

February 15, 2012

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

Via email: director@fasb.org

Dear Technical Director,

RE: Proposed Accounting Standards Update to Topic 810, "Consolidation – Principal versus Agent Analysis (File Reference No.: 2011-220)

The Blackstone Group ("Blackstone") is pleased to comment on the proposed Accounting Standards Update on Consolidation (Topic 810), *Principal versus Agent Analysis (the "Proposed Update" or "Update"*).

We have long been of the view that a decision maker in the asset manager sector should not consolidate any managed fund or vehicle if the decision maker is acting in an agent capacity. Consolidation results in an unnecessary gross up of financial statements which will then no longer provide meaningful information to investors. Users will no longer have financials distinct from consolidated funds which are owned primarily by fund investors and in which the decision maker acts in a fiduciary capacity. Consolidation also exponentially increases the risk of fraud as the actual assets available to the asset manager and the liabilities for which the asset manager is responsible will be obscured.

Overall we are strongly supportive of the FASB's approach in developing guidance around whether a decision maker is acting in a principal or agent capacity and are particularly supportive of the qualitative approach proposed.

Our comments on the proposals in the Update are set out below:

Question 1: When determining whether a decision maker is a principal or an agent, the proposed amendments require the analysis to consider the decision maker's overall relationship with the entity and the other parties involved with the entity. This analysis would be based on a qualitative assessment. Do you agree with this approach? If not, why?

We agree with the approach proposed by the FASB to perform a qualitative assessment to determine whether a decision-maker is acting in a principal or agent capacity. We believe that such an approach appropriately assesses the relationships between the decision-maker, its related parties and an entity, which would not be obvious in a quantitative analysis. We are strongly supportive of the move towards principles-based accounting.

Question 2: The evaluation of a decision maker's capacity would consider the following factors:

- a. The rights held by other parties
- b. The compensation to which the decision maker is entitled in accordance with its compensation agreement(s)
- c. The decision maker's exposure to variability of returns from other interests that it holds in the entity.

Are the proposed factors for assessing whether a decision maker is a principal or an agent appropriate and operational? If not, why? Are there any other factors that the Board should consider including in this analysis?

We agree that the evaluation of a decision maker's capacity should be considered in totality by an evaluation of all relevant facts and circumstances, including the factors set out in the Proposed Update. Our comments on each of the factors to consider are noted below:

The Rights Held by Other Parties

We agree with the FASB that rights held by a single party would be determinative of the decision maker acting in an agent capacity. We are also of the view that when multiple, unrelated parties have the right to remove the decision maker and these rights are substantive, that this should also be determinative of the decision maker acting in an agent capacity, irrespective of the absolute number of parties that are required to act together to remove the decision maker or the dispersion of such interest holders. We do not believe that the number of parties needed to exercise removal or liquidation rights or their dispersion is relevant to the analysis of whether the decision maker is acting in a principal or agent capacity. Comparing a limited partnership to a corporation, we note that limited partners have as much control as shareholders in voting for or against the appointment/removal/renewal of a decision maker. In corporations, the shareholder base may be widely dispersed and numerous, yet the concept of control by the shareholders is not disputed. We believe that the same logic should apply to limited partnerships.

We note that while the existence of substantive removal or liquidation rights should in themselves be determinative of the decision maker acting in an agent capacity, the absence of removal or liquidation rights should not automatically lead to the conclusion that the decision maker is acting in a principal capacity. A presumption of control should not exist; rather the analysis should be based on all relevant factors.

The Compensation That A Decision Maker Is Entitled To

We agree that if the decision maker's compensation is commensurate with the services provided and includes only terms, conditions or amounts that are customarily present in arrangements for similar services negotiated on an arm's length basis, that this would be a strong indicator that the decision maker is acting in an agent capacity.

Compensation arrangements of both advisors and general partners are heavily negotiated with limited partners and, as a result, reflect market-based fee structures. A structure in which a limited partner pays a base management fee of 2% and a performance-based fee of 20% of appreciation is not uncommon in the private equity industry. As this reflects market-based terms, we believe that this would weight the capacity in which a decision maker is acting towards an agent.

In considering the interaction between removal rights and the magnitude of a decision maker's exposure to variability, we believe that the existence of a market-based fee structure which reflects the level of service provided would not create such diversity between the economic interests of the decision maker, even if other interests are held, compared to other interest holders such that there is a presumption of control by the decision maker.

