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Submitted electronically via email to director@fasb.org

Jackson M. Day
Technical Director
Financial Accounting Standards Board (FASB)
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Re: Agenda Request – Reexamination of Accounting Standards Update No. 2022-03, Fair Value Measurement of Equity Securities Subject to Contractual Sale Restrictions

Dear Mr. Day:

Fidelity Investments ("Fidelity")[1] requests that the Financial Accounting Standards Board (the "Board") reexamine Accounting Standards Update No. 2022-03 ("ASU 2022-03"), a 2022 update to the guidance in Topic 820 (Fair Value Measurement) relating to the fair value measurement of equity securities subject to contractual sale restrictions.[2] We urge the Board to reevaluate the questions addressed in ASU 2022-03 and issue a further update revising the guidance on this subject for the reasons discussed below, including significant relevant changes in market dynamics and related assumptions since the issuance of ASU 2022-03.

Executive Summary

Fidelity disagrees with ASU 2022-03 and believes that the guidance in Topic 820 should be revised, at least with respect to investment companies as defined under Topic 946 (Financial Services – Investment Companies). Contractual sale restrictions, such as lock-up agreements, can have a material impact on the economic value of public equity securities. Ignoring these restrictions in fair value measurement results in valuations that do not reflect the price that would be received in an orderly transaction between market participants at the measurement date. The fair value framework should reflect the perspective of market participants, including the impact of contractual restrictions that affect the ability to realize value. The current guidance in ASU

[1] Fidelity is one of the world's largest providers of financial services, including investment management, retirement planning, portfolio guidance, brokerage, benefits outsourcing, and many other financial products and services. Fidelity administers approximately $18 trillion in assets from over 50 million individual investors, 29,000 employer client firms, 16,000 wealth management firms and institutions, and 8.5 million clearing and custody accounts. https://www.fidelity.com/about-fidelity/our-company.

[2] *See* Financial Accounting Standards Board Accounting Standards Update No. 2022-03 (June 30, 2022), available at https://www.fasb.org/page/ShowPdf?path=ASU%202022-03.pdf&title=ACCOUNTING%20STANDARDS%20UPDATE%202022-03%E2%80%94Fair%20Value%20Measurement%20(Topic%20820):%20Fair%20Value%20Measurement%20of%20Eq.

2022-03, requiring fair value measurement based solely on the price of unrestricted securities, has the potential to disconnect reported values from economic reality, which could be to the detriment of open-end registered investment companies (*i.e.*, mutual funds) and their shareholders. Indeed, the Investment Company Act of 1940 (the "1940 Act") imposes on fund advisers and boards specific fair valuation obligations to ensure the accuracy of fund net asset values ("NAV") and to protect fund investors – especially those in vehicles featuring daily liquidity. The potential decoupling of fair value from economic reality under ASU 2022-03 not only threatens harm to mutual fund shareholders (*e.g.*, through the potential to result in overstated NAVs) but is also in tension with Securities and Exchange Commission ("SEC") rules and guidance regarding the fair valuation of fund holdings under the 1940 Act.

Fidelity's views expressed here, especially as they relate to investment companies, are consistent with the dissenting views of three Board members discussed in ASU 2022-03[3] and the majority of the public comments submitted in advance of its issuance.[4] The importance of revisiting this topic has been brought into even sharper relief by market developments in the interim. Since ASU 2022-03 was issued, the capital markets have experienced a pronounced decline in initial public offering ("IPO") activity. The past four years have seen a significant shift in market dynamics: many private companies are remaining private for longer periods and, accordingly, are becoming larger and achieving higher valuations before going public. As a result, when these companies eventually list, the economic impact of lock-up restrictions may be substantially higher than anticipated by the Board when ASU 2022-03 was issued. The divergence between the accounting fair value (which ignores restrictions) and the actual economic value that market participants would ascribe to restricted shares has significantly widened. This divergence could impact NAVs; lead to differential treatment of purchasing, redeeming, and remaining investment company shareholders; and result in potential distortions in performance reporting and compensation arrangements.

In summary, the approach mandated in ASU 2022-03 does not reflect economic reality, is inconsistent with regulatory requirements under the 1940 Act and SEC guidance, is increasingly problematic given the materiality of lock-up restrictions in today's market, and with a potential uptick in IPO activity on the horizon, requires reconsideration before registered investment company shareholders are more meaningfully impacted.

1. The Approach Mandated in ASU 2022-03 Does Not Reflect Economic Reality

The touchstone principle of fair valuation measurement under Topic 820 has long been grounded in economic reality: "when measuring fair value a reporting entity shall take into account the characteristics of the asset or liability if market participants would take those

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[3] *Id* at 11-16 (dissenting views of Messrs. Cannon, Jones, and Kroeker).

