

September 30, 2010

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

Re: File Reference No. 1810-100

Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities

Dear Mr. Golden:

OppenheimerFunds, Inc. ("OFI")¹ appreciates the opportunity to comment on the proposed Accounting Standards Update, *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities* ("ASU" or the "Proposal") [Financial Instruments (Topic 825) and Derivative Instruments and Hedging (Topic 815)].

As a proponent of providing financial statement transparency to assist investors in mutual funds, OFI supports the direction of the Financial Accounting Standards Board ("FASB" or the "Board") in its pursuit of enhanced qualitative disclosures to provide the financial statement user with relevant and concise reporting. However, OFI has serious reservations and concerns about certain aspects of the Proposal, discussed below.

Among other things, the Proposal would (1) require investment companies to recognize transaction costs on the purchase and sale of portfolio investments and derivatives as an expense within the statement of operations and within the expense ratio; (2) require money market funds that comply with Rule 2a-7 under the Investment Company Act of 1940, as amended (the "Investment Company Act") to measure their investments at fair value (rather than amortized cost) when reporting holdings in their financial statements; and (3) require investment companies to measure financial liabilities at fair value and include all changes in fair value in the net increase, or decrease, in net assets resulting

¹ OFI is the investment manager for more than 100 registered investment companies comprising the Oppenheimer family of mutual funds (the "Funds"). Including its affiliates, OFI manages assets in excess of \$170 billion.

from operations for the period (that is, to recognize those changes in fair value of financial liabilities in earnings).

Transaction Costs

OFI strongly opposes recognizing transaction costs on the purchase and sale of portfolio securities as an explicit expense in a fund's statement of operations and, thereby, within the fund's expense ratio. We believe that current GAAP for investment companies, which requires transaction costs incurred to be included in the cost of securities purchased (and deducted from the proceeds of sales) appropriately recognize those costs as a decrease in the reported gain on the fund's portfolio (or an increase in the reported loss). This recognizes transaction costs as a cost of trading the portfolio, rather than as a recurring expense. As discussed below, we are very concerned that the Proposal would undercut the value of the expense ratio of a mutual fund as a measure of a fund's recurring expenses. We are also very concerned that the application of this part of the Proposal cannot reasonably be applied to fixed income securities or other securities that trade on a bid-asked basis without the imposition of explicit brokerage commissions. In particular, the lack of any guidance in the Proposal as to how this would be applied to fixed income securities invariably will result in lack of comparability across funds in different fund complexes and across reporting periods. We urge the Board to retain the current fund accounting for transaction costs.

Investment companies currently include transaction costs in the cost basis of securities purchased and deduct transaction costs from the proceeds of securities sold. While these transaction costs are not recognized as an explicit expense in the fund's statement of operations, they are deducted immediately from fund assets, thus decreasing net assets and net asset value per share. These unrealized and realized amounts are reflected in the current period statement of operations within the net change in unrealized appreciation, or depreciation, and net realized gain, or loss, respectively.

The Proposal states that the Board believes portfolio transaction costs should be reflected as current period expenses, rather than capitalized and deferred because such costs do not directly relate to the financial asset or liability's fair value.² We note that current accounting treatment for investment companies does not enable them to capitalize and defer transaction costs. As described above, these costs are immediately recorded against the fair value of investment securities, decreasing gain, or increasing loss on the fund's investment securities.

At issue is whether transaction costs should be recognized as a current period expense in the statement of operations as the Board has suggested or whether transaction costs should be offset against the fair value of the investment companies' investments and reflected in the current period net change in unrealized appreciation, or depreciation, and net realized gain, or loss, in the statement of operations. We believe transaction costs for investment companies should follow current practice and should not be expensed for the reasons below:

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² Paragraph BC51 of the Proposal.

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- Investment companies currently recognize transaction costs as the cost of purchasing and selling portfolio securities presented as gain, or loss, as opposed to an expense.³ Transaction costs are the direct result of the acquisition and sale of investment securities and should therefore be offset against the portfolio in order to present an accurate assessment of the gain, or loss, from investing activities. The treatment in the proposed ASU would, in our opinion, inappropriately characterize these transaction costs as expenses similar to management fees, shareholder servicing fees and other ongoing expenses.
- Financial statement users commonly view expenses for investment companies presented in the fee table as recurring operating expenses that are associated with the ongoing operations. The expense ratio derived from those operating expenses is used for marketing purposes, is disclosed in the prospectus, and is used by investors to get some perspective on prospective expenses of the fund. In recent years operating expenses, as represented by the expense ratio within the financial statements, have become a key performance attribute for investment companies. The treatment in the proposed ASU would, in our opinion, weaken the usefulness of the expense ratio to investors, since transaction costs from portfolio securities trading can vary substantially from year to year.
- Investment companies portfolio transactions and the associated transaction costs incurred can vary substantially from period to period, due to, but not limited to, shareholder cash flows, changes in portfolio investment strategies, and external market conditions persistent during the period. For example, if two identical funds were compared side-by-side, one with shareholder inflows and the other with no shareholder activity, the fund with shareholder inflows would have higher transactions costs during the period assuming it invested the inflows in additional investments. Under the Proposal, the fund with shareholder inflows would disclose a higher expense ratio but could have a higher return compared to the fund with no shareholder flows simply because of other investing activities that may have benefited performance. This situation would conflict with the current understanding of expense ratios for investment companies and confuse investors. A recent independent study noted that domestic corporate bond spreads ranged from approximately 10 bps to 240 bps points during the recent market crisis in late 2008 and early 2009. If transaction costs are characterized as an operating expense, we are concerned that it will introduce significant volatility into the expense ratio for investment companies, which will confuse investors and financial statement users.
- If transaction costs are characterized as expenses for investment companies, it would reduce reported net investment income, the net investment income ratio and the reported standardized yield. It is anticipated that during certain market conditions, reported net investment income could become negative for investment companies with investment objectives that focus on generating income, as a result of characterizing volatile transaction costs as expenses. Investment companies with

