



Capital Research
and Management Company
333 South Hope Street
Los Angeles, California 90071-1406

VIA ELECTRONIC DELIVERY

October 19, 2009

Mr. Russell G. Golden
Director, TA&I
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Re: File Reference No. 1710-100

Dear Mr. Golden:

Capital Research and Management Company serves as investment adviser to the American Funds, one of the oldest and largest mutual fund families in the nation. We appreciate the opportunity to comment on the Exposure Draft – Proposed Accounting Standards Update: Fair Value Measurements and Disclosures (the “Exposure Draft”).

As a global research-based investment firm, we are a large consumer of financial reporting. As the investment advisor to a large mutual fund family, we also produce financial reporting for millions of retail mutual fund shareholders. In both roles, we agree with the FASB’s goal of providing financial reporting that is sufficiently useful for investors to justify the related costs for issuers.

The Capital Group Companies

American Funds Capital Research and Management Capital International Capital Guardian Capital Bank and Trust

DRAFT
Mr. Russell G. Golden
October 19, 2009
Page 2 of 12

To achieve this goal for mutual funds,¹ it is important to distinguish our regulatory and operating environment from that of a typical operating company. Mutual funds value their portfolio securities daily and calculate a net asset value (“NAV”) to effect purchases and redemptions of their shares. This process is governed by statutory requirements, regulations and guidance from the Securities and Exchange Commission (the “SEC”).² The Investment Company Act of 1940 also imposes specific oversight responsibilities for this valuation process on mutual fund directors, a majority of whom are required to be independent of the fund’s adviser. Most mutual funds’ boards of directors have approved policies and procedures to engage and oversee multiple external pricing sources (such as pricing vendors and market-makers) rather than broadly use the related investment adviser’s own proprietary pricing models to price portfolio securities. Independence is important, since the SEC has brought a number of enforcement actions against funds when their investment professionals appeared to exert improper influence over the pricing process.³

Our funds have extensive procedures to evaluate the external prices that we receive. For example, we may consider other external pricing sources (such as alternative vendors or dealers), our own internal information (such as transactions and bid-lists) as well as our own proprietary models in evaluating these pricing sources. Importantly, to the extent we use internal proprietary models, we generally do so to evaluate the reasonableness of external prices rather than to directly price the security. We believe that using our own proprietary pricing models and standard inputs would generally be inappropriate and insufficient to price the number and breadth of mutual fund holdings consistent with our responsibility for calculating an appropriate daily NAV.

¹ Many of the observations and suggestions in this letter also apply to commingled daily valued funds that are offered to defined contribution plans. We encourage the FASB to consider similar treatment for all “investment companies” as defined in ASC 946-10-05-2.

² The SEC requires mutual funds to follow GAAP when calculating NAV. As a result, changes in accounting standards may have a daily impact on mutual fund operations rather than, in the case of many operating companies, merely four times a year.

³ See, e.g. In the Matter of Mitchell Hutchins Asset Management (Release no. IC-2280) (1997); In the Matter of Piper Capital Management, Inc. (Release no. IC-26167)(2003); In the Matter of Garrett Van Wagoner (Release no. IC-26579) (2004); and In the Matter of Heartland Advisors, Inc. (IC-28136)(2008).

DRAFT
Mr. Russell G. Golden
October 19, 2009
Page 3 of 12

We believe this brief background and the following suggestions are critical for properly balancing benefits and costs of the proposed Exposure Draft in a manner that will benefit mutual fund investors.

1. FASB should not require sensitivity disclosures for mutual funds.

We recognize that the FASB has historically been reluctant to impose different requirements on various industry groups. However, we believe the benefits of providing reasonably possible alternative pricing inputs (referred to as “sensitivity disclosures”) to mutual fund investors are dwarfed by the related costs.

