November 18, 2021

VIA ELECTRONIC SUBMISSION

Ms. Hillary Salo
Technical Director, FASB
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

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

Dear Ms. Salo:

The Global Financial Institutions Accounting Committee of the Securities Industry and Financial Markets Association ("SIFMA")[1] appreciates the opportunity to comment on the Financial Accounting Standards Board's ("FASB's" or the "Board's") Proposed Accounting Standards Update (the "Proposed Update") "Fair Value Measurement (Topic 820): Fair Value Measurement of Equity Securities Subject to Contractual Sale Restrictions." Our committee members use fair value to manage risk, interact with customers and counterparties and for internal and external reporting of financial information.

We appreciate the Board's attempt to address diversity in practice, however, we do not believe the approach taken by the Board resolves the fundamental issue or will be operational across all fact patterns. We also agree with the arguments made by dissenting Board Members for the following reasons:

- The framework of ASC 820 is based on "exit price" or fair value from a market participant's perspective. However, ASC 820 has a fundamental flaw in its application to financial instruments in that it limits the "market participant view" with the "unit-of-account" concept. The "unit-of-account" concept in a fair value framework introduces an entity-specific concept which can result in non-economic conclusions on fair value for certain financial instruments. While there are "workarounds" created either through standard setting, such as the "portfolio exception," or practical interpretations on how the

[1] SIFMA is the leading trade association for broker-dealers, investment banks, and asset managers operating in the U.S. and global capital markets. On behalf of our industry's nearly one million employees, we advocate for legislation, regulation, and business policy affecting retail and institutional investors, equity and fixed income markets, and related products and services. We serve as an industry coordinating body to promote fair and orderly markets, informed regulatory compliance, and efficient market operations and resiliency. We also provide a forum for industry policy and professional development. With offices in New York and Washington, D.C., SIFMA is the U.S. regional member of the Global Financial Markets Association (GFMA).

“unit-of-account” should be defined by analogy to other topics within GAAP, there remain practice issues such as the one addressed by the Proposed Update.

- Absent a re-opening of the issue of whether the “unit-of-account” is the appropriate starting point for the valuation of financial instruments, when the application of the “unit-of-account” rule creates non-economic results, we would encourage the Board to redefine the “unit-of-account” or “unit-of-value” to align the conclusion with the overarching framework of fair value from a market participant’s perspective.

- We believe that when there is clear, observable market evidence that market participants are pricing the existence of the transfer restrictions in their determination of the value of a financial instrument <u>not subject to those same restrictions</u>, those restrictions should be viewed as a characteristic of the financial instrument <u>subject to such restrictions</u> and included in the “unit-of-account.” That is, the fair value for these restricted securities should be priced using the fair value of the unrestricted securities as a starting point for estimating fair value, adjusted for liquidity and volatility over the period of restriction.

- The Proposed Update states in the basis for conclusions (BC5), that “the objective of financial reporting is to provide information that is useful to investors….” We believe the Board can achieve the same result of reducing diversity in practice by clarifying when the unit-of-account should be defined as the “unit-of-value.” This approach would have the benefit of aligning accounting conclusions with the existing fair value framework and economic reality.

We expand on these concepts and address the Board’s specific questions in the appendix to this letter. Should you have any questions or require further information concerning any of the matters discussed in this letter, please do not hesitate to contact the undersigned Timothy Bridges (tim.bridges@gs.com).

Regards,

Timothy J Bridges

Timothy Bridges, Managing Director, Goldman Sachs & Co. LLC
Chair, SIFMA Accounting Committee

CC: Dina Nussbaum, Goldman Sachs & Co. LLC
Chair, SIFMA Task Force FASB Fair Value Restricted Equities Proposal
Kevin Zambrowicz, Managing Director & Associate General Counsel, SIFMA

FASB Questions:

Question 1—Restriction Type: Do you agree with the Board's decision on scope to include all contractual restrictions that prohibit the sale of an equity security? Please explain why or why not.

