net asset value. We believe it would be inappropriate to consider the values of many high grade fixed-income instruments to be Level 2 or Level 3 estimates, because we believe the pricing methods used are most appropriate for such instruments and reflect current market prices. Additional estimates of fair value for such instruments that would be required under the income and cost approach would provide little or no benefit.

Further, we believe the definition of "active market" results in the provisions pertaining to the use of Level 1 estimates in the fair value hierarchy to be overly restrictive. For certain types of financial instruments, although there may be a quoted market price that is readily and regularly available under the definitions in the Exposure Draft, it may nevertheless be inappropriate or impractical to use that estimate in all cases for purposes of determining fair value. For example, there may be news pertaining to an issuer before the close of the market that is yet to be reflected in the trading price of the issuer's security, which would call into question whether quoted market prices are reliable. Or, a market maker in a security may make a trade just prior to the close of the market, which may not be reflected in the closing market price. Alternatively, for money market funds, amortized cost may be used to determine value as permitted under Rule 2a-7 of the 1940 Act, because the method "approximates" fair value. We are concerned that paragraph 15 may require the use of Level 1 estimates in these instances, which would be inconsistent with SEC requirements.

We read footnote 6 of paragraph 7 to imply that the Board has contemplated that while it would be unusual to use other methods to estimate fair value when quoted market prices in active markets for financial instruments are regularly and readily available, situations may arise, like those described above which may warrant other approaches. We believe this point should be more clearly addressed in the final Standard. One possible way to address this would be to remove the concepts discussed in paragraph 7 that refer to multiple approaches to estimating fair value for Level 1 estimates, and instead expand the definition of "active markets" to address whether pricing information is "reliable". We believe this would be consistent with the SEC's approach to fair value. For Registered Funds, ASR 118 indicates that when the validity of market quotations appears to be questionable, further consideration should be given to whether "market quotations are readily available." The Commission has indicated that this includes situations when pricing information is not reliable. Such a broadening of the definition of active markets would allow preparers of financial statements the appropriate level of flexibility to follow a method that best estimates fair value.

Section II: Level 1 Reference Market

Issue 6: In this proposed Statement, the Level 1 reference market is the active market to which an entity has immediate access or, if the entity has immediate access to multiple active markets, the most advantageous market. Appendix B provides general guidance for selecting the appropriate reference market (Example 5). Is that guidance sufficient? If not, what additional guidance is needed?

We are concerned with the potential requirement that the last sale price for a security traded in its principal market may not be used to value the position on days when the last sale in a secondary (but active) market reflects a higher (more advantageous) price. There is a large and growing number of dually-listed stocks that trade actively on more than one exchange (e.g., (i) the New York Stock Exchange and a "regional" domestic exchange, or (ii) a foreign exchange and the New York Stock Exchange). Currently, Registered Funds designate a principal market for their dually-listed securities for purposes of valuing holdings, consistent with ASR 118. ASR 118 indicates: "In the case of securities listed on more than one national securities exchange the last quoted sale, up to the time of valuation, on the exchange on which the security is principally traded should be used or, if there were no sales on that exchange on the valuation date, the last quoted sale, up to the time of valuation, on the other exchanges should be used." Registered Funds identify principal markets in a thoughtful and consistent manner by considering trading volumes. Generally, there are large differences in volumes for actively traded dually-listed stocks that trade on, for example, the NYSE vs. regional exchanges. In the majority of these cases, significantly more of trading occurs on the NYSE and, therefore, Registered Funds designate the NYSE as the principal market.

It is unclear whether the Exposure Daft follows the principal market approach of ASR 118. The text of the proposed Statement would require a continual evaluation of secondary markets to determine whether quoted prices for identical assets are regularly and readily available, and when such prices are more advantageous, to estimate fair value using the secondary market price. This approach would require significant changes to pricing systems and vendor contracts, in order to accommodate a constant "toggling" between markets. However, Paragraph C46 of the Basis for Conclusions would seem to suggest that the Board may believe the most advantageous market should be used for securities when no single market represents the principal trading market. If this is in fact what the Board intends, we believe it should be clarified in the Standard rather than in the Basis for Conclusions.

