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September 25, 2012

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

Re: *Disclosures about Liquidity Risk and Interest Rate Risk (Topic 825)*
File Reference No. 2012-200

Dear Ms. Cosper:

The Investment Company Institute¹ is pleased to offer comments on the proposed FASB Accounting Standards Update, *Disclosures about Liquidity Risk and Interest Rate Risk* (ASU or Proposal). The ASU would require investment companies to disclose: 1) an available liquid funds table, 2) a cash flow obligations table, and 3) any additional quantitative and narrative disclosures necessary to provide financial statement users with an understanding of the fund's liquidity risk.²

SEC registered investment companies currently include in their financial statements a comprehensive schedule of investments listing separately and describing each security held. We believe the proposed available liquid funds table is redundant of the schedule of investments and unnecessary, as currently required disclosures provide comprehensive information on securities held. We recommend that the final standard indicate that an entity need not provide the proposed available liquid funds table if it already provides substantially similar information elsewhere in its financial statements.

Cash flow obligations of most open-end mutual funds are insignificant relative to total assets and available liquid funds. Where an entity has no material cash flow obligations, we presume that the

¹ The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of \$13.3 trillion and serve over 90 million shareholders.

² Investment companies measure substantially all of their assets at fair value with changes in fair value recognized in net income. Accordingly, investment companies would not be "financial institutions" for purposes of the ASU and they would not be required to provide the liquidity gap maturity analysis, the interest rate risk disclosures, the repricing gap analysis, and the interest rate sensitivity disclosures. We support the Board's determination that investment companies need not provide these disclosures.

standard materiality provision included in all financial accounting pronouncements – the provisions of this statement need not be applied to immaterial items – would enable such entity to not provide the proposed cash flow obligations table. We recommend a framework for assessing materiality in this context that is similar to statement of cash flows exemption for investment companies provided in ASC 230-10-15-4. We elaborate on our comments and recommendations below.

Available Liquid Funds Table

SEC registered investment companies must include in their financial statements a schedule of investments listing separately and describing each security owned by the fund at period end.³ For each security, the description must include the name of the issuer and title of issue (*e.g.*, for fixed-income securities the interest rate and maturity date), number of shares or principal amount, and fair value. Investments must be categorized by 1) type (*e.g.*, common stock, preferred stock, fixed-income, short-term investments, *etc.*) and 2) industry or geographic region. The schedule of investments must also disclose a subtotal for each category of investments together with their percentage value compared to net assets. Funds must also provide a listing of each open derivative contract in similar detail. In many instances, the schedule of investments will include a “short-term investments” or similar category that includes, for example, cash balances, investments in repurchase agreements, commercial paper, and money market funds. Any securities encumbered, pledged or loaned are identified as such.⁴

The detailed listing of investments by type, combined with subtotals and percentage relative to net assets, provides fund financial statement users with a complete understanding of available liquid funds and makes the proposed available liquid funds table redundant and unnecessary.

We would also note that open-end funds must stand ready to redeem fund shares and pay redemption proceeds within seven days of a redemption request. To meet these requirements, mutual funds must maintain a high degree of portfolio liquidity. In particular, mutual funds can invest no more than 15% of their total net assets in “illiquid securities” (*i.e.*, any security which may not be sold or disposed of in the ordinary course of business within seven days at approximately the value at which the mutual fund has valued the investment).⁵ Money market funds, whose investments are limited to short-term, high-quality securities are subject to even more stringent liquidity requirements.⁶ The high

³ See Rule 12-12 of Regulation S-X.

⁴ See Illustrative Financial Statements for Investment Companies included in the AICPA Audit and Accounting Guide – Investment Companies (May 1, 2011).

⁵ See Revisions of Guidelines to Form N-1A, U.S. Securities and Exchange Commission, Release Nos. 33-6927, IC-18612 (March 12, 1992).

⁶ Rule 2a-7 under the Investment Company Act of 1940 regulates the credit quality, maturity, diversification, and liquidity of money market fund investments. In particular, money market funds 1) are required to hold high-quality securities that pose minimal credit risks and have received ratings in the top two categories from two nationally recognized statistical rating organizations; 2) cannot acquire a portfolio security with a remaining maturity of greater than 397 days and must maintain a

degree of portfolio liquidity mandated for open-end funds further limits the utility of the proposed tabular disclosure.

We recommend that the final standard indicate that an entity need not provide the proposed available liquid funds table if it already provides substantially similar information elsewhere in its financial statements.