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³ See Topic 946-320-40-1

⁴ White Paper – *Corporate Bond Trading Costs During the Financial Crisis,* Peter Ciampi, Interactive Data Corporation; Eric Zitzewitz, Dartmouth College, June 2010.

income related investment objectives typically hold portfolios of fixed income assets that earn income based on a stable effective interest rate. The proposed ASU would create a difference in the treatment of income from portfolio investments versus the treatment of expenses as a result of including these volatile transaction costs. We are concerned that such change would understate the income return associated with the investment and could be misleading to investors.

Current tax regulations require transaction costs to be included in the cost basis of securities purchased and deducted from proceeds of sales when determining gain/loss, similar to current investment company practice. By characterizing transaction costs as operating expenses, the proposed ASU would cause reported net investment income to be different than taxable income. This difference would be material to investment companies because they are required to distribute all of their taxable income to shareholders to avoid excise taxes at the fund level. The change would create a permanent difference in the amount of net income an investment company would be required to distribute to avoid excise taxes compared to what it earned and reported within its financial statements. It would create permanent differences in the reported standardized yield, which is determined on the basis of financial reporting results, not actual distributions, and the distribution yield, which is determined on a tax basis (by measuring actual cash distributions over the period). Furthermore, the taxable income distributions received by shareholders will always exceed the net income reported in the financial statements for the period. Again, we are concerned that such change would weaken the usefulness of reported net income in the financial statements of investment companies and confuse investors.

The proposed ASU is clear in the implementation of transaction costs for equity securities, which are limited to explicit costs that typically involve the payment of brokerage commissions and related fees. However, the proposed ASU does not describe in enough detail how funds would determine the transaction costs associated with fixed income securities, which trade on a bid-ask basis without explicit commissions or fees. In addition, the proposed ASU does not address determining transaction costs for certain derivative instruments that trade without explicit fees.

It is unclear if the proposed ASU is intended to include fixed income securities and derivative instruments, but if it is, we have concerns with the application as noted below:

- There is no uniform method to determine implicit transaction costs embedded in the bid-ask spread for the purchase and sale of fixed income securities. This limitation will lead to subjective results and comparability issues.
- Trading and accounting systems are currently not designed to determine and record the difference between the fair value price and the transaction price for purchases and sales of fixed income securities.
- Investment companies currently fair value their fixed income holdings with external "evaluated" prices as of 4:00 PM eastern each business day in order to calculate their net asset value per share ("NAV"). It appears that the proposed ASU would require a fair value determination at the point of each purchase and sale of a fixed income

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⁵ See paragraph IG16 of the Proposal.

security in order to comply with what we believe to be the Proposal's intent. We ask for clarification on the implementation of this particular point.

If the Proposal is adopted as issued, the investment company industry would need significant time between the finalization of the ASU and the effective date in order to develop and implement the required changes to trading and accounting systems. The proposed two to three year implementation period would be challenging given the level of involvement by market participants. In addition, the Proposal would require investment companies to maintain two sets of accounting records for every security held, by lot, for financial reporting and tax purposes. Based on our understanding of the Proposal, as discussed above, we anticipate our costs to implement the Proposal to be very significant and equivalent to a large portion of the cost of our fund accounting function today.

In summary, investment companies do not defer transactions costs, but instead deduct them immediately from net assets within "net increase (decrease) in net assets resulting from operations" in the statement of operations. We believe that the current treatment for transaction costs of investment companies provides better information to financial statement users compared to the proposed treatment in the ASU. The current treatment properly links transaction costs with investing activities, which are combined and captured in the daily NAV and total return. This current treatment was designed to represent the true economics of the income return, or distribution yield, which is unique to investment companies. In addition, the current treatment provides financial statement users with expenses and expense ratios that represent true operating activities.

