



February 15, 2012

Technical Director
File Reference No. 2011-200
Financial Accounting Standards Board
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PricewaterhouseCoopers LLP appreciates the opportunity to comment on the FASB's Proposed Accounting Standards Update, *Financial Services - Investment Companies (Topic 946)* (the "Proposal").

We support the FASB and IASB's (the "Boards") efforts to develop a common definition of an investment company and provide additional guidance aimed at capturing the appropriate population of investment companies for which fair value accounting for their investments is the most relevant measurement attribute. We continue to hear from asset managers and investors that fair value accounting for investments held by investment companies best reflects the entities' investment objectives and provides the most relevant and decision-useful information. We agree. In our view, the most relevant information for users of an investment company's financial statements does not depend on how much of an interest the investment company has in its investees. Fair value accounting for those investments also generally provides the basis for the net asset values at which many investors enter and exit investments in investment companies.

We are concerned, however, about the significant differences between the Boards' respective proposals. For example, the Boards' differ in their proposed treatment of a controlling financial interest in an investment company held by a non-investment company parent. Such significant differences should be eliminated in order to achieve a truly converged standard.

The need for judgment to determine if an entity is an investment company

We believe that the FASB has identified the appropriate factors for consideration in determining whether an entity is an investment company. While these factors are described as specific criteria that must be met in order for an entity to be considered an investment company, judgment will be required when assessing the criteria. We support the application of judgment. We believe it is important in order to appropriately identify the population of entities that should qualify as investment companies and those that should not.

Our most significant concern with the criteria is that the pooling-of-funds criterion seems to preclude all single investor entities from qualifying as an investment company. Many single investor funds represent the interests of multiple underlying participants, such as in pension plans and sovereign wealth funds where the fair value reporting of the investment company provides the most relevant information to evaluate investment performance and make decisions on how to best allocate financial resources. In addition there are types of entities that currently, or may wish to, report in a manner consistent with the investment company model outlined in the Proposal, but will not qualify because they would fail the pooling criterion as defined. These



might include parallel funds, funds established to carry out regulated US merchant banking activities, and funds set up for an individual or a group of family members. For example, an asset manager may set up a "parallel" entity to a qualifying investment company for a group of its employees or for a particular investor. Although the parallel entity mirrors the activities and transactions of the qualifying fund, it may not qualify as an investment company under the Proposal. This would result in two identical entities reporting under separate models. Therefore we recommend that the FASB modify the pooling-of-funds criterion to allow for more judgment to be exercised in assessing single investor entities, including considering the business purpose and reporting model of the investors (e.g., whether fair value reporting is required for the investor) so that the most relevant reporting can be provided to the users of investment company financial statements. This would place a greater responsibility on management and auditors to reach appropriate judgments. We believe this will promote the best possible financial reporting outcome for financial statement users.

We also propose modifications to some of the other criteria – see our responses to the specific questions in Appendix A. We believe that by incorporating our proposed changes, the criteria, taken as a whole, would provide a sufficiently robust framework for identifying the appropriate population of entities that should qualify as investment companies while at the same time preventing potential abuses of the proposed definition.

Investment company accounting should be retained on consolidation

We support the FASB's proposal to retain investment company accounting on consolidation by a parent that is not itself an investment company. Consequently, we disagree with the IASB's opposing view. In our view, an investment company is fundamentally different from other types of operating entities and its nature does not change because of consolidation by a non-investment company parent. We understand that the IASB's approach may have been driven by concerns about potential misuses of the investment company accounting model. We believe that concern should be addressed by a robust investment company definition. This difference between the Boards' proposals significantly undermines the ability of the Boards' standards to achieve consistency and comparability among reporting entities. We recommend that the Boards refocus their efforts to reach a converged solution on this matter.

An investment company should only consolidate controlled investees in limited circumstances

We do not believe that consolidation of controlled investee funds, where such a fund represents an investment for the purpose of obtaining returns from capital appreciation, investment income, or both, would provide information that is more decision-useful for investors. For those funds, we prefer the IASB's approach whereby all investments are accounted for at fair value.

We recommend that the Boards require an investment company to consolidate controlled investees in limited circumstances. An investment company should be required to consolidate a controlled investee that provides services related to the entity's own investment activities. We also believe that controlled investees formed in conjunction with an investment transaction, solely by design of the investment company for specific regulatory, tax, legal, or other business reasons of the investment company, such as to provide financing to the entity, should be consolidated. We note that the Proposal provides exceptions to certain investment company criteria for these types of subsidiaries, namely the requirements to hold multiple investments and the pooling-of-funds criterion.



Interaction with the Investment Property Entities project

The Proposal requires an investment company to consolidate an investment property entity in which it has a controlling financial interest. Under the Investment Property Entities proposal, investments other than in real estate properties, such as held-to-maturity securities, are recorded at amounts other than fair value (unless the fair value option is elected). The Proposal permits the investment company to make a one-time election to remeasure all assets and liabilities of a consolidated investment property entity on the date of adoption. Subsequent to the adoption of the Proposal, investment companies will not be allowed to make this election for investment property entities they control. Therefore, consolidation by investment companies may result in certain investments being presented at an amount other than fair value. As a result, if the Board retains the requirement to consolidate an investment property entity, we recommend that the election to remeasure assets and liabilities at fair value for controlled investment property entities be allowed any time consolidation is first required.

In addition, where an investment company does not have a controlling financial interest in the investment property entity, we recommend the Proposal address whether the investment company can use the practical expedient to measure its investment in the investment property entity. This should include situations where the investment property entity has elected the fair value option for its other investments.

As discussed further in our response to the Board's Investment Property Entities proposal, we believe that a separate investment property entity accounting model is not necessary for real estate entities that are fundamentally investment vehicles reporting at fair value. We believe that the investment company reporting model may be the most appropriate for such entities.

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Attached to this letter are two appendices. Appendix A contains our responses to the Questions for Respondents included in the FASB Proposal. Appendix B contains our responses to the IASB's Exposure Draft.

If you have any questions, please contact Paul Kepple at (973) 236-5293, Donald Doran at (973) 236-5280, or Annette Spicker at (973) 236-4088.

Sincerely,

A handwritten signature in cursive script that reads "PricewaterhouseCoopers LLP".

PricewaterhouseCoopers LLP



Appendix A - Responses to Questions for Respondents in the FASB Proposal

Question 1: The proposed amendments would require an entity to meet all six of the criteria in paragraph 946-10-15-2 to qualify as an investment company. Should an entity be required to meet all six criteria, and do the criteria appropriately identify those entities that should be within the scope of Topic 946 for investment companies? If not, what changes or additional criteria would you propose and why?

We believe that the FASB has identified the appropriate factors to consider in determining whether an entity is an investment company. While these factors are described as specific criteria that must be met in order for an entity to be considered an investment company, judgment is required in assessing whether these criteria are met. We believe that the application of judgment is important in order to appropriately identify the population of entities that should qualify as investment companies and those that should not.