[4] *See* Fair Value Measurement of Equity Securities Subject to Contractual Sale Restrictions Comment Letters, available at https://www.fasb.org/projects/comment-letters/details?metadata=fasb_FairValueMeasurementofEquitySecuritiesSubjecttoContractualSaleRestrictions_0228221200&PageId=/projects/commentletter.html&searchText=&page=1.

characteristics into account when pricing the asset or liability at the measurement date."[5] The current guidance under ASU 2022-03 departs from this foundational principle, requiring that fair value be measured as if the security were completely unrestricted – ignoring the real and material impacts of contractual sale restrictions on liquidity and value. By disregarding these impacts, the guidance prescribes valuations that do not reflect the price that would be received in an orderly transaction between market participants at the measurement date. Market participants routinely consider the limitations imposed by such restrictions when determining the value of a security, as reflected in market data showing the price impact of contractual restrictions.

The dissenting Board members described research performed in the development of ASU 2022-03, finding that "the market price generally declines as the lock-up expiration date approaches and then stabilizes in the days after the expiration."[6] Fidelity's recent internal analysis is in line with these findings. Our review of U.S. IPOs since the beginning of 2020 (excluding de-SPACs) involving deal sizes of greater than $100 million and which are still trading today reflects that company share prices decline on average approximately 10% in the 30 days prior to the expiration of the contractual lock-up as markets anticipate a material increase in company share supply. According to the dissenting Board members, based on Board and academic research, while "the contractual sales restrictions appear to have an impact on the price of equity securities not subject to the sales restriction," such restrictions "clearly have a differential impact from an economic point of view on the owners of restricted shares that are precluded from realizing value for the shares during the restricted period."[7] Excluding consideration of these restrictions from fair value measurement could, in certain circumstances, result in potentially overstating asset values and misrepresenting the true economic position of investors and funds.

ASU 2022-03 distinguishes between contractual sale restrictions and regulatory sale restrictions (*e.g.*, unregistered shares issued in a private placement), requiring that the latter be considered in valuing the restricted security because the regulatory restriction is ostensibly an inherent characteristic of the security itself, whereas the contractual limitation is described as a characteristic of the issuer or holder of the security. From an economic perspective, however, this is a distinction without a difference. Market participants treat both types of restriction as fundamentally altering the right to sell and negatively affecting liquidity and value, because they both do, and therefore both types of restriction should be considered in the measurement of fair value. By introducing this arbitrary distinction into Topic 820, ASU 2022-03 created an internal contradiction at odds with Topic 820's basic valuation framework – that reporting entities are to follow the lead of market participants in measuring fair value. Market participants simply do not consider contractually restricted shares as having the same value as fully unrestricted shares.

The potential negative effect of the disconnect from economic reality under ASU 2022-03 is especially acute in the case of mutual funds and other 1940 Act investment companies that rely centrally on published NAVs – including to establish the price at which fund shares are sold

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[5] *Supra* note 2, at 4 (quoting paragraph 820-10-35-2B).

[6] ASU 2022-03 at 12.

[7] *Id*.

and redeemed, and to calculate asset-based service fees. As the SEC explained regarding these vehicles, "[p]roper valuation, among other things, promotes the purchase and sale of fund shares at fair prices, and helps avoid dilution of shareholder interests. Improper valuation can cause investors to pay fees that are too high or to base their investment decisions on inaccurate information."[8] The dissenting Board members stated their view that "in the case of investment companies … the obligations imposed by the restrictions directly affect the economics of transactions with investors."[9]

The heightened negative effect of ASU 2022-03 on investment companies and their shareholders was recognized by the dissenting Board members and the large majority of the comment submissions (including those of all "big four" accounting firms) when the update was proposed. Nevertheless, in adopting ASU 2022-03, the Board majority concluded that on balance the perceived benefits of the guidance (*e.g.*, uniformity of practice, reliance on objective price signals, reduced cost and complexity) outweighed the negative effects. We disagree with this conclusion. Mutual fund sponsors have well-developed infrastructures for the fair valuation of a wide array of securities with myriad characteristics, including the routine assessment of the effect of various liquidity and marketability limitations on share value. Incorporation of contractual sale limitations in this established process does not present any unique complexity, or any reason to predict greater variability of valuation treatment across firms than with respect to other types of considerations – including regulatory sale limitations that must still be incorporated in the valuation process under ASU 2022-03.

2. The Approach Mandated in ASU 2022-03 is Inconsistent with 1940 Act Requirements and SEC Guidance

Registered investment companies are also subject to specific fair valuation requirements under the 1940 Act, which further underscores the fundamental importance of grounding fair valuation in economic reality. ASU 2022-03 is in apparent conflict with the 1940 Act valuation obligations, potentially placing fund boards and advisers in an untenable position of having to comply with inconsistent standards.