We note also that the Securities and Exchange Commission has previously considered this issue in a concept release in 2003, in which it sought public comment on issues related to the measurement and disclosure of mutual fund transaction costs. The Release asked whether mutual funds should be required to quantify and disclose the amount of transaction costs they incurred in portfolio securities trading in their expense ratios and fee tables, or instead provide additional narrative disclosure about such costs [we note that funds are already currently required to disclose the total explicit brokerage commissions paid by a fund – but not implicit transaction costs for fixed income securities – in a table in the fund's Statement of Additional Information, under the requirements of SEC Form N-1A]. Since that Release was issued, and after reviewing the comments it received from the public and the mutual fund industry on that topic, the SEC has not changed its rules or disclosure forms to require funds to include such costs in their expense ratios or fee tables. We believe that SEC has tacitly recognized the practical difficulties and likely investor confusion that would be associated with measuring and recognizing transaction costs in the fee table and expense ratio of a fund.

We strongly urge the Board to consider excluding investment companies from the requirement to recognize transaction costs on the purchase and sale of portfolio investments, and derivatives, as an expense within the statement of operations.

Fair Value of Money Market Fund Investments

⁶ SEC Release Nos. 33-8349, 34-48952 and IC-26313, December 18, 2003 (the "Release").

OFI opposes the Proposal's requirement that money market funds fair value all investment holdings and report those values in their financial statements. Rule 2a-7 under the Investment Company Act permits money market funds to use amortized cost to calculate their net asset per share and for financial statement reporting purposes. The stringent requirements of Rule 2a-7 that are designed to limit investment risks for money market funds allow the use of amortized cost to represent fair value in instances where the amortized cost method is not materially different than the fair value method. A material difference is defined as any difference that would cause the NAV to round down to \$0.99 or less, or up to \$1.01 or more. Under the Rule, under the "shadow pricing process," money market funds are required to monitor the difference between amortized cost and fair value for its portfolio holdings and, if necessary, to fair value a holding where the fair value of the holding varies materially from the amortized cost, and to use that fair value in the calculation of the fund's NAV for daily investor transactions and for financial statement reporting purposes. We believe the proposed ASU will not provide additional transparency for investors and may well confuse money market fund financial statement users.

In addition, we believe this proposed disclosure is unnecessary as a result of the recently adopted amendments to Rule 2a-7 which require registered money market funds to fair value their investments and calculate their "shadow" NAV to $1/100^{th}$ of a cent on Form N-MFP filed with the SEC beginning on or about February 1, 2011. Form N-MFP will be filed with the SEC monthly and will be publicly available.

For these reasons, we urge the Board to clarify that money market funds may continue to measure their investments at amortized cost for financial statement reporting purposes.

Liabilities Measured at Fair Value

The ASU would require investment companies to report their financial assets and liabilities at fair value with all changes in fair value included in "net increase (decrease) in net assets resulting from operations."⁷

Investment companies are currently required to fair value assets and liabilities related to investments in securities and derivative contracts, but not other financial liabilities. The difference in the current practice for investment companies and the proposed ASU is the requirement to fair value financial liabilities that are not related to an investment. An example of a liability related to an investment would be a swap contract recorded at fair value where the investment company would have to pay the current market price, or exit price, to the counterparty to liquidate the position. An example of a liability not related to an investment would be a payable for (the amount remaining due under) a bank borrowing.

We oppose the requirement, insofar as it would apply to investment companies, to fair value all financial liabilities in the financial statements, with the exception of liabilities related to investments in securities and derivatives, for the reasons below:

 Investment companies must be able to process daily, or periodic, investor redemptions of their shares at the fund's NAV, the measurement of which contemplates that funds can sell investment securities and derivatives at their fair

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⁷ See paragraph BC21 of the Proposal.

values or exit prices. Typically, non-investment financial liabilities, such as debt from a fund's bank borrowings, can only be liquidated at their historical costs and cannot be sold or transferred to another party at their current fair values. In those situations, investment companies would typically value their borrowings at their historical costs in order to cover current and potential investor redemptions at NAV. This long standing practice for investment companies is critical to the fair treatment of shareholders and financial statement users. This practice ensures that investors who redeem their shares in the current period do not get a higher NAV and, as a result, unfairly pass the burden of the costs of fund bank borrowings solely to the remaining shareholders.

- Most liabilities for investment companies, such as income payable amounts, are short term in nature, so their costs are equivalent to their fair values.
- If the U.S. GAAP financial statements of investment companies are required to reflect liabilities at fair value, an investment company's financial statements could display an NAV that does not correspond to the actual redemption net asset value. In order to prevent unfair investor treatment, discussed above, investment companies might report an operational NAV for investor subscription and redemption purposes that deviates from the NAV for financial statement reporting purposes. This would likely result in further investor confusion and concern.

We do not believe the requirement to fair value all financial liabilities for investment companies would be useful to shareholders of mutual funds and their financial statement users. Instead we believe the current practice for investment companies, which allows the option to fair value certain non-investment related financial liabilities that do not have the concerns discussed above, is more accurate and provides better information to shareholders, potential investors, and financial statements users.

We appreciate the opportunity to comment on the ASU. Please do not hesitate to contact me should you require additional information.

Thank you for your consideration, sincerely,

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Treasurer of the Oppenheimer Funds

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