We are concerned, however, that the FASB has articulated the pooling-of-funds criterion in a manner that does not allow for the application of sufficient professional judgment. See further our response to Questions 7 and 9 on this point.

We also propose some modifications and clarifications to certain of the other criteria, as discussed further below:

Criterion (a) - Nature of the investment activities

The Proposal requires that an investment company hold multiple investments. However, certain entities may be created for the primary purpose of investing in a single asset, such as an entity set up by multiple investors to invest in a single investment where individually the investors would not have the appropriate scale. We do not believe the number of investments held by an entity is a critical factor in assessing whether that entity meets the definition of an investment company. Further, including this requirement could prompt entities to structure around the requirement by adding nominal investments (e.g., short term, highly liquid holdings, such as US Treasuries or money market investments). We recommend that this requirement be removed.

Criterion (c) - Unit ownership

As further discussed in our response to Question 8, the unit-ownership and pooling-of-funds criteria should consider interests held by debt holders where those interests have the characteristics of equity (i.e., risks and rewards). We believe the substance of the interests issued by the entity should be considered rather than their legal form or accounting classification. We also recommend that interests such as certain subordinated debt investments or profit participating loans that economically participate in risks and rewards be considered in evaluating unit ownership.

Also discussed in our response to Question 8, we recommend further clarification on how to assess the unit-ownership and pooling-of-funds criteria when the entity being assessed is not a legal entity. For example, insurance company separate accounts typically are not separate legal entities and the assets of the separate accounts are owned directly by the insurance company.



Criterion (e) - Fair value management

We agree with a criterion based on fair value measurement since measuring assets at fair value is consistent with the business purpose of a fund. Fair value reflects the performance of the underlying assets, impacts manager compensation, and is typically the ultimate redemption value of the fund to its underlying investors. However, it is unclear how this criterion should be applied in certain cases. For example, funds may hold certain investments ultimately for recovery, such as bankruptcy receivables. These funds do not necessarily manage such investments on a fair value basis, either daily or on a short-term basis. We do not believe the Board intended to require investment companies to continually assess fair value, but rather that the investment company can perform the evaluation of the investments on a periodic basis such as fund redemption dates. We recommend that the Board revise the criterion to clarify this issue.

In addition, we are concerned with the proposed requirement that fair value be the primary measurement attribute for decision-making in certain circumstances. Investment companies may make investments primarily for investment income where the yield of the investment may be the primary attribute used to make decisions about investment performance. Fair value is certainly critical to the decision making process but may not be the primary factor in making decisions relating to the investment's performance. We do not believe the Boards intend that an entity not qualify as an investment company if it holds these types of investments. Accordingly, we recommend that additional guidance be included to clarify how to evaluate these types of investments in the context of this criterion.

Criterion (f) - Reporting entity

We suggest that the FASB elevate the guidance in paragraph BC 31 of the Basis for Conclusions to the body of the final standard to clarify that a portion of an entity, such as separate accounts of life insurance companies, typically are not separate legal entities but may still meet this criterion. We agree that these entities should qualify as investment companies under the Proposal and believe language to this effect in the final standard is important.

Question 2: The definition of an investment company in the proposed amendments includes entities that are regulated under the SEC's Investment Company Act of 1940. Are you aware of any entities that are investment companies under U.S. regulatory requirements that would not meet all of the proposed criteria in paragraph 946-10-15-2? If so, please identify those types of entities and which of the criteria they would not meet.

Yes, we believe certain entities that are investment companies under the 1940 Act may not meet all six criteria outlined in the Proposal. In particular:

The nature of investment activities criterion could preclude a Business Development Company from qualifying as an investment company when it conducts significant loan originations, because these activities are "other than . . . investing activities." We do not believe that origination activities should disqualify an entity from meeting the nature of investment activities criterion when such activities are not significant to the overall operations of the entity. Origination may simply provide an efficient means to acquire loans for investment purposes.



The prohibition from having a single unrelated investor under the pooling-of-funds criterion could preclude insurance company separate accounts from qualifying as investment companies, as the separate accounts themselves represent assets and liabilities owned by the sponsoring insurance company.

Question 3: The proposed amendments would remove the scope exception in Topic 946 for real estate investment trusts. Instead, a real estate investment trust that meets the criteria to be an investment property entity under the proposed Update on investment property entities would be excluded from the scope of Topic 946. Do you agree that the scope exception in Topic 946 for real estate investment trusts should be removed? In addition, do the amendments in the proposed Updates on investment companies and investment property entities appropriately identify the population of real estate entities that should be investment companies and investment property entities?

Yes, we agree that the scope exception for real estate investment trusts should be removed. We also believe that the amendments in the Proposal provide appropriate clarification on the population of real estate entities that should be investment companies.

Question 4: The proposed amendments would require an entity to reassess whether it is as an investment company if there is a change in the purpose and design of the entity. Is this proposed requirement appropriate and operational? If not, why?

We recommend that the Boards work together to develop consistent reassessment criteria. The IASB's proposal requires an entity to reassess whether it meets the criteria for an investment entity if facts and circumstances indicate a change to one or more of the criteria. The Proposal requires an entity to reassess only if there is a subsequent change in the purpose and design of the entity.

Under the FASB's proposed model, we are concerned that the nature of the changes that would be considered a change in purpose and design is not well defined in the Proposal. We recommend that the FASB clarify what would constitute such a change. We also believe that a reassessment that focuses on only fundamental changes in purpose and design may not consider other changes that are significant to the character of the entity. We suggest that the reassessment focus on whether there has been a significant change in the facts evaluated under the criteria to qualify as an investment company that could result in a different conclusion. Changes initiated by the entity itself may be relevant to the reassessment. However, certain actions, such as redemption activity by unrelated investors, should generally not impact the reassessment analysis if they represent normal activities of the entity. Examples could assist with providing this needed clarification.

Question 5: An entity may be an investment company when it performs activities that support its investing activities. As a result, a real estate fund or real estate investment trust (that is not an investment property entity) could be an investment company if the entity (directly or indirectly through an agent) manages only its own properties. However, the entity would be precluded from being an investment company if the other activities were considered more than supporting the entity's investment activities (for example, construction). Is this requirement operational, and could it be consistently applied?

We believe that holding an investment in an entity that provides investment related services should not preclude the holder of the investment from qualifying as an investment company. However, we agree that if an entity provides substantive services relating to investment activities of entities other than the reporting



entity or it is evident that the supporting activities are the primary substantive activities of the entity, it should not qualify as an investment company. For example, where loan origination appears to be the primary activity of the entity, this suggests the entity is not an investment company but rather a lender or finance company since the entity is moving away from being an investment company created with the objective of carrying out investment activities.

We agree that this requirement is operational and could be consistently applied. However, we recommend providing clarification on whether activities including services provided by an investment company to other affiliated entities, such as funds under common management (e.g., a transfer agent that provides services to multiple funds in a group of affiliated investment funds), would cause an entity to fail this criterion. We do not believe such activities should necessarily disqualify an entity from being considered an investment company. This is particularly the case where the services are performed for the affiliated group to achieve operational efficiencies on a cost reimbursement basis, rather than to generate profits for the entity or its affiliates, or are otherwise not significant to the entity.

