



1401 H Street, NW, Washington, DC 20005-2148, USA
202/326-5800 www.ici.org

November 12, 2021

Ms. Hillary H. Salo
Technical Director
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

Re: Fair Value Measurement of Equity Securities Subject to Contractual Sale Restrictions (Topic 820); File Reference No. 2021-005

Dear Ms. Salo:

The Investment Company Institute¹ appreciates the opportunity to comment on the proposed accounting standards update, *Fair Value Measurement of Equity Securities Subject to Contractual Sale Restrictions*.² The proposal seeks to address diversity in practice in measuring the fair value of equity securities subject to contractual sale restrictions (*e.g.*, an underwriter lock up agreement). Specifically, the proposal would clarify that a contractual sale restriction is not considered part of the unit of account of the equity security and therefore is not considered in measuring fair value. Instead, the fair value of the equity security subject to a contractual sale restriction would be measured on the basis of the market price of the same equity security without the contractual sale restriction (*i.e.*, the fair value of the security should not be adjusted to reflect the reporting entity's inability to sell the security on the measurement date). The proposal provides transition guidance for entities that qualify as an investment company (each, a "fund") under Topic 946, enabling a fund to continue to apply its existing fair value measurement policy to securities held at implementation that are subject to contractual sale restrictions.

¹ The [Investment Company Institute](https://www.ici.org) (ICI) is the leading association representing regulated funds globally, including mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and similar funds offered to investors in jurisdictions worldwide. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. ICI's members manage total assets of \$31.5 trillion in the United States, serving more than 100 million US shareholders, and \$10.0 trillion in assets in other jurisdictions. ICI carries out its international work through ICI Global, with offices in Washington, DC, London, Brussels, and Hong Kong.

² FASB Proposed Accounting Standards Update, Fair Value Measurement (Topic 820), *Fair Value Measurement of Equity Securities Subject to Contractual Sale Restrictions*, (September 15, 2021), File Reference No. 2021-005. The proposal is available at <https://www.fasb.org/jsp/FASB/Page/SectionPage&cid=1175805074609>.

We agree there is diversity in practice in measuring the fair value of equity securities subject to contractual sale restrictions, and we support the Board's efforts to clarify Topic 820 to improve comparability across reporting entities that hold such securities. We support the Board's conclusion that a contractual sale restriction is not considered part of the unit of account and therefore should be disregarded in measuring fair value. We acknowledge the concerns expressed by several Board members in the Alternative Views but believe that the benefits associated with the proposal (*i.e.*, objectivity in measurement, reduced complexity, improved comparability) outweigh those concerns. We also support the proposed transition guidance for investment companies. We elaborate on our views below.

Measurement of Securities Subject to Contractual Sale Restrictions

Topic 820 requires a reporting entity to take into account the characteristics of the asset or liability when measuring fair value if market participants would take those characteristics into account when pricing the asset or liability at the measurement date.³ A contractual sale restriction only affects the behavior of the holder of the security and does not affect the security itself. In that sense, the contractual sale restriction is an entity-specific characteristic that would not be taken into account by market participants. We agree that the principles of Topic 820 argue that the unit of account is the individual equity security and that such securities should be measured at the market price of the identical equity security that is not subject to contractual sale restrictions.

In contrast, a regulatory sale restriction (*i.e.*, the security is not registered for trading on an exchange) is a characteristic of the security. That is, the inability to sell the restricted security on an exchange does not differ on the basis of which entity holds the security. All market participants would consider the restriction in pricing the security, and the reporting entity should reflect the effect of the restriction in its valuation of the security. We believe the proposed changes to Topic 820 clearly articulate these principles and that they will eliminate the ambiguity in the current guidance that led to divergence in practice.

We believe the proposal will clarify and improve Topic 820, and we support it. Specifically, we believe the ability to measure equity securities subject to contractual sale restrictions at the market price of the identical equity security will improve objectivity and reliance on observable market inputs in fair value measurement. We also believe that the proposal will reduce cost and complexity in that reporting entities will not be required to determine and apply discounts to equity securities subject to contractual sale restrictions. Finally, we believe the proposal will improve comparability in that all reporting entities will exclude the contractual sale restriction from the unit of account when measuring fair value.

Alternative Views

We acknowledge the alternative views expressed by several Board members that securities subject to contractual sale restrictions should be discounted relative to the identical freely traded equity security of

³ Topic 820-10-35-2B.

the same issuer. Those Board members believe that the distinction between restrictions that are asset-specific or entity-specific are arbitrary and that the proposal creates a disconnect between economic fair value and accounting fair value because value can be realized only through sale.

As a practical matter, we believe any disconnect would generally be immaterial for open-end funds because of the SEC rule that limits their illiquid investments.⁴ In our view the benefits associated with the proposal (increased objectivity, decreased cost and complexity, and improved comparability) outweigh these concerns. One way to address these concerns would be to require disclosure informing financial statement users of the nature of any contractual sale restrictions on the reporting entity's security holdings if the contractual sale restrictions are material to the reporting entity. For example, the Board could consider a requirement to provide note disclosure about the proportion of the fund's investments that are subject to contractual restrictions and the weighted average duration of the restrictions.

Transition Guidance

The proposal includes transition guidance enabling entities that qualify as an investment company under Topic 946 to apply the proposed amendments in a manner intended to reduce the impact on the fund's daily net asset value calculation. An investment company owning an equity security in which the contractual arrangement that restricts sale was executed before the adoption date of the proposed amendments would continue to measure the fair value of the equity security until the contractual restriction expires or is modified using its existing fair value measurement policy. The proposed transition guidance should enable a fund that currently applies a discount to equity securities subject to contractual sale restrictions to avoid any predictable increase in its net asset value attributable to adoption of a final standard. The proposed transition guidance will benefit funds that issue and redeem shares daily, and we strongly support it.

We appreciate the opportunity to comment on the proposal and would be pleased to provide any additional information you may require. If you have any questions on our comments or recommendations, please contact the undersigned at 202/326-5851 or smith@ici.org

Sincerely,



Gregory M. Smith
Senior Director

⁴ Rule 22e-4 under the Investment Company Act of 1940 effectively limits an open-end fund's illiquid investments to no more than 15% of its net assets. Illiquid investments are those that the fund reasonably expects cannot be sold or disposed of in current market conditions in seven calendar days or less without the sale or disposition significantly changing the market value of the investment. The disconnect may be material for other types of investment companies not subject to rule 22e-4 (e.g., private funds). Requiring a discount, however, may cause comparability issues where different funds apply different discount rates to the same security.

cc: Jenson Wayne
Chief Accountant – Division of Investment Management
US Securities and Exchange Commission