The Decision Makers Exposure to Variability of Returns From Other Interests Held By The Decision Maker

Again, we agree with the FASB's proposals with respect to distinguishing between positive only returns and interests that expose the decision maker to both positive and negative returns. An arrangement in which the decision maker is only exposed to positive returns would be indicative of an agency relationship. The existence of clawback arrangements would not change this assessment so long as the decision maker fees can never fall below zero over the life of a fund.

The existence of other interests that expose a decision maker to variability must be considered in conjunction with rights held by other parties and compensation arrangements. Often, a decision maker is required contractually, or because it is customary, to demonstrate skin in the game by investing alongside other investors. This can be a pro-rata interest or a subordinate interest that exposes the decision maker to first loss. The purpose of both of these is to align interests. We are somewhat concerned by a decision maker's interest in the subordinate interest of a CLO vehicle and that, coupled with a lack of rights held by other parties could lead to the presumption that the decision

maker is acting in a principal capacity, however, we see no difference between this and a pro-rata interest, so long as the variability that the decision maker is exposed to is not significant. This is further discussed in our response to Question 9.

We appreciate the direction taken by the FASB in evaluating the interests held by related parties and argue that the decision maker should only consider direct and indirect interests rather than an aggregation of all related party interests in the principal versus agent evaluation.

Overall, we generally agree with the factors to consider set out in the Proposed Update and believe that a qualitative assessment results in a more complete evaluation of the relationship between a decision maker and an entity than a quantitative analysis.

Question 3: The proposed Update would require judgment in determining how to weigh each factor in the overall principal versus agent analysis. Do you agree that the proposed amendments, including the related implementation guidance and illustrative examples, will result in consistent conclusions? If not, what changes do you recommend?

We agree with the FASB that each of the above factors should be considered collectively and different weightings applied to each factor. We believe generally that the illustrative examples allow the principal versus agent analysis to be based on the judgment of management of all relevant facts and circumstances without introducing bright-lines. However, we have specific concerns about the conclusions reached in Case E: Asset Backed Collateralized Debt Obligation which we address in our response to Question 9.

Question 4: Should substantive kick-out and participating rights held by multiple unrelated parties be considered when evaluating whether a reporting entity should consolidate another entity? If so, do you agree that when those rights are held by multiple unrelated parties, they should not in and of themselves be determinative? If not, why? Are the guidance and implementation examples illustrating how a reporting entity should consider rights held by multiple unrelated parties in its analysis sufficiently clear and operational?

As noted in our response to Question 2, we believe that substantive kick-out rights held by multiple unrelated parties should be considered in the principal versus agent analysis. As previously discussed, the number of parties is not relevant so long as a mechanism exists for parties to exercise such rights.

We believe that the existence of kick-out rights exercisable by a simple majority should in itself be determinative that the decision maker is acting in an agent capacity. We do not believe a reporting entity to be a principal if it can be removed by a vote of a simple majority of unrelated parties. We caution, however, that the lack of kick-out rights should not be determinative of the decision maker acting in a principal capacity.

Question 5: The proposed Update would not include a criterion focusing on the level of seniority of a decision maker's fees when evaluating the decision maker's capacity. Do you agree that the seniority of the fee relative to the entity's other operating liabilities that arise in the normal course of the entity's activities should not be solely determinative of a decision maker's capacity? If not, why?

We agree with the above proposal to remove the seniority of fees requirement. The subordination of fees has no relevance to the capacity in which a decision maker is acting. We note in our response to Question 9 that the existence of subordinate fees has historically led to the conclusion that fees are variable interests that could potentially be significant which overshadowed the capacity in which an appointed collateral manager was acting. We believe that the removal of such a condition allows for a more complete assessment of whether the decision maker is a principal or agent.

Question 6: The evaluation of a decision maker's capacity places more emphasis on the decision maker's exposure to negative returns (for example, an equity interest or a guarantee) than interests that only expose the decision maker to positive returns. When performing the principal versus agent analysis, should the assessment differentiate between interests that expose a decision maker to negative returns (or both negative and positive returns) from interests that expose the decision maker only to positive returns? If not, why?

We agree that the proposal to distinguish between positive only and positive and negative returns assists in the overall assessment of the capacity in which a decision maker is acting. We agree that positive only returns are indicative of an agency relationship. We also believe that positive and negative returns can be indicative of an agency relationship, depending on the nature of the potential negative returns.