A. Sensitivity disclosures do not facilitate current investment decisions with respect to mutual fund shares.

Investors in a traditional operating company may find sensitivity disclosures helpful to assess, for example, the company’s market value, its potential earnings and cash flows, the impact of potential losses within its capital structure, its prospects and potential funding needs in various reasonably possible scenarios. An operating company’s sensitivity disclosures may, in some cases, allow an investor to evaluate whether or not other investors are fairly pricing its securities. Any resulting arm’s-length transactions between investors may impact prices for the issuer’s securities and encourage efficient allocation of capital.

In contrast, a mutual fund’s NAV is not determined by a market of mutual fund investors. Transactions in mutual fund shares occur between the fund and individual investors at the NAV derived from the market prices or fair values of the funds portfolio holdings, each of which change on a daily basis. Unlike operating company, which would be required to notify investors on form 8-K if a significant asset purchase or sale occurs following the date of its balance sheet, a mutual fund’s core daily business is to buy and sell securities. As a result, it would be difficult for a mutual fund investor to translate historic sensitivity

DRAFT
Mr. Russell G. Golden
October 19, 2009
Page 4 of 12

disclosures into a current investment decision. For example, a mutual fund investor would be unable to determine if the fund still owned the securities covered by the sensitivity disclosures or the extent to which the fund's current or, in the case of a transaction, the fund's next NAV would incorporate prices based on such disclosures. Since there is no separate market in mutual fund shares, the only potential relevance of sensitivity disclosures would be to evaluate a fund's process for calculating its NAV.

B. Sensitivity disclosures offer mutual fund shareholders limited practical perspective for their fund's process for calculating NAV.

Proponents assert that sensitivity disclosure could provide investors with greater context and dimension for their fund's NAV as well as help investors understand factors that could influence the variability of the NAV and identify material exposures to aggressive estimates. We believe that these theoretical arguments are at odds with our historical experience regarding FAS 157 disclosures to-date and with broader trends in mutual fund disclosure. At issue, of course, is not whether the disclosure could have a theoretical benefit, but rather whether the practical benefits to mutual fund shareholders justify the actual costs that such disclosures impose on them.

To determine whether supplementing current FAS 157 disclosures with sensitivity disclosures will benefit mutual fund investors, it seems relevant to first inquire what uses mutual fund investors are making of the current disclosures. Put differently, are mutual fund shareholders asking the questions that sensitivity disclosures are designed to answer? Since our funds first began implementing FAS 157 disclosures for periods ending in February 2008, to our knowledge, we have not received a single inquiry from a retail mutual fund investor regarding such disclosures. The only inquiries which we have received were from retirement plans trying to comply with the disclosure requirements themselves. This is important – the sole questions have related to how another entity that invests in the American Funds should report such holdings for the purpose of complying with its own disclosure obligations, rather than relevance of the disclosure itself, how the

DRAFT
Mr. Russell G. Golden
October 19, 2009
Page 5 of 12

levels are determined, pricing methodologies or inputs, or the sensitivity of pricing to various scenarios. This is the case despite heightened media attention regarding this new disclosure. This same trend is also reflected in organizations such as Morningstar and Lipper, which evaluate mutual funds on both an absolute and relative basis. The only two Morningstar articles we found that refer to FAS 157 involved a compliance solution and an operating company. We similarly found no Lipper articles that referred to FAS 157. While the length of the Exposure Draft's comment period did not permit us to consider shareholder focus groups, the lack of shareholder questions seems instructive.

Not only are shareholders not actively requesting additional information on FAS 157 such as sensitivity disclosures, such disclosures could be confusing or misleading. For example, providing a range of values could confuse or mislead a mutual fund investor, since the daily NAV is the only accessible value. Evaluating the period-end NAV on the basis of the sensitivity disclosures and subsequent market action also seems potentially misleading and prejudicial. Subsequent market volatility following the measurement date could imply an ineffective pricing process or, if severe, a failure of imagination in considering reasonably possible alternatives. Using sensitivity disclosures and 20/20 hindsight to evaluate a fund's NAV on a historical measurement date will most likely contribute either to investor confusion or to an unjustified loss of confidence in the NAV process. By definition, the daily NAV process seeks to value based on well-disclosed procedures at each day's current value, not an anticipated future value.