Question 7—Clarity and Operability: Do you agree that the proposed amendments and, in particular, the definition of a restricted security provide the necessary clarity to resolve existing diversity in practice? Please explain why or why not. Are the proposed amendments operable and auditable? If not, which proposed amendment or amendments pose operability or auditability issues and why?

Response:

Yes. We agree that the scope of this clarification should include all "contractual restrictions." However, the Proposed Update does not specifically define what a "contractual restriction" is other than by way of example. We believe the Proposed Update should provide guidelines on what is a "contractual restriction" and in what circumstances these contractual restrictions should be included in the fair value of a security.

The Proposed Update defines a "restricted security" by defining what it is not, that is, an equity security that is "registered" for sale. In our experience, and as we describe in more detail below, determining whether a "contractual restriction" is a legal characteristic of the security itself, whether a security is restricted from sale as a function of local law or regulation, or by a separate contract such as an underwriting agreement, is complex and very much dependent on facts and circumstances, exchange rules and jurisdictional security law. We believe this definition will be hard to operationalize in the US markets and even more so, by way of analogy, to other jurisdictions and securities exchanges.

For instance, under federal securities laws in the U.S., even if an equity security is exempt from registration under Rule 144, the holder may not be able to freely resell the securities on an exchange or in the OTC markets given the volume and manner of sale limitations that Rule 144 may impose. Similarly, even if the security is registered for resale with the SEC, it is possible the registration statement may not be useable at the time the holder wishes to sell—registration statements that have been declared effective can later be withdrawn or suspended, and in some cases the holder may be subject to periodic contractual limitations on the use of that registration statement (*e.g.*, issuer imposed "black outs"). In non-U.S. jurisdictions, the concept of registering resales may not exist at all. For these reasons, we believe drawing any distinction between regulatory limitations and contractual limitations would be arbitrary—in both cases, the limitations are legally binding and can have the very real effect of curtailing the holder's market access.

In summary, securities may be subject to various legal, regulatory or contractual restrictions that impede a holder's ability to access the primary market and realize the market value for the security. Given the broad and varied nature of securities laws across jurisdictions in and out of the U.S., and given the myriad forms of contractual provisions that can apply to securities ownership and resale, it is too simplistic to reduce the concept of market access to "registered" or "exempt from registration".

It is also unclear why the Proposed Update limits the definition of a restricted security to the equities market. Legal, regulatory and other contractual restrictions on transferability exist for debt securities and other financial instruments. The Proposed Update should provide a consistent approach for evaluating these restrictions across the broad spectrum of financial instruments.

In general, we believe the approach taken by the Proposed Update is very limiting. It does not provide guidance on how to consider the valuation attributes of an unregistered/non exchange traded equity security that is not subject to any contractual restrictions on transferability as compared to a "contractually restricted" unregistered security. It provides no guidance on factors to consider to differentiate between a "contractual restriction, a "legal restriction" or a "restriction that arises out of regulation", market practice, exchange rules, an arrangement amongst the entire shareholding group, a subset of the shareholding group, or an agreement with the issuer and its underwriter as a condition for issuance of the original security; most critically, it does not provide guidance on why these factors should be differentiated for purposes of the valuation of the security by the investor. In our view, the Board's approach fails at the attempt to resolve the conundrum of when is a restriction a "characteristic of the security" by simply sidestepping the main issue that is creating the diversity in practice and creating an arbitrary rule that itself will be hard to operationalize.

Question 2—Measurement: Do you agree with the Board's decision that a contractual restriction prohibiting the sale of an equity security is not considered part of the unit-of-account of the equity security and, therefore, should not be considered in measuring fair value? Alternatively, should the Board amend the guidance in Topic 820 (or elsewhere in GAAP) such that contractual sale restrictions would be required to be considered in determining fair value?

Response:

As described in our response to question 1, we do not believe the Proposed Update provides clear guidance on what a "contractual restriction" is and when it should or should not be viewed as a characteristic of the financial instrument. Nor does it provide sufficient basis for conclusion as to when such restrictions should be considered part of the unit-of-account of a financial instrument.