We see little benefit to users of financial statements associated with any mandate to utilize most advantageous rather than principal market price for financial instruments, when compared to the costs shareholders of Registered Funds could incur to receive this information.⁶ Nor do we believe use of the most advantageous

⁵ Paragraph C46. of the Proposal indicates that the most advantageous market is the market with the price that would maximize the net amount that would be received for an asset and minimizes the amount that would be incurred for a liability.

⁶ Absent resolution of these conflicts, we are unsure how Registered Funds would comply with their obligation under the federal securities laws to file audited financial statements that comply with both generally accepted accounting standards and SEC security valuation requirements.

market for any single transaction is necessarily representative of the actual markets that we would necessarily execute trades. If a security were to transact at the most advantageous price for a sustained period in a secondary market, the majority of trading would migrate to that market and we would accordingly recognize that market as the principal market. Finally, where a dually-listed security trades concurrently, or in close time proximity, actively on multiple exchanges, any observed differences in prices are most often insignificant.

Section III: Measurement of Blocks

Issue 8: For unrestricted securities with quoted prices in active markets, many FASB pronouncements (including FASB Statement No. 107, Disclosures about Fair Value of Financial Instruments) require that fair value be estimated as the product of a quoted price for an individual trading unit. For large positions of such securities (blocks) held by broker-dealers and certain investment companies, the AICPA Audit and Accounting Guides for those industries (the Guides) permit fair value to be estimated using blockage factors (adjustments to quoted prices) in limited circumstances. In those cases, the unit of account is a block.

The Board initially decided to address that inconsistency in this proposed Statement as it relates to broker-dealers and investment companies. The Board agreed that the threshold issue is one of determining the appropriate unit of account. However, the Board disagreed on whether the appropriate unit of account is the individual trading unit (requiring the use of quoted prices) or a block (permitting the use of blockage factors). The majority of the Board believes that the appropriate unit of account is a block. However, the Board was unable to define that unit or otherwise establish a threshold criterion for determining when a block exists as a basis for using a blockage factor. The Board subsequently decided that for measurement of blocks held by broker-dealers and certain investment companies, current practice as permitted under the Guides should remain unchanged until such time as the Board fully considers those issues.

For those measurements, do you agree with the Board's decision? If applicable, what approaches should the Board consider for defining a block? What, if any, additional guidance is needed for measuring a block?

It is our understanding that the AICPA Audit and Accounting Guide, *Audits of Investment Companies* (the Audit Guide), permits fair value to be estimated using blockage factors only when it is determined under ASR 118 that market prices are not "readily available". On a number of occasions, the SEC Staff has clarified that a Registered Fund cannot determine market prices are not "readily available" for an unrestricted security that trades in an active market solely because the company holds a large quantity of the outstanding shares of the issuer or hold's an amount that is a significant portion of the security's average daily trading volume. ⁷ While we

⁷See "Dear CFO" letter from John S. Capone, Chief Accountant – Division of Investment Management, Securities and Exchange Commission (February 14, 2001) and Letter from Lynn Turner, Chief Accountant, Securities and Exchange Commission to Mark Sever, Chair – Accounting Standards Executive Committee, (April 11, 2001) ("Turner Letter"). The 2001 Turner Letter refers to AICPA consideration of a standard setting project related to block discounts noting, "Even if AcSEC completes a project on blockage, SEC registrants will continue to be precluded from applying a

acknowledge that the Audit Guide contains a "Stand-Still" clause that permits certain non-public investment companies to estimate fair value with blockage factors based on the entity's prior experience, we do not believe the Audit Guide ever explicitly or implicitly allowed the use of blockage factors in the manner being considered by the Board. Further, we believe the considerations for using blockage factors for brokers and dealers of securities are fundamentally different than those of Registered Funds. Brokers and dealers in securities are required to file computations of net capital pursuant to Rule 15c3-1 of the Securities Exchange Act of 1934, which require certain "haircuts" on proprietary positions to ensure a minimum net capital. These are inherently conservative calculations. Alternatively, Registered Funds are subject to the Investment Company Act of 1940. Shareholders of open-end Registered Funds transact at net asset value daily. Net asset value must be determined using quoted market prices when market quotations are readily available – in order to be fair to buyers, sellers and continuing shareholders – where, of course, no bias toward conservatism is appropriate.