For purposes of calculating NAV, Rule 2a-4 sets forth a clear dichotomy: "[p]ortfolio securities with respect to which *market quotations are readily available* shall be valued at current market value, and other securities and assets shall be valued at *fair value as determined in good faith* by the board."[10] Rule 2a-5 elaborates that "a market quotation is readily available only when that quotation is a quoted price (unadjusted) in active markets for *identical investments that the fund can access at the measurement date*, provided that a quotation will not be readily available *if it is not reliable*."[11] By definition, shares subject to a contractual sale restriction on the measurement date cannot be sold at the current market price for otherwise-

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[8] *See* SEC, Final Rule Release, "Good Faith Determination of Fair Value," Release No. IC-34128 (December 3, 2020), available at https://www.sec.gov/files/rules/final/2020/ic-34128.pdf.

[9] *Supra*, note 2 at 15.

[10] 17 CFR § 270.2a-4(a)(1) (emphases added).

[11] 17 CFR § 270.2a-5(c) (emphasis added).

identical unrestricted shares of the same security, and thus that price is not a "readily available" quotation for the restricted shares. The market quotation in this circumstance is not reliable for purposes of valuing the shares held by the investment company, and the shares must be priced at fair value.

Accordingly, under the 1940 Act rules, the fund *may not* default to valuing the restricted shares at the market price of the unrestricted shares without considering the impact on value of the sale restriction (which ASU 2022-03 appears to *mandate*); instead, the restricted shares *must* be fair valued "in good faith" according to fair value methodologies established by the fund (which may include delegation of duties to the fund adviser as the "valuation designee"). Under this dichotomy, there is no basis for the distinction drawn in ASU 2022-03 between regulatory sale restrictions and contractual sale restrictions: under neither type of restriction would the current market price of unrestricted shares be "readily available" for the restricted shares, and thus neither type of restricted share could be valued by default at the market price without considering the effect on value of the restriction (*i.e.*, applying the fund's established fair value methodologies).

Forcing funds to ignore the economic impact of lock-up restrictions when applying fair valuation methodologies, as ASU 2022-03 seems to compel, is inconsistent with the obligation to determine fair value in good faith. Sale restrictions can significantly impair the ability to realize value, especially when the restriction period is lengthy or the security is otherwise illiquid. As a matter of industry-wide practice, Fidelity and other mutual fund sponsors routinely apply adjustments to reference public market prices when the shares being valued cannot currently be sold at that price. This is a basic feature of many funds' fair valuation methodologies.

As the SEC emphasized in its 2020 release accompanying Rule 2a-5's adoption, compliant fair valuation methodologies are expected to be "consistent with those used to prepare the fund's financial statements and thus [to] be consistent with the principles of the valuation approaches laid out in ASC Topic 820."[12] But the Board's subsequent adoption of ASU 2022-03 inserted a rigid default valuation rule into Topic 820 that is at odds with both the general principles of Topic 820 *and* the spirit of the SEC rules. Fund boards and advisers thus have no choice but to determine fair value based on the available market price of unrestricted shares, despite the fact that Rule 2a-4 presents fair value as an alternative valuation methodology to be used when no market price is available. The Topic 820 guidance should be further revised to alleviate this tension. Should the guidance remain unchanged, the Board's mandate is likely to face scrutiny before regulators and courts.

We disagree with any suggestion that the negative effect of ASU 2022-03 on mutual fund NAVs will always be muted or immaterial because of the 15% limitation on fund holdings of illiquid investments under Rule 22e-4.[13] The SEC and its staff have long advised that a reasonable threshold for determining whether a NAV calculation error is material (and thus

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[12] *Supra* note 7 at 21.

[13] 17 CFR § 270.22e-4.

requires correction) is $0.01 per share or 0.5% of NAV[14] – which has accordingly become the industry standard materiality threshold in fund NAV error policies. As a practical matter, this low materiality threshold can be readily satisfied even by relatively modest calculation errors on single fund holdings far below the 15% size limit. By complying with ASU 2022-03, the NAV calculation using a fair value methodology that does not take into account the contractual restrictions was different by more than $0.01 per share / 0.5% of NAV in several instances than the NAV calculation using a fair value methodology that took into account the contractual sales restrictions. We expect the impact of ASU 2022-03 to potentially grow in the current larger, later stage, IPO market.

3. The Approach Mandated in ASU 2022-03 is Increasingly Problematic Given the Materiality of Lock-Up Restrictions in Today's Market

The anticipated impact and materiality of lock-up restrictions on valuations, and thus the potential distorting effect of ASU 2022-03, have only increased since its adoption. Over the past four years, the market has seen a significant decline in the number of IPOs, with companies remaining private much longer than in prior periods. Since 2021 (when the amendment to the Accounting Standards Update was being considered by the Board), the average percentage of IPOs has declined by approximately 48%.[15] With the dearth of IPOs in recent years, more companies have remained private for longer periods and as a result, have grown larger with higher valuations at the time of IPO. Indeed, the number of private companies with valuations of $1 billion or more (*i.e.*, "unicorns")[16] has increased by approximately 6,700% since 2010.[17] This shift means that the difference between the accounting fair value under ASU 2022-03 (ignoring lock-up restrictions) and the actual economic value (which reflects the inability to sell restricted shares) is now much more pronounced and material than what would have been assumed and/or anticipated four years ago.