Question 6: The proposed implementation guidance includes examples of relationships or activities that would indicate that an entity obtains or has the objective of obtaining returns from its investments that are not capital appreciation or investment income. Do you agree with these examples? If not, how would you modify the examples while still addressing the Board's concerns identified in paragraphs BC15 and BC16?

Yes, we agree with the examples.

Question 7: To be an investment company, the proposed amendments would require an entity to have investors that are not related to the entity's parent (if there is a parent) and those investors, in aggregate, must hold a significant ownership interest in the entity. Is this criterion appropriate? If not, why?

In principle, the criterion is appropriate for determining whether an entity is an investment company. However, we believe certain types of entities with a single investor may not qualify as an investment company, such as pension funds, sovereign wealth funds, and certain bank collective funds. See our response to Question 9 for a further discussion on single investor funds.

Furthermore, certain funds, whose investors are limited to advisory personnel and their families, may be established as parallel vehicles to other funds that have unrelated investors, or parallel funds may be created for a single shareholder to facilitate different pricing structures or liquidity needs in an established investment strategy. Since these parallel funds may have no substantive investment from other than related parties of the parent (or the parent itself), they would not qualify as investment companies under the Proposal. This would result in substantially identical entities with identical activities reporting under different accounting models. We therefore recommend the Board allow for more judgment in assessing single investor entities under the pooling-of-funds criterion. This modification should include business purpose and reporting model of investors (e.g., whether fair value reporting is required for the investor) as key considerations in the analysis of this criterion.

We are also concerned that provisions commonly found in private equity and venture capital funds could be viewed as equivalent to a put option. For example, in the event of failure to meet capital commitments by



investors, another current investor (which may be an affiliate of the fund or its sponsor) may step in to assume the previous investment and honor the remaining capital commitment. This could be considered the exercise of a put option. If these are considered put options, then those investors would have to be combined with the parent interests when evaluating the pooling of funds criterion. We believe these provisions are intended as protective measures to avoid disruption of the operation of the fund, rather than a put option as contemplated by the FASB. We recommend that this be clarified.

Question 8: The proposed unit-ownership criterion would require an entity to have ownership interests in the form of equity or partnership interests to be an investment company. The entity would consider only those interests in determining whether it meets the proposed pooling-of-funds criterion. Therefore, a securitization vehicle, such as a collateralized debt obligation, may not qualify as an investment company under the proposed amendments because it may not meet the unit-ownership or the pooling-of-funds criterion. The entity would not consider interests held by its debt holders when evaluating these criteria to be an investment company. For entities that do not have substantive equity interests (for example, those considered variable interest entities under Subtopic 810-10), should the unit-ownership and pooling-of-funds criteria to be an investment company consider interests held by debt holders? Please explain.

Yes, the unit-ownership and pooling of funds criteria should consider interests held by debt holders where those interests have the characteristics of equity (i.e., risks and rewards). We believe the substance of the interests issued by the entity should be considered rather than their legal form or accounting classification. The criteria should include interests such as certain subordinated debt investments or profit participation loans that economically participate in risks and rewards of an entity. AICPA Statement of Position 07-1, "Clarification of the Scope of the Audit and Accounting Guide *Investment Companies* and Accounting by Parent Companies and Equity Method Investors for Investments in Investment Companies," provided an example of a collateralized loan obligation that would be considered an investment company based on a pooling of funds from numerous investors, even though most of those interests were structured in the form of debt. The requirement that investors obtain ownership interests may therefore represent a significant change in practice for collateralized debt obligations that currently report as investment companies.

It is also unclear how to assess the unit-ownership and pooling-of-funds criteria when the entity being assessed is not a legal entity. For example, insurance company separate accounts are typically not separate legal entities and the assets of the separate accounts are owned directly by the insurance company. In addition, some of those separate accounts are not registered under the 1940 Act. BC31 indicates how to consider the reporting unit criterion for separate accounts, and implies that the investors to be assessed for the unit ownership criterion would be the separate account product policyholders. We believe this concept is important and recommend it be incorporated into the ASU.

Question 9: Certain entities may meet all of the other criteria to be an investment company but have only a single investor (for example, a pension plan). The amendments in FASB's proposed Update on investment property entities provides that if the parent of an entity is required to measure its investments at fair value under U.S. GAAP or the parent entity is a not-for-profit entity under Topic 958 that measures its investments at fair value, the entity would not need to meet the unit-ownership and pooling-of-funds criteria to be an investment property entity. Considering the Board's concerns identified in paragraph BC24, should the criteria in this proposed Update be amended to address situations in which the entity has a single investor?



Our most significant concern with the criteria is that the pooling-of-funds criterion does not allow for the application of sufficient professional judgment. The criterion seems to preclude all single investor entities from qualifying as an investment company. Single investor funds may be formed for valid economic reasons, rather than for the purpose of achieving a specific accounting outcome (as discussed in BC 24). For example, the single investor may act in a fiduciary capacity on behalf of others. Qualification as an investment company may be the most appropriate conclusion in these situations.

In many instances, these single investors are pension plans (both private and government), sovereign wealth funds, endowments, or individuals (including family offices) required to present all investment holdings at fair value and recognize changes in fair value through earnings under existing specialized accounting requirements in US GAAP. It may also be common for bank collective funds, limited partnerships, and similar vehicles to be established with only one substantive investor (or one group of related investors). For bank collective funds, the use of fair value accounting (and a reporting format similar to investment company presentation) is generally required under banking regulations¹. Further, some investors require advisers to establish such vehicles, parallel to existing multi-investor vehicles, to protect their interests, both legally and economically (e.g., to not be subject to large cash inflows and outflows from other investors, which may affect overall returns).

While we agree that the exemption in the investment property entities proposal for entities that measure their investments at fair value would be an approach that may provide an appropriate outcome for many single investor entities, such as pension plans and not-for-profit entities, it may not address all situations. There are other types of entities that currently, or may wish to, report in a manner consistent with the investment company model outlined in the Proposal, but may not qualify under the Proposal because they would fail the pooling criterion. Common examples are certain hedge, private equity, and venture capital funds that operate as "co-invest" vehicles (managed in a manner parallel to funds that would clearly qualify as investment companies under the ASU). Their investors are limited to advisory personnel and their families in order to allow them to participate in fund investment strategies with differing fee structures. Single investor funds may also be established to carry out regulated US merchant banking or Small Business Administration (SBA) investment activities. These activities are highly regulated under governmental oversight with the aim of providing financing and other sources of capital to certain targeted market segments, and are consistent with the purpose of capital appreciation to be received upon sale of an investment, rather than investing for purposes of control.

