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Mr. Russell G. Golden
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Financial Accounting Standards Board
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LETTER OF COMMENT NO. 63

Reference No. 1550-100 – Preliminary Views, Financial Instruments with Characteristics of Equity

Dear Mr. Golden

Fidelity International Limited appreciates the opportunity to comment on the FASB's **Preliminary Views, Financial Instruments with Characteristics of Equity**.

By way of background, FIL Limited ("FIL") is a privately owned asset manager operating under the Fidelity International brand; provides investment advisory, management, and investor services for a range of collective investment schemes and separately managed accounts for individual and institutional customers including pension plans. FIL also develops markets and sells/licenses mutual fund-related application software and invests in emerging businesses. FIL'S head office is in Bermuda. FIL also operates in many other countries across the world, principally in Europe and Asia. FIL reports to its shareholders and other financial statement users under Accounting Principles Generally Accepted in the United States of America. FIL is a separate company from FMR Corp which operates under the Fidelity Investments brand in the United States.

FIL as an organization manages over \$250bn in client assets under management and is a significant user of financial statements.

We are concerned with the proposals on several grounds:

- The proposed basic ownership model has the potential for some of what is currently classified as equity to be reported as a liability, contrary to the substance of the instruments, particularly in the context of a private company equity share ownership plan. This would produce information that is not meaningful to the users of private company accounts;
- The proposed model effectively defines liabilities as those instruments that do not meet the definition of equity. While we support a principles based approach this is unsatisfactory as these items may or may not meet the generally accepted definitions of a liability. We would recommend that the FASB provide more specific "characteristics of liabilities";
- Defining equity as the most subordinated creditor means that the classification of an instrument may change over time when its intrinsic characteristics do not, and that the same instrument in different entities may be classified differently. We believe this hinders the objective of comparability.



An example illustrating the above issues would be where a private company with a basic equity structure issues a new series of more subordinated equity in a recapitalisation. The original equity holders would be reported as creditors:

- which was not the substance of the transaction,
- is not in accordance with current generally accepted definitions of a liability,
- means that the same instrument has changed in classification over time and an identical instrument in an equivalent company that had not recapitalised in this way would likely still be classed as equity.
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We believe that the definition of equity should relate to the economic substance of equity i.e. whether the instrument's primary characteristic is to expose the holder to the gains and losses of the reporting entity.

We also believe that equity should not be defined in isolation but rather in conjunction with a definition of liabilities and as such we would prefer to see no change until the Conceptual Framework and Financial Statement Presentation projects have made further progress. In the absence of delay until this time we believe an interim solution could be support of the ownership - settlement approach.

We appreciate the opportunity to express our views. If you have any questions regarding our comments or would like to discuss any in more detail, please contact Philip Haslam on 011 44 1737 837482.

Sincerely,

A handwritten signature in black ink, appearing to read "Deborah Speight".

Deborah Speight

Director – Bermuda Finance



Appendix – Fidelity International Limited’s responses to the specific questions raised in the Notice for Recipients

Basic Ownership approach

1. Do you believe that the basic ownership approach would represent an improvement in financial reporting? Are the underlying principles clear and appropriate? Do you agree that the approach would significantly simplify the accounting for instruments within the scope of this Preliminary View and provide minimal structuring opportunities?

No. For the reasons stated in the summary section we believe the basic ownership approach hinders comparability across entities and across time periods by defining equity relative to other issued instruments rather than against its that instrument’s own characteristics.

Perpetual Instruments

2. Under current practice, perpetual instruments are classified as equity. Under the basic ownership approach (and the REO approach, which is described in Appendix B) certain perpetual instruments, such as preferred shares, would be classified as liabilities. What potential operational concerns, if any, does this classification present?

There are no operational concerns assuming the liability is not mandatorily remeasured.

3. The Board has not yet concluded how liability instruments without settlement requirements should be measured. What potential operational concerns, if any, do the potential measurement requirements in paragraph 34 present? The Board is interested in additional suggestions about subsequent measurement requirements for perpetual instruments that are classified as liabilities.

We believe that perpetual financial instruments that participate in the gains and losses of the entity should be classed as equity costing their entirety. Other perpetual instruments should be classified as a liability at historic cost with the option to record at fair value in accordance with FAS 159.

Redeemable Basic Ownership Instruments

4. Basic ownership instruments with redemption requirements may be classified as equity if they meet the criteria in paragraph 20. Are the criteria in paragraph 20 operational? For example, can compliance with criterion (a) be determined?

We have no comment as we do not agree with the basic ownership approach.



Separation

5. A basic ownership instrument with a required dividend payment would be separated into liability and equity components. That classification is based on the Board's understanding of two facts. First, the dividend is an obligation that the entity has little or no discretion to avoid. Second, the dividend right does not transfer with the stock after a specified ex-dividend date, so it is not necessarily a transaction with a current owner. Has the Board properly interpreted the facts? Especially, is the dividend an obligation that the entity has little or no discretion to avoid? Does separating the instrument provide useful information?

We have no comment as we do not agree with the basic ownership approach.

Substance

6. Paragraph 44 would require an issuer to classify an instrument based on its substance. To do so, an issuer must consider factors that are stated in the contract and other factors that are not stated terms of the instrument. That proposed requirement is important under the ownership-settlement approach, which is described in Appendix A. However, the Board is unaware of any unstated factors that could affect an instrument's classification under the basic ownership approach. Is the substance principle necessary under the basic ownership approach? Are there factors or circumstances other than the stated terms of the instrument that could change an instrument's classification or measurement under the basic ownership approach? Additionally, do you believe that the basic ownership approach generally results in classification that is consistent with the economic substance of the instrument?