We believe the principal of "exit price" from the "perspective of a market participant" is already clear in the framework of ASC 820 and should be used to guide the analysis on whether a contractual, legal or other restriction is a characteristic of the security and should be included in the unit-of-account.[2]

[2] ASC 820-10-35-2B.

Therefore, the solution should focus on what factors should be considered when analyzing whether a market participant would incorporate the transfer restrictions in determining price. For example, we believe a market participant would consider whether the issuer was involved in negotiations of the restriction, whether the contractual restrictions were negotiated contemporaneously with and in contemplation of a security offering, and whether the restrictions are subject to market disclosure such that its existence can be readily observed and used by market participants in pricing the unrestricted shares. If these factors exist, then the contractual restrictions should be incorporated in the fair value of the restricted shares. The path to a conclusion on when to incorporate contractual restrictions in the fair value of a security should be entirely from the perspective of a market perspective. This approach would yield a consistent path to a conclusion on the question of "what is a characteristic of the security" irrespective of the form used to create the contractual restriction such as documented by legend on the security as required in the US markets for unregistered shares, in a shareholder agreement or in a separate lock-up agreement that was entered into by and among the shareholders and issuer as part of a share offering. We believe the overriding factor that should be taken into consideration is whether market participants would be aware of the transfer restrictions and incorporate that information in their investment decisions for the <u>unrestricted shares</u>. There is precedence in GAAP[3] on taking an expanded definition of "unit-of-account" and considering all factors of contractual arrangements entered into contemporaneously and in contemplation to achieve the appropriate economic substance of a transaction rather than focusing solely on form.

This approach does not conflict with fact patterns where an investor is restricted from transfer that arise through entity-specific arrangements such as a security pledge as collateral to a loan agreement or a bilateral contract entered into by a shareholder that is not publically announced. A market participant trading the unrestricted shares would not consider that information in their investment decisions.

Similarly, the proposed approach described above would not conflict with the Board's decision to specifically prohibit the consideration of block discounts when determining fair value. The size of position holdings in a single name stock may not be available information to all market participants and the holding entity can choose to liquidate the block on a P*Q (price times quantity) basis over time in a manner that can be absorbed without moving the market.

We also believe the Board's conclusion that a holder of a registered security subject to transfer restrictions, whether by way of law, regulation or contract, would transact in the exchange market as the principal market is flawed. An investor subject to a lock-up arrangement who, for whatever reason, needs to exit the position, can only legally do so by either renegotiating the lock-up arrangement with the shareholder group subject to all the required market disclosures or by transferring the shares to a new investor subject to the lock-up (such transfers generally require consent of the shareholder group subject to the lock-up/contractual restriction). We think this is clearly distinguishable from an entity-specific restriction such as a pledge arrangement in a

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[3] *See, e.g.,* ASC 815 and ASC 606 and ASC 860 all have specific rules and implementation guidance to address these issues.

collateral agreement where the entity can choose to substitute the collateral or repay the borrowing obligation and then exit the position through the principal market. The lender in the pledge arrangement is also using the principal market to price the collateral and risk manage the borrowing because to the extent there is a borrower default, the pledged but unrestricted shares will be foreclosed on and liquidated through the most liquid market.

Question 3—Entity Type: Should all types of entities use the same unit-of-account when measuring the fair value of an equity security subject to a contractual sale restriction, or should certain types of entities (for example, investment companies, broker dealers, and pension plan financial statements) have a different unit-of-account? Please explain your response.

Response:

Conceptually we believe all entities should use the same unit of valuation for valuing an identical investment. If a financial instrument is described as accounted for at "fair value", that should have one meaning under GAAP, irrespective of the type of entity holding the investment or the accounting policies they apply, assuming they can exit the position in the same principal market. The expectation that fair value would be applied in a uniform manner[4] was the overriding intent behind the issuance of the accounting standard on fair value measurement. A uniform definition of "fair value" for financial instruments is particularly important for all financial services companies as it underlies how we manage our business and the related risks.