We recommend that the FASB modify the pooling-of-funds criterion which will allow for more judgment to be exercised in assessing single investor entities. This would include taking into consideration the business purpose and reporting model of the investment company's investors (e.g., whether fair value reporting is required for the investor). This would place a greater responsibility on management and auditors to reach appropriate judgments. We believe this will promote the best possible financial reporting outcome for financial statement users. By incorporating our proposed changes, the criteria, taken as a whole, would provide a sufficiently robust framework for identifying the appropriate population of entities that should qualify as investment entities while at the same time preventing significant potential abuses of the proposed definition. In addition, we recommend the FASB consider whether further exceptions may be warranted for entities created for purposes of regulated investing activities.

¹ See, for example, Office of the Comptroller of the Currency (OCC) Regulation 9.18(b)(6)(ii).



Question 10: The unit-ownership and pooling-of-funds criteria in the proposed amendments do not consider the nature of the entity's investors for evaluating if an entity is an investment company. That is, the criteria do not differentiate between passive investors and other types of investors. Do you agree that the nature of the investors should not be considered in evaluating the unit-ownership and pooling-of-funds criteria?

We believe the nature of the investors should be considered in some circumstances as a factor in evaluating the unit-ownership and pooling-of-funds criteria, as discussed in our response to Question 9.

Question 11: The proposed amendments would require that substantially all of an investment company's investments are managed, and their performance evaluated, on a fair value basis. Do you agree with this proposal? If not, why? Is this proposed amendment operational and could it be consistently applied? If not, why?

As discussed in our response to Question 1, we agree with a criterion based on fair value measurement since measuring assets at fair value is consistent with the business purpose of a fund. However, we believe further clarification of the concept is required.

Question 12: The proposed amendments would retain the requirement that an investment company should not consolidate or apply the equity method for an interest in an operating company unless the operating entity provides services to the investment company. However, the proposed amendments would require an investment company to consolidate controlling financial interests in another investment company in a fund-of-funds structure. An investment company would not consolidate controlling financial interests in a master-feeder structure. Do you agree with this proposed requirement for fund-of-funds structures? If not, what method of accounting should be applied and why? Should a feeder fund also consolidate a controlling financial interest in a master fund? Please explain.

No, we do not agree that an investment company should consolidate another investment company in which it has a controlling financial interest, such as could exist in a fund-of-funds structure. We do not believe consolidation in these situations would provide useful information or greater transparency to investors. In fact, consolidation by the reporting fund may not reflect the true economic relationship between the fund and the underlying investee fund. For example, a sixty percent ownership interest of the underlying fund may only represent a small percentage of the total investment portfolio of the reporting fund; accordingly, consolidation of the underlying investee fund may result in assets, liabilities, and operating activity in the aggregate that is not reflective of the impact of the investee fund on the reporting entity's overall investment performance. Further, in a fund of funds structure, investment companies generally purchase interests in underlying funds (and investors consider those investments) for similar reasons that they purchase investments directly -- to gain capital appreciation or investment income, or both, in an efficient and cost effective manner. We question whether users would understand why a fund describes itself as a "fund-of-funds" is reporting a number of direct investments in securities in its financial statements. Presenting individual securities due to consolidation of a controlled entity would diminish the usefulness of the financial statements to users.

Further, as a result of the open-ended nature of many funds, consolidation and de-consolidation conclusions for underlying funds by the reporting entity are potentially subject to frequent change, adding further



complexity to the analysis for preparers and may potentially confuse financial statement users. In situations where the underlying investee funds are managed by unaffiliated advisors, obtaining timely and sufficient access to all of the underlying information required to prepare consolidated statements may provide further operational challenges and impose additional time and cost burdens on preparers.

We also note that consolidation of underlying investment companies and investment property entities could also be viewed as inconsistent with recent guidance in connection with other industry accounting. In ASU 2010-1, *Insurance (Topic 944): How Investments Held through Separate Accounts Affect an Insurer's Consolidation Analysis of Those Investments - a consensus of the FASB Emerging Issues Task Force*, the Board concluded that an insurer is not required to consolidate an investment in which a separate account holds a controlling financial interest if the investment is not or would not be consolidated in the standalone financial statements of the separate account. The basis for conclusions states "The Task Force noted that although the insurer may legally hold a controlling interest in an investment through its management of the separate accounts, it did not believe that consolidation of those investments appropriately portrayed the economics of the relationship or that consolidating the investment would provide useful information for financial statement users. The Task Force also concluded that consolidation would unnecessarily increase the complexity of an insurer's financial statements." The Proposal would likely require consolidation of investment companies by insurers in their standalone separate accounts. It is unclear whether it was the intention of the Board to change its decision regarding the usefulness to insurance company investors of consolidating certain investments of the separate accounts. We recommend the Board clarify this.

Consistent with the view that it is most appropriate to present controlling financial interests in operating entities at fair value, we believe the same principle should be applied to investments in other investment companies. Therefore, we propose that the FASB adopt an approach that is consistent with the IASB exposure draft, whereby all such controlled investments are accounted for at fair value.

However, there are limited circumstances where we believe an investment company should be required to consolidate another investment company. This would be the case, for example, when a subsidiary investment company is created in conjunction with an investment transaction solely by design of the parent company to facilitate investment strategies via separate legal or operating structures and achieve specific regulatory, tax, legal or other business objectives, such as providing financing. Absent these objectives, the parent would have made the investments directly in its own portfolio, and the underlying investment company entity would represent an extension of the parent fund's own operations. Because of the nature of this relationship, investors would be better served by the transparency provided by consolidating the underlying investment company. We believe this could be accomplished by expanding the exception that already exists in the Proposal to allow consolidation of entities that provide services to the parent investment company under ASU 946-10-55-3. We believe an additional exception could be provided to allow for consolidation of controlled investment companies that are created in conjunction with an investment transaction solely by design of other funds to facilitate investment strategies for regulatory, tax, legal or other business purposes, such as financing.

Consistent with our views discussed above, we agree that a feeder fund should not consolidate a master fund in which it has a controlling financial interest as the current reporting model provides appropriate transparency and useful information to investors. We recommend a similar approach be used for fund-of-fund structures by requiring additional disclosures for significant investments in underlying investment



companies to provide additional transparency into these structures. These additional disclosures might include further information on significant portfolio investments and the impact on certain key financial ratios found in the financial highlights. Another alternative that would provide greater transparency about the investments of the underlying investment companies would be to require their financial statements to be attached to that of the parent investment company if the investments are significant.

Question 13: The proposed amendments would require an investment company to consolidate a controlling financial interest in an investment property entity. Should an investment company be subject to the consolidation requirements for controlling financial interests in an investment property entity? If not, what method of accounting should be applied and why?

No, we believe an investment company should not consolidate an investment property entity in which it has a controlling financial interest for the same reasons noted in our response to Question 12. Consistent with the view that it is most appropriate to present controlling financial interests in operating entities at fair value, we believe the same principle should be applied to controlling financial interests in investment property entities.