We support the substance principle. We do not believe that the basic ownership approach generally results in classification that is consistent with the economic substance of the instrument. This is because in an entity with a hierarchy of various classes of differently subordinated shares, only the least subordinated would be classified as equity. The other classes of share, although having risks and rewards aligned with the gains and losses of the entity, would be classified as liabilities. We believe that this is misleading to the users of the financial statements who are, in many cases, the holders of those less subordinated shares.

Linkage

7. Under what circumstances, if any, would the linkage principle in paragraph 41 not result in classification that reflects the economics of the transaction?

We support the principle but believe that it is possible that multiple classes of common stock may not meet the criteria of paragraph 41. Rather than extend the principle we would prefer to see the definition of equity relate to the economic substance of equity i.e. whether the instrument's primary characteristic is to expose the holder to the gains and losses of the reporting entity



Measurement

8. Under current accounting, many derivatives are measured at fair value with changes in value reported in net income. The basic ownership approach would increase the population of instruments subject to those requirements. Do you agree with that result? If not, why should the change in value of certain derivatives be excluded from current-period income?

We have no comment on this item.

Presentation Issues

9. Statement of financial position. Basic ownership instruments with redemption requirements would be reported separately from perpetual basic ownership instruments. The purpose of the separate display is to provide users with information about the liquidity requirements of the reporting entity. Are additional separate display requirements necessary for the liability section of the statement of financial position in order to provide more information about an entity's potential cash requirements? For example, should liabilities required to be settled with equity instruments be reported separately from those required to be settled with cash?

We have no comment on this item.

10. Income statement. The Board has not reached tentative conclusions about how to display the effects on net income that are related to the change in the instrument's fair value. Should the amount be disaggregated and separately displayed? If so, the Board would be interested in suggestions about how to disaggregate and display the amount. For example, some constituents have suggested that interest expense should be displayed separately from the unrealized gains and losses.

We have no comment on this item.

Earnings per Share (EPS)

11. The Board has not discussed the implications of the basic ownership approach for the EPS calculation in detail; however, it acknowledges that the approach will have a significant effect on the computation. How should equity instruments with redemption requirements be treated for EPS purposes? What EPS implications related to this approach, if any, should the Board be aware of or consider?

We have no comment on this item.



Questions on the Ownership-Settlement Approach

1. *Do you believe the ownership-settlement approach would represent an improvement in financial reporting? Do you prefer this approach over the basic ownership approach? If so, please explain why you believe the benefits of the approach justify its complexity.*
2. *Are there ways to simplify the approach? Please explain.*

We believe that the ownership settlement approach would be preferable to the basic ownership approach, but is not necessarily preferable to delaying a new standard until a more comprehensive definition of liabilities has been developed.

If adopted, we would prefer to see the approach amended to include in equity any stock that participates in the gains and losses of the reporting entity.

Substance

3. *Paragraph A40 describes how the substance principle would be applied to indirect ownership instruments. Similar to the basic ownership approach, an issuer must consider factors that are stated in the contract and other factors that are not stated in the terms of the instrument. Is this principle sufficiently clear to be operational?*

We have no comment on this item.

Presentation Issues

4. *Statement of financial position. Equity instruments with redemption requirements would be reported separately from perpetual equity instruments. The purpose of the separate display is to provide users with information about the liquidity requirements of the reporting entity. What additional, separate display requirements, if any, are necessary for the liability section of the statement of financial position in order to provide more information about an entity's potential cash requirements? For example, should liabilities required to be settled with equity instruments be reported separately from those required to be settled with cash?*

We have no comment on this item.

Separation

5. *Are the proposed requirements for separation and measurement of separated instruments operational? Does the separation result in decision-useful information?*

We have no comment on this item.

Earnings per Share

6. *The Board has not discussed the implications of the ownership-settlement approach for the EPS calculation in detail. How should equity instruments with redemption requirements be treated for EPS purposes? What EPS implications related to this approach, if any, should the Board be aware of or consider?*

We have no comment on this item.



Settlement, Conversion, Expiration, or Modification

7. Are the requirements described in paragraphs A35–A38 operational? Do they provide meaningful results for users of financial statements?

We have no comment on this item.

Questions on the REO Approach

1. Do you believe that the REO approach would represent an improvement in financial reporting? What would be the conceptual basis for distinguishing between assets, liabilities, and equity? Would the costs incurred to implement this approach exceed the benefits? Please explain.

We believe that this approach is excessively complex and will confuse users of the financial statements.

Separation and Measurement

2. Do the separation and measurement requirements provide meaningful results for the users of financial statements?

No – see comment above.

Earnings per Share

3. The Board has not discussed the implications of the REO approach for the EPS calculation in detail; however, it acknowledges that the approach will have a significant effect on the calculation. How should equity instruments with redemption requirements be treated for EPS purposes? What EPS implications related to this approach, if any, should the Board be aware of or consider?

We have no comment on this item.

Other Alternatives

1. Some other approaches the Board has considered but rejected are described in Appendix E. Is there a variation of any of the approaches described in this Preliminary Views or an alternative approach that the Board should consider? How would the approach classify and measure instruments? Why would the variation or alternative approach be superior to any of the approaches the Board has already developed?

We have no comment on this item.