



April 1, 2009

VIA ELECTRONIC MAIL

Mr. Russell G. Golden
Technical Director
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, Connecticut 06856-5116



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LETTER OF COMMENT NO.

RE: Proposed FSP FAS 157-e – Determining Whether a Market Is Not Active and a Transaction Is Not Distressed

Dear Mr. Golden:

Fidelity Management & Research Company (“FMR”)¹ appreciates the opportunity to comment on the guidance in proposed FSP FAS 157-e (“FSP”) on determining whether a market for a financial asset is not active and a transaction is not distressed for purposes of fair value measurement under Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* (“FAS 157”). Our comments are limited to the application of the proposed FSP to open-end investment companies (or “mutual funds”) registered under the Investment Company Act of 1940, as amended (the “1940 Act”). In summary, FMR is concerned about the impact the proposed FSP will have on mutual funds and their shareholders because (i) most importantly, in an inactive market it will harm fund shareholders by separating the valuations attributed to certain fund holdings from the day-to-day prices a fund can expect to realize from them, (ii) it removes critical judgment from management in determining a security’s fair value, and (iii) it will provide opportunities for sophisticated investors to arbitrage funds at the expense of long-term investors. We urge the FASB to adopt the approach set forth in the 1940 Act and the SEC’s Accounting Series Release No. 118 (“ASR 118”) for mutual funds.

Unlike operating companies, mutual funds must value their shares every day based on the market values of the individual securities held in their portfolios. Proper and timely valuation of portfolio securities is critical to ensure that fund share prices derived from those valuations will be fair to shareholders, who purchase and redeem shares on a daily basis.² Because mutual funds must stand ready to redeem shares upon demand by a shareholder, there is an expectation that a fund’s NAV will reflect what it

¹ FMR serves as the investment adviser for the 376 registered investment companies in the Fidelity Group of Funds with aggregate net assets of over \$1 trillion.

² See Investment Company Institute, “Valuation and Liquidity Issues for Mutual Funds” (Feb. 1997) at 1.



would expect to receive from selling its securities in the current market – active or inactive. Depending upon the extent of redemptions and the amount of cash on hand at any given time, funds often need to sell portfolio securities to meet their redemption obligations. The nexus between the actual market value of portfolio securities and the value of fund shares is critical to ensure that, when redeeming or purchasing shares, a fund shareholder receives cash or shares equal to his *pro rata* portion of the aggregate value of the securities in the fund's portfolio. If a redeeming shareholder, for example, receives more or less than that value, the fund (and the shareholders remaining in it) or the shareholder, respectively, will be unfairly diluted. We are concerned that, by forcing management in many circumstances to ignore market prices when a market is deemed inactive, the proposed FSP will dilute the interests of fund shareholders by artificially inflating the fund's NAV as compared with the actual value it could expect to realize if it sells holdings to meet redemptions.

We believe that the current valuation framework for fund portfolio securities, as set forth in the 1940 Act and ASR 118, is a more equitable approach for mutual fund shareholders and therefore more appropriate for funds. The 1940 Act requires mutual funds to use market quotations for portfolio securities, when readily available, in calculating fund net asset values ("NAVs") and establishing fund share prices.³ When market quotations for portfolio securities are not readily available for NAV calculation, mutual funds must use fair value as determined in good faith by their boards of trustees.⁴ ASR 118 instructs mutual funds to use quoted sales information when valuing portfolio securities to compute their NAVs and, when such information is not available, to use bid and ask prices quoted by broker-dealers.⁵ Even if sales have been infrequent or the market in a security is thin, ASR 118 states that "further consideration should be given to whether 'market quotations are readily available.'"⁶ Importantly, in these cases, ASR 118 does not require a mutual fund to presume that market quotations are not readily available when markets are inactive.⁷ To the contrary, ASR 118 presumes that funds will continue to use market quotations to price their securities in markets that are not active – e.g., thin markets or where there are infrequent sales – unless the fund determines that such quotations are not readily available.⁸ The SEC staff has noted that funds are not permitted to ignore market quotations, as required by the proposed FSP under certain circumstances, and must exercise reasonable diligence to obtain market quotations for their portfolio securities before they may properly conclude that market quotations are

³ See Section 2(a)(41) of the 1940 Act; Rule 2a-4.

⁴ See *id.*

⁵ See Accounting Series Rel. No. 118, Inv. Co. Act Rel. No. 6295, 1970 SEC LEXIS 668 (Dec. 23, 1970), at *8.

⁶ *Id.* at *9.

⁷ See *id.*

⁸ See *id.*



not readily available.⁹ As noted above, the emphasis on market quotations has been paramount in the valuation of fund shares for many years because it minimizes dilution caused by a disconnect between the price of the fund itself and the aggregate daily value of its portfolio holdings.

We also believe application of the proposed FSP model in the current environment may create arbitrage opportunities that could invite exploitation by sophisticated investors, encourage frequent trading, and deter investment by long-term investors. In situations in which a market is not active and the quoted price is deemed to be associated with a distressed transaction, the FSP requires a fund to use a valuation technique other than one that uses the quoted price without significant adjustment. Such techniques would invariably result in a fair value for the security that is greater than the quoted price and correspondingly increase the fund's NAV on that date. Sophisticated investors who are aware that application of the FSP to a fund is likely to result in an artificial increase in the fund's NAV could redeem shares of the fund when markets for certain securities are not active, which would result in dilution to long-term investors in the fund.¹⁰

Finally, we believe the proposed FSP removes critical judgment from management in determining a security's fair value. Whether the market for a particular security is active or inactive should be considered by fund management, but only as one of many factors in determining whether a quoted market price is reliable and if alternative approaches to estimating fair value are appropriate. Under the ASR 118 model, while factors such as abnormally wide bid-ask spreads over a specified period of time and low trading activity in a security may be indicative of an inactive market, it may still be reasonable to conclude that market quotations are reliable and to apply a market approach to estimating fair value. Such a conclusion may be more appropriate and practical for mutual funds, whose shares are redeemable upon demand, than for operating companies.

For the reasons described above, we urge the FASB to adopt the guidance in ASR 118, or at least to afford additional time to engage the industry regarding other, more equitable approaches.

As an aside, we note that the ongoing application of the proposed FSP in the valuation of fund portfolio securities will present significant operational challenges to mutual funds, as they must value their portfolios on a daily basis, and the application of the March 16, 2009 proposed effective date would have the unintended effect of forcing funds to reconsider retroactively pricing decisions that were incorporated into fund NAVs between that date and the date of public notification of the FSP.

⁹ Letter to Craig S. Tyle, General Counsel, Investment Company Institute, from Douglas Scheidt, Associate Director and Chief Counsel, Division of Investment Management, U.S. Securities and Exchange Commission, dated April 30, 2001.

¹⁰ Although mutual funds may implement a number of measures to deter market timing and protect fund shareholders, such as redemption fees and excessive trading policies, such measures may not always be effective at preventing frequent trading in this case.



FMR appreciates the opportunity to comment on the proposed FSP and we welcome the opportunity to discuss further any of the issues addressed in this letter.

Very truly yours,

A handwritten signature in cursive script, appearing to read "Ken Robins".

Kenneth B. Robins
Treasurer
Fidelity Equity and High Income Funds

A handwritten signature in cursive script, appearing to read "John R. Hebble".

John R. Hebble
Treasurer
Fidelity Fixed-Income and Asset Allocation Funds

cc: Richard F. Sennett, Chief Accountant
Division of Investment Management
U.S. Securities and Exchange Commission