Question 14: The proposed amendments would prohibit an investment company from applying the equity method of accounting in Topic 323 to interests in other investment companies and investment property entities. Rather, such interests would be measured at fair value. Do you agree with this proposal? If not, why?

Yes, we agree that all investments should be recorded at fair value for the reasons discussed in our response to Question 12.

Question 15: An investment company with a controlling financial interest in a less-than-wholly-owned investment company subsidiary or an investment property entity subsidiary would exclude in its financial highlights amounts attributable to the noncontrolling interest. Do you agree that the amounts attributable to the noncontrolling interest should be excluded from the calculation of the financial highlights? If not, why?

As discussed in our response to Question 12, we do not believe that an investment company should consolidate controlling interests in investment company or investment property entity subsidiaries. However, if such controlling interests are required to be consolidated, then we agree that the amounts attributable to the noncontrolling interest should be excluded from the calculation of the financial highlights as it better reflects the true economics attributable to the investment.

Question 16: If an investment company consolidates an investment property entity, the proposed amendments require the investment company to disclose an additional expense ratio that excludes the effects of consolidating its investment property entity subsidiaries from the calculation. Do you agree? If not, why?

As discussed in our responses to Questions 12 and 13 above, we do not believe an investment company should consolidate an investment property entity in which it has a controlling financial interest. However, if consolidation is required, we agree that the investment company should disclose an expense ratio that excludes the effects of non-investment activities of the investment property entity, as it will better reflect the



costs of executing the investment activities of the investment company for investors. In addition we would also recommend that the Board remove the requirement to disclose the expense ratio that includes the total costs associated with consolidated investment property entities. An expense ratio including these amounts does not provide investors with any relevant or comparable data since it will include a mix of property types that have varying expense structures.

Question 17: Do you agree with the additional proposed disclosures for an investment company? If not, which disclosures do you disagree with, and why? Would you require any additional disclosures and why?

We generally agree with the additional proposed disclosures for an investment company. However, we believe that presenting the nature and extent of any significant restrictions on an investee's ability to transfer funds to the investment company may not result in useful information for investors and may be operationally difficult to prepare. For example, an investment company may have difficulty in determining why an investee is not paying a dividend and whether this relates to a restriction that would meet this criterion, or if it is part of the underlying investee's strategy to reinvest cash. We also request further clarification on whether the FASB intends for these restrictions to only be disclosed for formal restrictions on transfers or whether it was intended to also apply more broadly to include implied restrictions (e.g., a going concern scenario).

The definition of "investee" in the master codification glossary states that an investee is "an entity that issued an equity instrument that is held by an investor." Thus, disclosure would be required for publicly-held financial institution investees that may have restrictions on dividends resulting from regulatory capital requirements, or for any publicly-traded company subject to dividend restrictions under debt covenants. Identification of the restrictions for each investment in these situations would be onerous and of little value to financial statement users and we believe does not reflect the FASB's intent.

In addition, the Proposal requires additional disclosures under ASC 946-20-50-15 for circumstances where an investment company intends to provide financial support to an underlying portfolio company. Because the requirement is so broad there may be wide diversity in how it is interpreted and implemented by investment companies. Some may interpret intention of support to include additional equity purchases during a normal capital raise by a portfolio company. We suggest the FASB clarify when this disclosure would be required. We do not recommend any additional disclosures other than those suggested in Question 12 related to fund of funds.

Question 18: The proposed amendments would retain the current requirement in U.S. GAAP that a noninvestment company parent should retain the specialized accounting of an investment company subsidiary in consolidation. Do you agree that this requirement should be retained? If not, why?

Yes, we agree that this requirement should be retained. As noted above, the Boards have already acknowledged that an investment company is different from a commercial entity and their financial statement users have different financial reporting needs. We believe the criteria to determine whether an entity should qualify as an investment company are tightly defined and should lower the risk of potential abuses, such as structuring an investment company within a corporate structure. As a result, we believe that the fair value presentation of the investment company, which is useful to the investors, would also be the most useful presentation to the investors of the investment company's parent.



Question 19: An entity that no longer meets the criteria to be an investment company would apply the proposed amendments as a cumulative-effect adjustment to retained earnings as of the beginning of the period of adoption by calculating the carrying amounts of its investees as though it had always accounted for its investments in conformity with other applicable U.S. GAAP, unless it is not practicable. If not practicable, the entity would apply the proposed amendments as of the beginning of the period of adoption. Do you agree with this proposal? If not, why?

Yes, we agree with the proposed transition accounting. For entities that no longer qualify as investment companies, it may be impracticable to determine carrying values accurately in some circumstances, particularly when interests have been held for long periods of time.

Question 20: How much time would be necessary to implement the proposed amendments?

We encourage the FASB to obtain input from preparers on the amount of time and effort required, and the potential operational challenges, in order to implement these requirements before establishing an effective date for the final standard. That input should consider the interplay with both the *Real Estate – Investment Property Entities (Topic 973)* and *Consolidation (Topic 810): Principal vs. Agent Analysis* proposals.

Question 21: The proposed amendments would prohibit early adoption. Should early adoption be permitted? If yes, why?

Yes, we believe early adoption should be permitted, with the further stipulation that entities must also adopt the related *Real Estate – Investment Property Entities (Topic 973)* and *Consolidation (Topic 810): Principal vs. Agent Analysis* proposals concurrently.

Question 22: The proposed amendments would apply to both public and nonpublic entities. Should the proposed amendments apply to nonpublic entities? If not, how should the proposed amendments differ for nonpublic entities and why?

We believe the recognition, measurement, and consolidation procedures guidance in the Proposal should apply equally to public and nonpublic entities. While we also believe that the final disclosure requirements should apply equally to public and nonpublic entities, the Board should consider feedback received from nonpublic entity constituents to determine whether specific exceptions should be permitted.



Appendix B - Responses to Questions for Respondents in the IASB Proposal

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

5 January 2012

Dear Sirs

Exposure draft: Investment entities

PricewaterhouseCoopers LLP appreciates the opportunity to comment on the IASB's exposure draft ED/2011/04 *Investment entities* ('the proposal').

Following consultation with members of the PricewaterhouseCoopers network of firms, this response summarises the views of the member firms that commented on the proposal. "PricewaterhouseCoopers" refers to a network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.

We support the IASB's efforts to work with the FASB to develop a common definition of an investment entity. Specialised accounting has existed in US GAAP for investment companies for many years and is well understood by both preparers and users. We continue to hear from asset managers and investors in investment entities that they believe fair value accounting of investments by such entities best reflects their investment objectives and provides the most decision-useful information. Fair value accounting for the underlying investments also generally provides the basis for the net asset values at which many investors enter and exit these investments. We believe that the most relevant information for users of an investment entity's financial statements does not depend on how much of an interest the investment entity has in its investees. We welcome the IASB's approach to provide differentiated fair value reporting for qualifying investment entities.

However, we are concerned that there are significant differences between the Boards' respective proposals. Significant areas of divergence, for example the Boards' differing approaches to the treatment of a controlling financial interest in an investment entity by a non-investment entity parent, should be eliminated.