We note that the level of interests other than fees that expose a decision maker to negative returns should be assessed qualitatively to determine if there is a requirement for the decision maker to hold such interests. Often, investors seek the decision maker to align its interest with investors by making an investment. This, we believe, does not preclude the decision maker from acting in an agent capacity.

Question 7: A reporting entity would be required to evaluate whether there has been a change in the decision maker's capacity by considering whether there has been a change in the purpose and design of the entity. For example, the purpose and design of the entity may change if the entity issues additional equity investment that is at risk to the decision maker. Do you agree with this proposed requirement? If not, please specify when this relationship should be reassessed and why.

We agree with this proposal.

Question 8: The Board decided to include the principal versus agent assessment as a separate analysis within the overall consolidation assessment, rather than replacing the current guidance for evaluating whether a decision-making arrangement is a variable interest (and accordingly, a principal) with the revised principal versus agent analysis. The Board believes that if an entity's fee arrangement does not meet the definition of a variable interest (for example, a nominal performance-based fee), the decision maker should not be required to continue the consolidation assessment. Do you agree? If not, why?

We agree with this proposal.

Question 9: The Board expects the proposed principal versus agent guidance may affect the consolidation conclusions for entities that are consolidated as a result of the decision maker having a subordinated fee arrangement (for example, collateralized debt obligations). However, the Board does not otherwise expect the proposed amendments to significantly affect the consolidation conclusions for securitization entities, asset-backed financing entities, and entities formerly classified as qualifying special-purpose entities. Do you agree? If not, why?

We <u>do not</u> agree with the FASB's expectation that the consolidation conclusion relating to CLO vehicles will not change as a result of the application of the principal-agent analysis as proposed in the Update. Historically, a CLO has been consolidated under ASC 810 (FASB Statement 167, "SFAS 167") as the decision maker has a) the power to direct activities that most significantly affect the economic performance of an entity and b) the obligation to absorb losses or the right to receive returns that could potentially be significant to the entity. Under SFAS 167, a decision-maker would meet the power condition as a single unrelated party could not remove the decision maker. Due to the subordination of incentive fees, fees were considered variable interests that under a quantitative analysis could potentially be significant. As a result, the CLO was consolidated by the decision-maker. The changes proposed in the Update with respect to the evaluation of whether the decision maker is acting as a principal or agent may lead, correctly in our opinion, to a conclusion that the decision maker is acting as an agent. Consider the following fact patterns:

Fact Pattern 1:

- Manager A is appointed collateral manager by the sponsor of a CLO vehicle, unrelated to the Manager.
- Manager A is required to actively manage a pool of loans and bonds, subject to broad parameters set out in the Collateral Management Agreement, to maximize returns to note holders of various seniority.
- Manager A gets paid a senior fee of 10 basis points, a subordinate fee of 40 basis points and an incentive fee of 20% of excess cash flows generated by the vehicle. The incentive fee is subordinate to all other distributions. The fees are all market-based fees commensurate with the level of services provided.

- Manager A can be removed by a supermajority of 66 2/3 % of the most senior outstanding note class note holders.
- Manager A has no other economic interest in the CLO.

Under SFAS 167, a consolidation conclusion would be reached as Manager A has both power and economics that could potentially be significant. In contrast, under the Proposed Update an evaluation of whether Manager A is acting in a principal or agent capacity is required based on all relevant factors. While kick out rights can only be exercised by a supermajority, the market-based compensation arrangement and the lack of other interest in the CLO, would lead to an evaluation that the manager is acting in an agent capacity. As noted above, we believe this is the correct conclusion.

Fact Pattern 2:

• As above, except a separate fund entity managed by a related party of Manager A, holds a 20% interest in the subordinate note tranche. Manager A has no equity interest in the fund holding the subordinate note interest.

Under SFAS 167, the conclusion would be the same as for Fact Pattern 1 due to power and the economics provided in the fee structure alone. Under the Proposed Update, the principal versus agent analysis would lead to the conclusion that Manager A is acting in an agent capacity, despite the existence of an economic interest held by a separate fund managed by a related party to Manager A, as Manager A has an indirect interest of 0%. Again, we believe that this is the appropriate conclusion as the collateral manager is simply a paid service provider.