We understand the Board took the approach of linking fair value to the concept of "unit-of-account" for financial instruments to ensure that entities would not conclude that a block discount at any level of the fair value hierarchy would be appropriate. This outcome is consistent with that reached under IFRS where only terms which are characteristics of the instrument within its unit-of-account may be (and in fact are required to be) considered in determining fair value while entity-specific restrictions may not. However, unit-of-account does not always align with unit of valuation for certain financial instruments. Unit-of-account is also not always the same for different reporting entities, based on their use of specialized GAAP, or across the application of US GAAP vs IFRS. For example, a financial institution making a fair value election for a bundle of registered equity interests that otherwise would be an "equity method" investment for an entity subject to that accounting measure may view that investment as a "single unit-of-account." However, an investment company, for which equity method of accounting is generally not applicable for its investment portfolio, would need to evaluate fair value for the same investment at a share level. This is but one example where the starting point of "unit-of-account," creates an

[4] SFAS 157: Reason for issuing the standard: "Prior to this Statement, there were different definitions of fair value and limited guidance for applying those definitions in GAAP. Moreover, that guidance was dispersed among the many accounting pronouncements that require fair value measurements. Differences in that guidance created inconsistencies that added to the complexity in applying GAAP. In developing this Statement, the Board considered the need for increased consistency and comparability in fair value measurements and for expanded disclosures about fair value measurements."

"entity-specific" override to the more basic concepts of fair value from the perspective of a market participant and unit of valuation.

Additionally, from an operational perspective, the accounting concept of "unit-of-account" is not well prescribed in the literature for all fact patterns; it often relies on practice or application by analogy and therefore is subject to interpretation. This disconnect between unit-of-account and unit of value has been resolved for most fact patterns through the "portfolio" exception for portfolios of offsetting risks and through practice and interpretations. However, it continues to have pockets of unresolved issues like the one the Proposed Update is trying to resolve.

If the Board is unwilling to re-debate the concept of using "unit-of-account" as the starting point for the application of ASC 820 for financial instruments, we believe our proposed approach to resolve the narrow issue related to restrictions on transferability and whether they are a "characteristic of the security" would be to simply define the "unit-of-account" for this purpose to include any legal, regulatory or other contractual arrangements that a market participant would take into account when pricing the financial instrument. This will resolve the diversity in practice and align the accounting value with the economic valuation.

Question 4—Disclosures: Would qualitative or quantitative disclosures (for example, describing the nature of a contractual sale restriction on an equity security and the related amount recognized on the balance sheet) help users in understanding the effects of a contractual restriction on the sale of an equity security held by a reporting entity? Please explain why or why not. For reporting entities, what costs would be incurred to disclose that information?

Response:

We do not believe additional qualitative or quantitative disclosures are necessary. ASC 820 has a robust framework for disclosures around valuations of positions that are not valued based on an observable market.

Question 5—Transition: Do you agree with the transition guidance in this proposed Update? Please explain why or why not.

Response:

We agree with the transition guidance. A change to a fair value methodology is a change in estimate which is generally recognized through current earnings.

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Question 6—Implementation: How much time would be necessary to implement the proposed amendments? Should the amount of time needed to implement the proposed amendments by entities other than public business entities be different from the amount of time needed by public business entities? Please explain your response.

Response:

If the FASB moves forward with the Proposed Update as drafted, subject to amendments to address the operational concerns we raised, we believe adopting the amendments should not require a significant effort. However, the Proposed Update is inconsistent with economic reality and as is generally the case when accounting does not align with economics, there may be a desire to restructure existing agreements or choose alternative arrangements for new deals to align the accounting fair value with the economic reality. We ask that the FASB provides enough time between finalizing the Proposed Update and the effective date to allow the markets to adjust for the conclusion.