The need for judgement to determine if an entity is an investment entity

We believe that the Board has identified the appropriate factors for consideration in determining whether an entity is an investment entity. While these factors are described as specific criteria that must be met in order for an entity to be considered an investment entity, judgement will be required when assessing the criteria. We believe that the application of judgement is important to appropriately identify the population of entities that should qualify as investment entities.

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Our most significant concern with the criteria is that the pooling-of-funds criterion does not allow for the application of professional judgement. The criterion as drafted would seem to preclude all single investor entities from qualifying as an investment entity. We agree that certain types of single investor entities should not qualify as an investment entity, but we believe that entities where the single investor acts in a fiduciary capacity on behalf of others should qualify as an investment entity. This may include, for example, certain pension and sovereign wealth funds. We recommend that the Board modifies the pooling-of-funds criterion to allow for more judgement to be exercised in assessing single investor entities. We acknowledge that this would place a greater weight on management and auditors to reach appropriate judgements but believe this is necessary to achieve the appropriate financial reporting outcome for financial statement users. We also propose some modifications to other criteria – see our responses to the specific question in the Appendix. We believe that the criteria in the proposal as a whole, including our proposed changes, are sufficiently robust so that significant potential abuses will be prevented.

There are other types of entities that currently, or may wish to, report in a manner consistent with the investment entity model outlined in the proposal, but may not currently qualify because they fail the pooling criterion as defined. These might include parallel funds, funds established to carry out regulated US merchant banking activities and funds set up for an individual or a group of family members. For example, an asset manager may set up a "parallel" entity to a qualifying investment entity for a group of its employees or for a particular investor, which mirrors the activities and transactions of the qualifying fund. This parallel entity may not itself qualify as an investment entity. We recommend that the Board further considers whether additional types of single or related investor entities should be considered investment entities.

Retention of investment entity accounting on consolidation by a non-investment entity parent

We support the FASB's proposal to retain investment entity accounting on consolidation by a non-investment entity parent. Consequently we disagree with the IASB's opposing view. We agree that an investment entity is fundamentally different from other types of operating entities, and do not believe that the nature of an investment entity changes because of consolidation by a non-investment entity parent. Concerns about potential misuses of the investment entity accounting model are addressed in how an investment entity is defined. This difference between the Boards' proposals significantly undermines the ability of the Boards' standards to achieve consistency and comparability among reporting entities. We believe that the Boards should produce a converged solution.

Consolidation of an investment entity subsidiary by an investment entity parent

While the FASB has proposed that an investment entity should consolidate another investment entity in which it has a controlling financial interest, the IASB's proposal takes an alternative view by suggesting that an investment entity should fair value substantially all investees, including a subsidiary that is an investment entity. Both Boards, however, would require a subsidiary providing services related to investment activities to be consolidated.

Both proposed approaches would represent a change from current industry practice under US GAAP, which permits consolidation of another investment entity, but does not explicitly require it. In practice, investment entities generally only consolidate wholly-owned investment companies that are created for regulatory, tax, legal or other purposes and are formed in conjunction with the parent



investment entity. The FASB's approach would be a more significant change for "fund-of-fund" structures. In contrast, the IASB's approach could impact the accounting outcome for certain wholly-owned investment companies used for structuring purposes, such as leverage, that are currently consolidated.

We do not believe that consolidation of controlled investee funds, where such a fund represents an investment for the purpose of obtaining returns from capital appreciation, investment income or both, results in information that is more decision-useful for investors. As a result, we prefer the IASB approach whereby all investments are accounted for at fair value.

We do, however, suggest expanding the limited circumstances where an investment entity is required to consolidate investees. In addition to situations where the entity is providing services related to investment activities, we recommend requiring consolidation of investment entity subsidiaries that were formed in conjunction with the parent investment entity for specific regulatory, tax, legal or other business reasons such as financing. We note that the FASB proposal provides exceptions to certain other of the investment entity criteria for these types of subsidiaries, namely the requirements to hold multiple investments and the pooling of funds criterion.

Fair value option for associates and joint ventures

We do not agree that the current fair value options contained in IAS 28 and IAS 31 should be narrowed so that they can only be applied by investment entities. The IASB should not limit the use of fair value and increase the use of equity accounting. Entities that would be particularly affected by the IASB's proposals are banks, insurers and asset managers, none of whom will qualify as investment entities, who use the fair value option for certain of their associate investments, primarily in pooled funds and those that back insurance liabilities.

Attached to this letter is an Appendix that contains our responses to the Invitation to comment.

If you have any questions, please contact John Hitchins, PwC Global Chief Accountant (+44 20 7804 2497) or Mary Dolson (+44 20 7804 2930) or Michael Gaull (+44 20 7213 5671).

Yours faithfully

PricewaterhouseCoopers LLP



Appendix

Responses to detailed questions in the exposure Draft: Investment entities

Question 1

Do you agree that there is a class of entities, commonly thought of as an investment entity in nature that should not consolidate controlled entities and instead measure them at fair value through profit or loss? Why or why not?

We agree that there is a class of entities whose business objective is to acquire and hold investments for capital appreciation and income or both (rather than to manage the underlying assets and operations of the investee for an indefinite period for strategic operating purposes). These investments may be held with varying degrees of influence, from passive investments to control. However, all such investments are likely to be managed on the same, fair value, basis. We further agree, therefore, that such entities should be required to measure their investees on a fair value basis. Presenting information in such a way is consistent with their business model, how many investors enter and exit such investments and with the way management is generally remunerated.

Question 2

Do you agree that the criteria in this exposure draft are appropriate to identify entities that should be required to measure their investments in controlled entities at fair value through profit or loss? If not, what alternative criteria would you propose, and why are those criteria more appropriate?

We believe that the Board has identified the appropriate factors for consideration in determining whether an entity is an investment entity. While these factors are described as specific criterion that must be met in order for an entity to be considered an investment entity, judgement is required in assessing these criteria. We believe that the application of judgement is important in order to appropriately identify the population of entities that should qualify as investment entities.

We are concerned, however, that the Boards have articulated the pooling-of-funds criterion in a manner that does not allow sufficient scope for the application of professional judgement. See further our response to question 4 on this point. We also propose some modifications and clarifications to certain of the other criteria:

Criterion (a) Substantive activities comprise investing in multiple investments for capital appreciation and/or investment income.

We note in the FASB ED that 'the Boards concluded that an investment entity may be involved in the day to day management activities of its investees for purposes of maximising the overall value of an investment (rather than generating strategic benefits)' (para BC18). This is not in the IASB's basis for conclusions. The words in the proposal, permitting 'services that relate only to the investment entity's own investment activities (e.g. investment advisory services)' (para B 2) could be read more narrowly, and we recommend that the IASB incorporates words similar to the FASB's ED paragraph BC 18 into the application guidance of the final standard.