It should be noted that mutual fund investors receive extensive disclosures regarding the valuation of portfolio securities and daily calculation of NAVs. These disclosures are required in the fund's offering documents, which must be continually updated as well as in periodic shareholder reports. In light of the uncertain benefits of sensitivity disclosures to mutual fund investors, adding several additional pages of technical disclosures seems directionally inconsistent with the SEC's most recent disclosure initiatives, which have focused on concise disclosures which are relevant and readily understandable to the average investor. For example, in its release adopting the summary mutual fund

DRAFT
Mr. Russell G. Golden
October 19, 2009
Page 6 of 12

prospectus, the SEC noted several studies and roundtables, one of which observed that current disclosures are: “bombarding investors with way more information than they can handle and that they can reasonably assimilate.”⁴ This trend reflects the self-evident fact that disclosure is only valuable if its relevance is clear to an investor.

C. Sensitivity disclosures could potentially be used to arbitrage the fund, similar to the market-timing scandals that occurred during 2003 and 2004.

We believe that sensitivity disclosures do not hold any relevance for a mutual fund investor’s current investment decision, nor do they represent a reasonable way to evaluate a fund’s NAV process. Ironically, if such disclosures have greater relevance than the minimal value we assign to them, it could be far more problematic for mutual funds and their shareholders. For example, if a sophisticated investor could identify that a fund’s NAV is mispriced, that investor could transact with the fund at the mispriced NAV and potentially dilute the fund’s other fund shareholders. This informational advantage is similar in concept to the market timing scandals of 2003 and 2004. At that time, certain investors (such as hedge funds) were able to identify when particular funds had mispriced their respective NAVs as a result of pricing certain non-U.S. equity securities using stale local closing prices even though significant market movements had occurred following the close of those markets but before the daily calculation of NAV. The potential impact, in both scenarios, is for one group of mutual fund investors to dilute the fund and harm the interests of remaining long-term mutual fund shareholders.

By their very name, mutual fund shareholders have mutualized investment benefits and costs and accordingly share a mutual interest in the integrity of fund pricing – they are not arms’-length adversaries. Importantly, investment advisers also recognize that an effective NAV process is fundamental to their long-term success – mispricings would

⁴ See, Don Phillips, Managing Director, Morningstar, Inc., Transcript of U.S. Securities and Exchange Commission Interactive Data Roundtable (June 12, 2006), available at <http://www.sec.gov/spotlight/xbrl/xbrlofficialtranscript0606.pdf>.

DRAFT
Mr. Russell G. Golden
October 19, 2009
Page 7 of 12

cause a loss of confidence in the fund or, if significant, could dilute the fund, depress long-term investment results and prevent the fund from meeting redemptions at NAV. For example, many fund groups that were tainted by the market timing scandals during 2003 and 2004 lost investors' confidence and suffered asset outflows of billions of dollars. Mutual funds' extensive regulatory structure, disclosure of their pricing procedures, independent oversight, and audit requirements also support this mutuality of interests in an effective NAV process that is fair to all shareholders.

D. Sensitivity disclosures would impose significant costs on mutual funds and their shareholders.

Our funds, like many other mutual funds, primarily use external pricing sources (such as prices obtained from vendors or dealers) to price portfolio securities. It might seem efficient to require these external pricing sources to supply the sensitivity disclosures since they alone have access to the information, models and inputs that are used to price the funds' securities.⁵ Even this "best case" scenario would have costs. At minimum, we estimate that this would triple the millions of dollars in fees we currently pay pricing vendors each year, because sensitivity disclosure would essentially require three daily prices rather than one: the actual price used, and a high and a low price under various scenarios. However, in practice these external pricing sources will not provide sensitivity disclosures, since, among other things, they are reluctant to share their own proprietary information, models and inputs or assume any role in their clients' disclosure obligations. For example, when FAS 157 was originally proposed, these vendors would not identify the FAS 157 valuation level for the assets which they price. There is no reason to expect that the external pricing sources will be willing to meaningfully assist mutual funds with sensitivity disclosures.