Cash Flow Obligations Table

For certain types of open-end funds (*e.g.*, index funds, money market funds) cash flow obligations typically are very small relative to total net assets. For example, an Institute member firm recently determined that total liabilities averaged three percent of total net assets across all open-end funds that it manages. In many instances, these liabilities are extremely short-term in nature (*e.g.*, payables for portfolio securities purchased, payables for fund shares redeemed, and accrued management fees payable) and will be settled long before the financial statements are released to investors.

For other mutual funds, however, cash flow obligations may be significant. For example, funds may engage in investment strategies that give rise to cash flow obligations, such as short sales, derivatives transactions, and purchase of securities on a delayed delivery or when-issued basis. Other types of SEC registered investment companies, such as closed-end funds and business development companies may issue debt or preferred securities.

Where a fund has no material cash flow obligations, we believe it should not be required to provide the proposed cash flow obligations disclosure. We recommend that the Board consider a framework for assessing whether a fund should provide the proposed cash flow obligations table that is similar to the statement of cash flows exemption provided to registered investment companies and other pooled vehicles. In particular, if the fund meets the following conditions, it would not be required to provide the cash flow obligations table:

1. During the period, substantially all of the entity's investments were highly liquid (for example, marketable securities, and other assets for which a market is readily available);
2. Substantially all of the entity's investments are carried at market value. Securities for which market value is determined using matrix pricing techniques would meet this condition. Other securities for which market value is not readily determinable and for which fair value must be

weighted average maturity or 60 days or less; 3) cannot invest more than five percent of assets in the securities of any single issuer; and 4) must maintain 10 percent of assets in "daily liquid assets," which means cash, U.S. Treasuries, or securities that mature or are subject to a demand feature within one business day. All funds also must have 30 percent of assets in "weekly liquid assets," which means cash, U.S. Treasuries, other government securities with remaining maturities of 60 days or less, or securities that mature or are subject to a demand feature within five business days.

determined in good faith by the board of directors would not;

3. The entity had little or no cash flow obligations, based on average cash flow obligations during the period, in relation to average total net assets. For the purposes of determining average cash flow obligations, obligations resulting from redemptions of shares by the entity, from unsettled purchases of securities or similar assets, or from covered options written generally may be excluded. However, any extension of credit by the seller that is not in accordance with standard industry practices for redeeming shares or for settling purchases of investments shall be included in average cash flow obligations; and
4. The entity provides a statement of changes in net assets.

We believe the above framework, which parallels the statement of cash flows exemption provided in ASC 230-10-15-4, would enable funds that are highly liquid and have little or no cash flow obligations to avoid providing disclosure that would be of little or no value to financial statement users. At the same time, the framework would ensure that funds with significant cash flow obligations would provide the proposed disclosure.

Definition of Available Liquid Funds

The Proposal describes available liquid funds as unencumbered cash, high-quality liquid assets, and borrowing availability. Unencumbered cash and high-quality liquid assets are free from restrictions, readily convertible to cash and include cash, cash equivalents, and unpledged liquid assets.

Mutual funds and other types of investment companies may have material cash flow obligations relating to short sales, open derivatives contracts in an unrealized loss position, or other trading strategies, necessitating presentation of the cash flow obligations table. In such instances funds may pledge cash or other portfolio securities as collateral with an exchange or derivative counterparty in order to ensure the exchange or counterparty that the fund will perform on its obligation. In such instances the cash or securities pledged are “flagged” in the schedule of investments and the total dollar amount of cash or securities pledged is disclosed.

As we read the proposal at 825-10-50-23T, such pledged assets could not be included in the proposed available liquid funds table, even though they are specifically set aside as collateral to satisfy the related cash flow obligation. If such assets are excluded from the available liquid funds table, we believe the proposed disclosures would cause readers to conclude that the fund has significant liquidity risks where, in fact, no risk exists because the pledged assets will satisfy the cash flow obligation. If an entity has pledged cash or assets specifically to satisfy disclosed cash flow obligations, then the pledged assets should be able to be included in the available liquid funds table (or the pledged assets should be shown as a contra item in the cash flow obligations table). Master netting agreements, and the disclosure requirements included in ASU 2011-11, *Disclosures about Offsetting Assets and Liabilities*,

should also be considered so as to ensure a fair presentation of cash flow obligations and available liquid assets.

If you have any questions on our comments or require additional information, please contact the undersigned at 202/326-5851 or smith@ici.org.

Sincerely,



Gregory M. Smith
Senior Director – Fund Accounting

cc: Jaime Eichen, Chief Accountant
Division of Investment Management
U.S. Securities and Exchange Commission