We agree that an investment entity should consider the services that it provides to its investees (paragraph B2). However, it is not uncommon for management or other activities to be performed by an entity outside the potential investment entity. Such activities, carried out as agent for the investment entity, should be imputed to the potential investment entity, for the purposes of determining its activities. Some text to this effect would be helpful.

Criterion (c) Ownership is represented by units of investments

We recommend that the criterion's application guidance explicitly refers to both unitized and non-unitized interests. In our view the differentiating factor for qualifying as an investment entity is the apportioning of the entity's net asset value and not the unit interests. For example, some limited partnerships do not issue units but have capital accounts that are entitled to net assets on liquidation. Although paragraphs 2(c) and B12 mention partnership interests, the criterion could be read to require "units". Similarly, where an entity is funded largely through profit-participating loans or other debt instruments that entitle the holder of such instruments to a portion of net assets, we believe that these should meet the criterion and we recommend that guidance is included to clarify.

Some have questioned whether or not listed private equity funds will qualify as investment entities under this criterion. Such funds have traded shares whose value may include elements of value related to the asset management activity of the listed fund (as opposed to, for example, puttable units at net asset value of the fund) or which otherwise do not trade at net asset value. It might be argued that such shares are not ownership units to which a proportionate share of net assets is attributed. We do not believe that the Board intended to make this criterion restrictive and we recommend that the Board clarifies this point so that the shares of listed private equity entities qualify under criterion 2(c).

Question 3

Should an entity still be eligible to qualify as an investment entity if it provides (or holds an investment in an entity that provides) services that relate to:

(a) its own investment activities?

(b) the investment activities of entities other than the reporting entity?

Why or why not?

Question 3 (a)

Yes. If an entity provides services that relate to its own investment activities, it should still qualify as an investment entity (subject to how such activities are defined – see our responses to question 2, criterion (a) and to question 4).

Question 3 (b)

We understand the question to mean that the entity that is 'held' to provide services is a subsidiary that is part of the investment entity's business, rather than an investee held for capital appreciation, investment income or both. We agree that if an entity provides (or holds an investment in another entity that provides) substantive services relating to investment activities of entities other than the



reporting entity, it should not qualify as an investment entity. The entity in such a case is carrying on asset management business and is moving away from being an entity set up with the objective of carrying out investment activities.

Question 4

(a) Should an entity with a single investor unrelated to the fund manager be eligible to qualify as an investment entity? Why or why not?

(b) If yes, please describe any structures/examples that in your view should meet this criterion and how you would propose to address the concerns raised by the Board in paragraph BC16.

We believe that the Board has identified the appropriate factors for consideration in determining whether an entity is an investment entity. While these factors are described as specific criteria that must be met in order for an entity to be considered an investment entity, judgement will be required when assessing the criteria. We believe that the application of judgement is important to appropriately identify the population of entities that should qualify as investment entities.

Our most significant concern with the criteria is that the pooling-of-funds criterion does not allow for the application of professional judgement. The criterion as drafted would seem to preclude all single investor entities from qualifying as an investment entity. We agree that certain types of single investor entities should not qualify as an investment entity, but we believe that entities where the single investor acts in a fiduciary capacity on behalf of others should qualify as an investment entity. This may include, for example, certain pension and sovereign wealth funds. We recommend that the Board modify the pooling-of-funds criterion to allow for more judgement to be exercised in assessing single investor entities. We acknowledge that this would place a greater weight on management and auditors to reach appropriate judgements but believe this is necessary to achieve the appropriate financial reporting outcome for financial statement users. We also propose some modifications to other criteria – see responses to specific questions. We believe that the criteria in the proposal as a whole, including our proposed changes, are sufficiently robust so that significant potential abuses will be prevented.

There are other types of entities that currently, or may wish to, report in a manner consistent with the investment entity model outlined in the proposal, but which may not currently qualify because they fail the pooling criterion as defined. These might include parallel funds, funds established to carry out regulated US merchant banking activities and funds set up for an individual or a group of family members. For example, an asset manager may set up a "parallel" entity to a qualifying investment entity for a group of employees or for a particular investor, which mirrors the activities and transactions of the qualifying fund. This parallel entity may not itself qualify as an investment entity. We recommend that the Board further considers whether additional types of single or related investor entities should be considered investment entities.

We also recommend that the Board addresses scenarios where a fund may, at initial set-up, have a single investor, who is related to the fund manager, who has 'seeded' the fund with an initial amount of capital. The single investor would expect its interest to be diluted as more investors are found. This would also apply when the entity is in the process of liquidation and has few investors. It should not cease, in such a case, to be an investment entity. Adding guidance would be consistent with guidance



on multiple investments (para B5) and is also consistent with what is included in the FASB's proposal on entities with single investors (ED para 946-10-55-3).

Question 5

Do you agree that investment entities that hold investment properties should be required to apply the fair value model in IAS 40, and do you agree that the measurement guidance otherwise proposed in the exposure draft need apply only to financial assets, as defined in IFRS 9 and IAS 39 *Financial Instruments: Recognition and Measurement*? Why or why not?

We agree that investment entities that hold investment properties should be required to apply the fair value model in IAS 40. Fair value accounting for investment properties is consistent with fair value for controlled investees.

Question 6

Do you agree that the parent of an investment entity that is not itself an investment entity should be required to consolidate all of its controlled entities including those it holds through subsidiaries that are investment entities? If not, why not and how would you propose to address the Board's concerns?

We support the FASB's proposal to retain investment entity accounting on consolidation by a non-investment entity parent. Consequently we disagree with the IASB's opposing view. We agree that an investment entity has fundamental differences from other types of operating entities, and do not believe that the nature of an investment entity changes because of consolidation by a non-investment entity parent.

Concerns about potential misuses of the investment entity accounting model are better addressed in how an investment entity is defined. We believe that the proposed definition of an investment entity is sufficiently narrow to limit the risk of abuse that the Board is concerned about. Our response to the Board's main concerns is as follows:

Concern 1: Structuring by an entity setting up an investment entity within a corporate structure

We believe the criteria to determine whether an entity is an investment entity or not are very tightly defined and that this should avoid potential abuses that the Board is concerned about. Specifically, the criterion on 'nature of investment activity', particularly given the additional guidance in paragraph B6, should be sufficient to prohibit the practices that concern the Board. In many cases where such an entity is formed we believe that the parent will likely have additional relationships and transactions with its subsidiary.

Concern 2: An investment entity's investee owns the investment entity parent's shares, which would then be measured at fair value rather than accounted for as treasury shares in the consolidated financial statements of the investment entity if the fair value roll up were permitted.



We believe this can be addressed through disclosures which is the solution suggested by the FASB (ED para BC35), who also, we note, believe that the circumstances are not widespread.

We request that the Board clarifies an additional issue regarding accounting at a parent or investor level. This is the situation where a non-investment entity investor has an associate interest in an investment entity. For example, an insurer has a 25% stake in a fund. We believe that the non-investment entity investor should either be permitted to fair value its investment entity associate or should be permitted to equity account using the numbers from within the investment entity associate (i.e. including fair value movements of that investment entity associate's underlying investees). The FASB ED ASU (page 4) indicates that fair value changes within the investment entity associate are carried through to the investor's share of associate profits. It would be helpful if the IASB would make this clear when it finalises its proposal.