⁵ As previously noted, our funds have extensive procedures to evaluate the external prices that we receive, in addition to the due diligence we conduct on individual sources. For example, we may consider other external pricing sources (such as alternative vendors or dealers), our own internal information (such as transactions and bid-lists) as well as our own proprietary models in evaluating these pricing sources.

DRAFT
Mr. Russell G. Golden
October 19, 2009
Page 8 of 12

As a result, if sensitivity disclosures are required, our funds would need either (1) to substitute our own proprietary models for external prices and seek approval for such change in procedures by our fund boards and make appropriate changes to our disclosure or (2) to try to replicate external prices using internal models and assumptions. The former approach would reduce the independence of our pricing and could cause us to lose the expertise and flexibility of external pricing sources. The latter approach would be an exercise of largely fictional precision which would require our investment professionals to develop and maintain models and assumptions that would directly correspond to the constantly evolving external prices and identify reasonably possible alternative inputs. This would require us to try to replicate precisely the pricing results of the information available to, and multiple proprietary pricing systems developed by, our external pricing sources, which we believe would be an extravagant and inefficient use of time, as well as generate significant costs that could eventually be passed on to fund shareholders.

The costs of sensitivity disclosures would not be limited to level 3 securities, but include a significant amount of our funds' portfolio securities, since securities may move between level 2 and level 3 as market conditions change. We would also need to evaluate these securities to be in a position to determine if there was a significant alternative input to disclose. Modeling both level 2 and level 3 securities would create an enormous burden, since this would include most of our approximately 11,000 fixed-income securities (excluding short-term securities).

Funds would also need to create and integrate these new proprietary pricing models with tracking and disclosure systems. Fund audit and disclosure costs would also increase as a result of sensitivity disclosures. The resulting security-by-security models and assumptions would also be very difficult to disclose to shareholders in clear alternative scenarios consistent with the goals and example provided in the Exposure Draft. For example, it would be difficult to provide meaningful sensitivity analysis for groups of securities with unique risks and potential lack of standardized valuation inputs such as private placements and private equity investments, corporate bonds of nearly insolvent

DRAFT
Mr. Russell G. Golden
October 19, 2009
Page 9 of 12

issuers or certain municipal bonds. Even incremental printing and shipping costs add up: we estimate that adding the equivalent of *one* full page of disclosure in shareholder reports would cost our funds' shareholders approximately \$1.6 million annually. Note that the example provided in the Exposure Draft was *two* pages for a *single* asset type.

Finally and perhaps most significantly, the issues are not limited to additional administrative costs but could have unintended consequences for investment decisions and market liquidity. The cost and administrative burden arising from sensitivity disclosures could reduce a mutual fund's willingness to consider investing in securities that are or may become subject to level 3 fair value measurements. Fund shareholders would also absorb the opportunity costs caused by eliminating investment choices available to pursue the fund's investment objectives.

2. Sensitivity disclosures are only relevant if an issuer's level 3 holdings are material.

The Exposure Draft would require all issuers to provide sensitivity disclosures for Level 3 fair value measurements, regardless of their materiality. We believe that this is overkill. Even as an investor in traditional operating companies where sensitivity disclosures have greater relevance, we would only find such disclosure useful if a particular company's level 3 holdings are material. In contrast, none of our funds hold more than 3% of their assets in level 3 securities. We suggest that sensitivity disclosures with respect to a small portion of a highly-liquid portfolio of an investment company that stands ready to redeem shares daily does not result in meaningful disclosure to mutual fund shareholders. A similar conclusion was reached by the board in ASC 230-10-15-4.

DRAFT
Mr. Russell G. Golden
October 19, 2009
Page 10 of 12

3. FASB should clarify requirements to disclose valuation techniques, changes to valuation techniques and reasons for transfers in and out of level 3.