Fact Pattern 3:

Same as for Fact Pattern 2, except the 20% interest subordinate note interest is held directly by Manager A to align interests with other investors. The notional value of the subordinate note interest held by Manager A is \$4m and the total notional value of the entire capital structure is \$400m.

Under SFAS 167, the conclusion would be the same as for Fact Pattern 2 due to the economics provided in the fee structure and the subordinate note interest held by the manager. Under the Proposed Update, application of the guidance as currently drafted would lead to the conclusion that Manager A is acting in a principal capacity as the rights held by other parties are not substantive and it is exposed to a first loss position through its direct interest in the subordinate note position. We believe that the CLO should not be consolidated. Although unrelated parties do not hold removal rights, the market based fees and the exposure to variability from other interests would imply that the manager is acting as an agent.

While the manager is exposed to the first loss, its maximum exposure to loss is limited to \$4m. Further, the interests held are to align interests with other investors.

As demonstrated above, we believe that the consolidation conclusion for CLOs will and **should** change as a result of the guidance contained in the Proposed Update. We welcome your feedback on our interpretation of the fact patterns noted above.

Question 10: Update 2010-10 was issued to address concerns that some believe that the consolidation requirements resulting from Statement 167 would have required certain funds (for example, money market funds that are required to comply with or operate in accordance with requirements that are similar to those included in Rule 2a-7 of the Investment Company Act of 1940) to be consolidated by their investment managers. The amendments in this proposed Update would rescind the indefinite deferral in Update 2010-10 and would require money market funds to be evaluated for consolidation under the revised guidance. The Board does not intend the application of the proposed Update to result in money market funds being consolidated. Do you agree that the application of the proposed Update will meet this objective? If not, why and what amendments would you recommend to address this issue?

We have no comment on this question.

Interests Held by Related Parties

Question 11: For purposes of applying the proposed principal versus agent guidance, the proposed amendments would require a reporting entity to include the decision maker's direct and indirect interests held in an entity through its related parties. Do you agree with the requirement that a decision maker should include its proportionate indirect interest held through its related parties for purposes of applying the principal versus agent analysis? Why or why not?

We agree with this proposal as it effectively considers the variability that a decision maker is exposed to more so than a simple aggregation of all related party interests. **Evaluation of Partnerships and Similar Entities**

Question 12: The amendments in this proposed Update would require a general partner to evaluate its relationship with a limited partnership (or similar entity) by applying the same principal versus agent analysis required for evaluating variable interest entities to determine whether it controls the limited partnership. Do you agree that the evaluation of whether a general partner should consolidate a partnership should be based on whether the general partner is using its decision-making authority as a principal or an agent?

Under current GAAP, a general partner would consolidate a partnership if limited partners do not have substantive removal or liquidation rights without any consideration given to the level of economic interest held by the general partner. We believe that the principal-agent evaluation should apply to partnerships and similar entities to align the consolidation guidance for similar structures.

Effective Date and Transition

Question 13: Do you agree with the proposed transition requirements in paragraph 810-10-65-4? If not, how would you propose to amend those requirements, and why? Please provide an estimate of how long it would reasonably take to implement the proposed requirements.

We agree with the transition adjustments proposed in the ASU. We believe that a period of time would be required to reassess whether entities are variable interest entities under the revised guidelines proposed in the Update and to determine a consolidation conclusion based on the principal versus agent guidance. We recommend that the Update has an effective date beginning at the start of a calendar year for public entities so that full year results are reflective of the new guidance. Therefore, we recommend that the FASB proposes an effective date of no earlier than fiscal periods beginning after December 15, 2013.

Question 14: Should early adoption be permitted? If not, why?

We believe that early adoption should be permitted, especially where a decision maker had previously consolidated fund entities which resulted in a gross up of financial statements that provided less meaningful information to users. It is in the interest of both preparers and users that early adoption should be permitted.

Nonpublic Companies

Question 15: Should the amendments in this proposed Update be different for nonpublic entities (private companies or not-for-profit organizations)? If the amendments in this proposed Update should be applied differently to nonpublic entities, please provide a rationale for why.

We have no comment on this question.

We appreciate the opportunity to comment on the Proposed Update. We welcome the opportunity to further discuss the comments and concerns raised in this letter. Please let us know if you have availability in the coming weeks to meet with us and discuss the issues noted above.

Yours truly,

Kathleen Skero

Finance Director

The Blackstone Group

Dathlen Skew