If, as was common throughout the industry prior to the issuance of ASU 2022-03, a holder applies a discount to the locked-up securities to account for their reduced marketability, the impact of that discount gets further magnified when applied to a much larger base value. Accordingly, the absolute price difference between the accounting fair value and the economic value grows proportionally. For example, a 15% discount applied to a $500 million position in locked-up securities produces a $75 million price differential, whereas the same 15% applied to a $5 billion position in the same fund (the increasingly more common position size of private companies prior to IPO), produces a $750 million differential. This dynamic means that for today's larger, later-stage IPOs, the accounting fair value ignoring the lock-up restriction is even more disconnected from the price at which holders can actually monetize their shares. The

[14] *Supra* note 7 at 73 ("While we decline to establish that specific standard as what constitutes a 'material error in the calculation of net asset value' for purposes of the final rule, we agree that relying upon that standard would not be unreasonable.").

[15] *See* SEC, Data and Research, "Initial Public Offerings (IPOs)" available at https://www.sec.gov/data-research/statistics-data-visualizations/initial-public-offerings-ipos#select-stats.

[16] *See* Corporate Finance Institute, definition of "Unicorn," available at https://corporatefinanceinstitute.com/resources/valuation/unicorn/.

[17] *See* Pitchbook Financial Database as of 2/28/26.

impact of ignoring these restrictions is not theoretical – it can have real consequences for fund performance reporting, manager compensation, and, most importantly, shareholder protection. If a fund's NAV is overstated for these reasons, it would pay redeeming shareholders too much, charge subscribing shareholders too much, dilute existing shareholders if it is net redemptions, and may overpay service providers that receive fees based on a percentage of net assets. The current approach risks potentially distorting NAVs and undermining investor confidence in reported valuations.[18]

4. ASU 2022-03 Requires Reconsideration

Given these developments, we urge the Board to reconsider the guidance in ASU 2022-03 as it applies to equity securities subject to contractual sale restrictions. We believe that fair value measurements should reflect all factors that market participants would consider, including the impact of lock-up agreements and other restrictions on marketability, liquidity, and value. Accordingly, we urge the Board to revise ASU 2022-03 to require that holders consider contractual sale restrictions in making fair value determinations of equity securities consistent with applicable fiduciary duties and federal law.

In the alternative, as described in the views of the three dissenting Board members[19] in ASU 2022-03, there are other available approaches to revising the guidance to incorporate the economic impact of contractual sales restrictions in fair valuation. These alternatives include (i) amendments requiring the recognition of contractual sales restrictions as a separate unit of account (offsetting the value of the related securities) by all reporting entities; and/or (ii) industry-specific guidance applicable to investment companies that are subject to Topic 946, the 40 Act, and other SEC guidance which collectively require investments to be measured at fair value in good faith and issue financial statements that are consistent with the measurement principles in Topic 946, requiring that certain contractual restrictions be considered in measuring fair value.

Conclusion

We acknowledge the Board's efforts to promote consistency and objectivity in fair value measurement, but we believe that any such benefits under ASU 2022-03 are dramatically outweighed by the negative consequences discussed above in the context of securities subject to contractual sale restrictions. We respectfully request that the Board revisit this subject and issue revised guidance that allows for the consideration of contractual restrictions in fair value measurement, in line with economic realities, market participant assumptions, and regulatory requirements.

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[18] The timeliness of reconsideration is underscored by the fact that even had the Board initiated its post-implementation review process in connection with ASU 2022-03, such review would not allow for an adequate evaluation of whether the amendment is achieving its stated objective in light of the dearth of IPOs and significant change in market circumstances since its adoption. Any review process would be void of statistically significant data upon which to assess the impact of ignoring contractual restrictions on securities on the resulting valuation, and ultimately, the investors.

[19] *Supra* note 2at 14-16.

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Fidelity would be pleased to provide further information, participate in any direct outreach efforts that the Board undertakes, or respond to questions the Board may have about our comments.

Sincerely,

Cc: Richard R. Jones, Chair, FASB
Hillary H. Salo, Vice Chair, FASB
Christine Ann Botosan, Board Member, FASB
Frederick L. Cannon, Board Member, FASB
Susan M. Cosper, Board Member, FASB
Marsha L. Hunt, Board Member, FASB
Joyce T. Joseph, Board Member, FASB