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VIA ELECTRONIC DELIVERY

September 30, 2010

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

Re: *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities* (File Reference No. 1810-100)

Dear Mr. Golden:

The Independent Directors Council¹ 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* (the “Proposal”).² IDC’s comments focus on one specific aspect of the Proposal – the requirement that investment companies recognize transaction costs on the purchase and sale of portfolio securities as an expense for financial reporting purposes. This would cause transaction costs to be included in a fund’s expense ratio. Investment company directors have a duty to represent the interests of fund shareholders, including ensuring that they receive clear and

¹ IDC serves the fund independent director community by advancing the education, interaction, communication, and policy positions of fund independent directors. IDC’s activities are led by a Governing Council of independent directors of Investment Company Institute member funds. ICI is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds, and unit investment trusts. Members of ICI manage total assets of \$11.18 trillion and serve almost 90 million shareholders, and there are approximately 2,000 independent directors of ICI member funds. The views expressed by IDC in this letter do not purport to reflect the views of all fund independent directors.

² See Proposed Accounting Standards Update *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities* (May 26, 2010).

useful disclosure. IDC has consistently been in favor of disclosure that is clear, easy to understand, and helpful to investors.³ This Proposal runs contrary to those objectives, and we therefore oppose it.⁴

The Proposal's requirement to report transaction costs as a fund expense would render a fund's expense ratio useless as a tool for investors to compare funds and make informed investment decisions. Research shows that investors most often consider a fund's fees and expenses prior to purchasing fund shares.⁵ Investors rely on expense ratios to compare the costs of different funds and estimate future costs associated with an investment in a fund. They are able to do this because a fund's expense ratio is made up of its operating expenses, which are generally stable and recurring from year to year. Transaction costs, on the other hand, can fluctuate significantly as a result of a variety of factors, including market conditions, fund flows, and atypical events, such as a fund merger or portfolio manager change. These fluctuations, if included in the expense ratio, would undermine the comparability of fund fees and create significant confusion for investors with respect to future fund expenses.

Moreover, under the Proposal, the comparability of expense ratios would be severely undermined for the simple reason that there is no consensus around a specific and accurate methodology for determining transaction costs other than commission costs. The Proposal contains no specific guidance for measuring transaction costs for fixed-income securities, which trade on a bid-ask spread basis, without any explicit commission. Consequently, funds would be required to develop their own methods for measuring transaction costs for fixed-income transactions, which would raise comparability concerns. If this issue were addressed by applying the Proposal only to equity securities, then funds investing primarily in equity securities would artificially appear to be more expensive. Investors, when faced with funds that appear to be more expensive, may make investment decisions that

³ See *e.g.*, letter from Robert W. Uek, Chair, Independent Directors Council to Nancy M. Morris, Secretary, U.S. Securities and Exchange Commission (February 15, 2008) available at <http://www.sec.gov/comments/s7-28-07/s72807-51.pdf> (strongly supporting the SEC's layered approach for prospectus disclosure, in part because its standardized format would promote the effective comparisons of funds).

⁴ We also note that the Proposal would not advance convergence between generally accepted accounting principles (GAAP) and IFRS. This is because funds based in jurisdictions that apply IFRS do not recognize transaction costs incurred in the form of bid-ask spreads on fixed-income trades as an explicit expense. Instead, fund purchases of fixed-income securities are initially recognized at the purchase price.

⁵ See *Understanding Investor Preferences for Mutual Fund Information*, Investment Company Institute, Aug 25, 2006, available at http://www.ici.org/pdf/rpt_06_inv_prefs_full.pdf.

disproportionately skew their asset allocation and are not necessarily appropriate for their investing needs.

Other types of transaction costs that cannot be reliably measured include opportunity costs and market impact costs. These costs can have a significant impact on the overall cost of trading. Without a single, agreed-upon measure for *all* types of transaction costs, the Proposal is fundamentally flawed.

Currently, transaction costs are recognized as part of the cost of purchasing and selling portfolio securities – as opposed to a recurring operating expense – and are appropriately accounted for as part of the gain or loss on the fund’s portfolio. This approach makes sense because transaction costs are inextricably linked to the purchase and sale of securities and must be offset against the portfolio in order to present an accurate picture of the gain or loss from the fund’s investment activity.

The changes discussed in the Proposal are not new. In 2003, the U.S. Securities and Exchange Commission issued a concept release that, among other things, requested comment on whether funds should be required to include transaction costs in their expense ratios.⁶ At that time, the Investment Company Institute recommended enhanced disclosure regarding transaction costs, but argued strenuously against including such costs in the expense ratio and fee table for many of the reasons discussed above. ICI’s view on the issue has not changed⁷ and, to date, the SEC aptly has not proposed or required funds to recognize transaction costs as an explicit expense in their financial statements, or to include such costs in their expense ratios. Instead, the SEC now requires expanded and more prominent disclosure in the prospectus relating to a fund’s annual portfolio turnover rate, which many view as a proxy for transaction costs. The SEC, in determining to require more prominent disclosure of portfolio turnover and declining to expense transaction costs, acknowledged the significant difficulties associated with measuring and recognizing transaction costs.⁸

⁶ See *Concept Release: Request for Comments on Measures to Improve Disclosure of Mutual Fund Transaction Costs*, SEC Release Nos. 33-8349; 34-48952; IC-26313 (December 19, 2003) available at <http://www.sec.gov/rules/concept/33-8349.htm>.

⁷ See Comment Letter from Gregory M. Smith, Director – Operations/Compliance & Fund Operations, Investment Company Institute to Russell G. Golden, Technical Director, Financial Accounting Standards Board, regarding Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities (File Reference No. 1810-100) (September 24, 2010).

⁸ See *Enhanced Disclosure and New Prospectus Delivery Option for Registered Open-End Management Investment Companies*, SEC Release No. 33-8998 (January, 13, 2009), available on the SEC’s website at <http://www.sec.gov/rules/final/2009/33-8998.pdf>.

Mr. Russell G. Golden

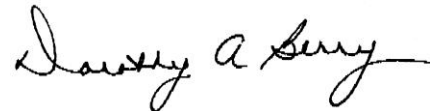
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Based on the foregoing, IDC strongly opposes accounting for transaction costs as an expense instead of as a cost of trading the portfolio. We are hard pressed to see the benefits of this Proposal. Rather, we are concerned about the detrimental effect it would have on the almost 90 million mutual fund shareholders.

If you have any questions, please feel free to contact Amy B.R. Lancellotta, IDC Managing Director, at 202/326-5824 or amy@ici.org.

Sincerely,

A handwritten signature in black ink that reads "Dorothy A. Berry". The signature is written in a cursive, flowing style.

Dorothy A. Berry
IDC Vice Chair

cc: Richard F. Sennett
Chief Accountant – Division of Investment Management
U.S. Securities and Exchange Commission