We believe it is important for the Board to clarify in the final standard that use of blockage factors is not permitted for Registered Funds under the Audit Guide. Nevertheless, if the Board continues to pursue the concept of estimating fair value based on large blocks, we disagree with the concept in the Exposure Draft that the appropriate unit of account is a block because such an approach assumes that an entity's intent would be at all times to transact in the block market. While Registered Funds may trade in block markets, it is also common to trade in individual trading units. Consistent with the objective of the Exposure Draft, our traders seek the most advantageous price that can be achieved when trading in the normal course of business. This may involve utilizing multiple brokers when trading large positions. Further, we believe mandated use of a block unit of account would assume trading patterns outside the normal course of business. Application of block discounts to last sale prices for actively traded securities seems to suggest that significant numbers of Registered Funds' shares would be redeemed or that the fund itself may be in fact be liquidated in the near-term. This, we believe, is akin to "fire sale" pricing.

Registered Funds may not necessarily sell securities to meet redemption requests. Funds generally have incoming cash (e.g., proceeds from newly issued shares, dividends and interest on portfolio securities). Also, funds typically invest a portion of their assets in short-term securities (e.g., commercial paper, repurchase agreements) that can be readily converted to cash for the purpose of funding redemptions. Funds have the right to delay redemption proceeds up to seven days if making immediate payment would adversely affect the fund. Funds typically also reserve the right to borrow money from banks and/or other funds in the complex, particularly in order to meet abnormal redemptions. In addition, funds also have the right and often find it to be in the interests of continuing shareholders to satisfy certain redemptions in kind rather than in cash. Finally, not all Registered Funds provide for the redemption of shares. For instance, closed-end investment company shares are listed for trading on organized exchanges.

Absent any indication that securities would be sold in the near-term, we are concerned that mandated use of the block trading unit would cause redeeming/departing shareholders to receive less than their fair share of fund assets.

blockage factor in estimating the fair value of unrestricted investments if a quoted price in an active market is available."

Similarly, purchasing/incoming shareholders would be buying shares at "bargain" prices to the detriment of existing long-term shareholders. The only scenario where we believe it may be appropriate for the Board and the SEC to consider the use of a block trading unit would be when actual liquidity constraints (e.g., a sustained period of abnormal redemptions) prevent a Registered Fund from selling its securities at quoted market prices for an extended period of time.

Reduces Consistency, Reliability and Comparability

The Exposure Draft indicates that the FASB's fair value guidance seeks to improve financial reporting through increased consistency, reliability and comparability. If block discounts based on the number of shares held relative to trading volume, market capitalization or other measures are required, consistency and comparability of values of Registered Funds' holdings will be impaired relative to current practice.

For example, "Registered Fund A" with a "small" holding in a particular security would presumably utilize the principal market closing price to value its holding, while "Registered Fund B" with a "large" holding would presumably discount the market closing price to value its holding in the same security. This may occur within a single fund family (e.g., when two funds within the same mutual fund complex hold shares in a particular issuer), or across different fund families. We are particularly concerned with this proposal because we regularly publish the financial statements of multiple funds having the same reporting periods in the same document. We suspect that shareholders would be confused to see the same security valued at different prices in different funds' reports at the same date under the same cover. Additionally, we are concerned that funds' reported performance would be affected by the size of their holdings rather than the change in value of their holdings over the reporting period.

The Turner Letter indicates that the SEC staff is concerned that application of blockage factors could create earnings management opportunities. "For example, a block of stock may be acquired and a discount from the market value may be recorded. In many cases, that stock will not be sold as a block, but instead in smaller amounts, creating gains, and increasing earnings reported to investors. This practice decreases the quality of earnings." We share these concerns.

Section IV: Fair Value Hierarchy

Level 3 Estimates

Issue 9: This proposed Statement would require that in the absence of quoted for identical or similar assets or liabilities in active markets, fair value be estimated using multiple valuation techniques consistent with the market approach, income approach and cost approach whenever the information necessary to apply those techniques is available without undue cost and effort (Level 3 estimates). Appendix b provides general guidance for applying multiple valuation techniques (Examples 6-8). Is that guidance sufficient? If not, what additional guidance is needed?