We suggest that the FASB clarify the requirement to disclose valuation techniques and related changes. Mutual funds may use a variety of pricing sources: primary and alternative pricing vendors, transaction prices, dealer quotes, matrix pricing such as yield-based adjustments or internal models. For our funds, changes in pricing sources occur on a daily basis, such as when a transaction price suggests that a particular pricing source may be more representative than another. Calculating the impact and rationale for these changes at the security level across an entire portfolio could be extremely onerous and be of limited benefit to investors. In our view, a better approach would be to identify the valuation techniques and related changes for broad classes of securities, rather than attempting to identify valuation techniques and related changes on a security level.

We agree with the proposal to reconcile level 3 securities. However, we would find it helpful for the FASB to clarify expectations for describing the reasons for transfers in and out of level 3. Setting aside purchases and sales, we would expect and propose that, in most cases, disclosing that the transfers from or to level 3 was due to the availability or unavailability of sufficient market observable inputs would satisfy our disclosure obligation. Disclosure of particular circumstances at the security level would be impracticable to obtain and difficult to disclose in a useful manner.

4. We agree with the proposed levels of disaggregation and with disclosing significant transfers in and out of levels 1 and 2, however believe that mutual funds should use values as of the end of the reporting period.

We agree with the proposed levels of disaggregation, with disclosing significant transfers in and out of levels 1 and 2 and describing the reasons for transfers. As a practical matter, our funds' disclosure has already been moving in this direction. For example, we have sought to disclose significant transfers in and out of levels 1 and 2 in order to

DRAFT
Mr. Russell G. Golden
October 19, 2009
Page 11 of 12

describe period-to-period differences caused by whether or not the U.S. equity markets were sufficiently volatile on the measurement date for us to adjust (using a vendor) the local closing prices of securities in non-U.S. time zones to reflect these more recent market conditions. Although this is a standard process mandated by the SEC to prevent market-timing (as discussed earlier), it is nonetheless useful to provide an explanation to dispel any confusion or alarm that this often large (in some cases representing 75% of a fund's net assets) classification change represents a sudden substantive diminution in the quality of our funds' prices.

Finally, although the Exposure Draft contains a presumption that significant transfers occur as of the beginning of the reporting period, mutual funds disclose the value of the transfer on the last day of the period. Using the value at the beginning of the reporting period would not make sense for mutual funds, since we value portfolio securities on a daily basis and the financial statements are based on the reporting date value, not a prior value from 90, 180 or 365 days earlier. We believe that disclosing the value and the reason for the significant transfer between levels 1 and 2 is sufficient.

* * * * *

Thank you for considering these comments. We believe that it is important to be deliberate and to consider unintended consequences of policy decisions. As we have indicated in this letter, accounting policies which may be beneficial for operating companies can have unintended negative daily consequences for mutual funds, such as limited benefits, excessive costs or pricing arbitrage. We encourage you to consider such consequences for mutual funds, so that the industry can continue to effectively support the nation's funding and savings needs.

We believe that with appropriate modifications, the final Standard could provide relevant, material and cost-effective disclosures that both our investment professionals and the fund shareholders they serve will find useful. Please feel free to contact any of us should you have any questions or wish to discuss our thoughts on the current proposal.

Sincerely,

Brian D. Bullard
Senior Vice President
(949) 975-3708

Deanna D. Hobson
Manager, Fixed Income Pricing
(310) 996-6467

David A. Pritchett III
Senior Manager, Equity Pricing
(757) 670-4818

Donald H. Rolfe
Chair, Fair Valuation Committee
(213) 615-0457

cc: The Hon. Mary L. Schapiro, Chairman of the SEC
The Hon. Kathleen L. Casey, Commissioner of the SEC
The Hon. Elisse B. Walter, Commissioner of the SEC
The Hon. Luis A. Aguilar, Commissioner of the SEC
The Hon. Troy A. Paredes, Commissioner of the SEC
Andrew J. Donohue, Director, Division of Investment Management
James L. Kroeker, Chief Accountant of the SEC
Richard F. Sennett, Chief Accountant, Division of Investment Management