We do not believe that requiring utilization of multiple valuation techniques consistent with the market approach, income approach and cost approach by Registered Funds to estimate values of Level 3 holdings is appropriate. The types of

financial instruments held by Registered Funds, in contrast to hard assets held by commercial and other enterprises, typically have unique characteristics that make one of the market approach, income approach or cost approach the obvious appropriate choice of methodologies for making Level 3 estimates. Registered Funds generally make determinations upon acquisition of Level 3 holdings, and periodically reconfirm the appropriateness of those determinations, as to which of the three estimation approaches is most appropriate in the circumstances. They consistently use the determined approach for their regular (usually daily) valuations and financial reporting.

Fair Value Disclosures

Issue 11: This proposed Statement would require expanded disclosures about the use of fair value to remeasure assets and liabilities recognized in the statement of financial position. Appendix B illustrates those disclosures. This proposed Statement also would encourage disclosures about other similar remeasurements that like fair value, represent current amounts. The Board concluded that those disclosures would improve the quality of information provided to users of financial statements. Do you agree? If not, why not?

The Exposure Draft identifies the objective of fair value disclosures to provide in one place, information about the extent to which fair value is used to re-measure assets and liabilities. Registered Funds are currently required under Regulation S-X to present a schedule of investments listing each security holding, the number of shares/principal amount, and the related fair value. These amounts are totaled by industry and presented as a percentage of net assets. Regulation S-X also requires registered funds to disclose in the notes to the financial statements, the methods used in determining value under the Investment Company Act of 1940.

The example provided in paragraph B22 illustrates that the reporting entity would present the fair values of various categories of assets (e.g. trading securities, derivatives, venture capital investments, etc.), subcategorized in the manner for which fair value was determined (i.e., trades/bids in identical securities, trades/bids in similar securities as adjusted for differences, and valuation models.) We submit that the categories proposed would not be relevant for Registered Funds given the existing requirements of the schedule of investments. As Registered Funds remeasure fair value on a daily basis, this illustration will serve only to replicate existing requirements in a slightly different format and location in the financial statements.

⁸ See SEC Regulation S-X, rule 12-12. Registered Funds may choose to provide a summary schedule of investments listing the top fifty holdings in their shareholder reports. Funds providing a summary schedule of investments in their shareholder report must file the full schedule of investments with the SEC and provide the full schedule of investments to shareholders upon request with charge.

⁹The SEC recently amended open-end mutual fund prospectus disclosure requirements to include an explanation of the circumstances in which the fund will use fair value pricing and the effects of using fair value pricing. These amendments were adopted in response to the increased incidence of market timing. See SEC Release No. IC-26418 (April 16, 2004).

We are also concerned that disclosure of the total amount of assets categorized by market inputs could be confusing for investors in Registered Funds, and may in fact lead investors to make inappropriate inferences regarding a fund's liquidity. As discussed above, we are concerned that the fair value hierarchy may establish a bias that that certain investment grade fixed-income instruments do not trade in "active markets". If so, it follows that users of financial statements will eventually attribute the disclosure of such market inputs to less liquidity, which, we believe, would be inappropriate and not part of the objective of the disclosure in the proposed Statement. To address liquidity disclosures, Registered Funds today must identify under Regulation S-X each restricted security held and disclose the acquisition date, cost, current fair value and the percentage of the total fair value of restricted securities to net assets at each reporting period-end. We believe this existing disclosure already allows an investor to properly assess a Registered Fund's liquidity. Further, the existing accounting policy disclosure required by Regulation S-X that is described above, would continue to provide investors with meaningful information to enable them to understand the fund's holdings, the related fair value amounts, and how those fair value amounts were determined, consistent with the objectives of paragraph B22.

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Of necessity, the Exposure Draft deals with many inherently complex topics. We appreciate how much effort has been required in its preparation. Unfortunately, we believe that, as proposed, it falls short in several critical respects and will generate significant problems for many Registered Funds and their shareholders. While we agree with the goal of achieving consistency in fair value measurements through one common standard, we believe the foundations of SEC requirements within ASR 118 should be preserved. In addition, we believe there are so many differences among the many types of assets and liabilities contemplated within the scope of the Exposure Draft, that to require them all to adhere to such strict proposals as those set forth would result in unintended consequences for many types of financial instruments.

The Exposure Draft needs significant additional revision before it is issued in final form. We therefore respectfully request that FASB reconsider these points prior to finalization.

We appreciate your time and consideration of our comments. If you have any questions or wish to discuss any of the issues addressed in this letter, please contact the undersigned at (617) 563-6564.

Very truly yours,

Christine Reynolds

Christine Reynolds
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