Question 7 (a)

Do you agree that it is appropriate to use this disclosure objective for investment entities rather than including additional specific disclosure requirements?

We agree with the Board's approach, which is that it is more appropriate to have a disclosure objective rather than to include a lengthy list of mandatory disclosures that may not be appropriate in all circumstances. We do, however, believe that the disclosure objective suggested in paragraph 9 of the exposure draft is not sufficiently specific. We are further of the view that the disclosure objective currently suggested in the exposure draft will not provide for consistency in disclosure. We suggest that the Board consider a more specific disclosure principle along the following lines:

"An investment entity shall provide information to enable users of its financial statements to evaluate the nature and financial effects of the investment activities in which it engages. It shall provide information about:

- The investment strategy of the entity;
- The types of significant investments held, including geographical and industry sector exposures and concentrations, including significant changes during the period;
- Change in the value of the investment portfolio during the period;
- A reconciliation of balances with owners of the entity (who may or may not be equity owners);
- Information on returns by unit of ownership."

Disclosures that are likely to meet this objective are:

- A description of the entity's investment strategy;
- A listing and description of the entity's significant investments and the entity's interest in those investments (e.g., percentage ownership, whether those investees are controlled, existence of the leverage in the investment structure, restrictions on disposal etc);
- A reconciliation of investments, showing movements arising from acquisitions, disposals, valuation changes and income;
- A reconciliation of ownership interests in the entity, including new capital, redemptions, distributions and recognised income or expense;
- Ratios of net income and gains per unit of ownership or by amounts of committed capital as appropriate.



Additional guidance may be required on how much detail will need to be given in respect of an entity's investment portfolio in order to ensure consistent information for users.

We also recommend that the Board carries out further outreach with users to better understand what disclosure is most meaningful to them and whether such disclosures differ across different types of investment entity. We further suggest the Board might undertake a review of the disclosures required by different stock exchanges for entities that are likely to qualify as investment entities, as these may give an indication of the disclosures that users are likely to find useful.

Question 7 (b)

Do you agree with the proposed application guidance on information that could satisfy the disclosure objective? If not, why not and what would you propose instead?

Consistent with our response to question 7(a) above, we believe the proposed application guidance could lead to inconsistent disclosures. Some may read the potential disclosures in the application guidance as being in effect mandatory, while others may see it as entirely voluntary, with, for example, IFRS 7 providing sufficient disclosure about the entity's investees. We believe that a more specific disclosure objective is more likely to be effective.

We have some concerns about the disclosure required by paragraph 10(c) of information about an intention to give future support. This information will often be confidential and may be prejudicial to the interests of the entity in question. There is also lack of clarity as to how an 'intention' to give support might be interpreted. It could range from a very broad internal suggestion within the investment entity to a formal public commitment.

We also recommend that the Board may want to do an analysis to determine which disclosures required by IFRS 7 and IFRS 12 may or may not be relevant to an investment entity. For example IFRS 12 would require an investment entity to disclose summarised financial information for its controlled investees, for which the non-controlling interest is material. This disclosure would be onerous and not relevant when the investees are accounted for on fair value basis.

We further note that US GAAP sets out methodologies for certain items, including income and net asset value per share or unit information. We encourage the IASB to work with the FASB and with users to determine whether such information is seen as, for example, equivalent to earnings per share and if or to what extent the IASB might wish to standardise methodology in order to enable comparison by users.

Question 8

Do you agree with applying the proposals prospectively and the related proposed transition requirements? If not, why not? What transition requirements would you propose instead and why?

In general, our view is that comparative periods should be adjusted when new accounting standards are applied, in order to aid comparability. We therefore believe that the proposal in the exposure draft should be applied from the beginning of the earliest period presented in an entity's financial



statements in the year of adoption, subject to an impracticability test. We agree that it may be impracticable to determine fair values accurately from this point in some circumstances. This may apply, for example, when an entity has been managed on a basis that approximates fair value but which would not comply with IFRS 13, *Fair value measurement*. However, we believe, given the nature of an investment entity's business, that fair value information will often be available for comparative periods

We commented on the date of adoption of IFRSs 10-12 in our response to the IASB's exposure draft *Mandatory effective date of IFRS 9 (proposed amendment to IFRS 9 (November 2009) and IFRS 9 (October 2010))*. In that response we recommended that the effective date of these standards should be delayed by at least one year, that is, until at least periods beginning on or after 1 January 2014. We propose the same date of adoption (i.e. at least 2014) for the investment entities exposure draft.

Question 9(a)

Do you agree that IAS 28 should be amended so that the mandatory measurement exemption would apply only to investment entities as defined in the exposure draft? If not, why not?

The fair value measurement exemption of IAS 28 is currently being used by funds, banks, insurers and other financial services entities and we believe that the exemption is used appropriately where fair value is likely to provide better information than equity accounting. It is used, for example, in the following circumstances:

- By an insurance entity with an associate interest that is held to back policyholder liabilities which themselves are measured at a current value. These interests are usually investments in funds.
- By investment managers holding associate interests in funds that they manage.
- By some banks for their associate interests in funds.

We believe that the options in IAS 28 and IAS 31 should not be narrowed.

Question 9 (b)

As an alternative, would you agree with an amendment to IAS 28 that would make the measurement exemption mandatory for investment entities as defined in the exposure draft and voluntary for other venture capital organisations, mutual funds, unit trusts and similar entities, including investment-linked insurance funds? Why or why not?

Consistent with our response to question 9(a) above, we would agree with the Board's alternative proposal to make the fair value measurement exemption under IAS 28 mandatory for investment entities and voluntary for other venture capital organisations, mutual funds, unit trusts and similar entities, including investment-linked insurance funds.



Other issues

Consolidation of an investment entity subsidiary by an investment entity parent

The IASB and FASB proposals are different regarding the scope of consolidation by an investment entity. Under the IASB proposal, an investment entity measures all entities that it controls, other than those providing services related to its own investment activities, at fair value. However, under the FASB proposal, an investment entity consolidates another investment entity as well as an entity that provides services to the investment entity (ED para 946-810-45-3 (a) & (b)).

The FASB proposal would result in the consolidation of a subsidiary investment in another fund. Consolidation of the fund subsidiary by the reporting fund generally does not reflect the true economic relationship between the investment entity and the underlying investee fund. For example, a sixty percent ownership interest of the underlying fund may only represent a two per cent of the total investments of the reporting fund; accordingly, consolidation of the underlying investee fund may result in assets, liabilities and operating activity in the aggregate that are not reflective of the impact of the investee fund to the reporting entity's overall investment performance. Disaggregation of such activity by consolidation would not improve the understandability, transparency or usefulness of such information.

Further, in a fund of funds structure, investment companies generally purchase interests in underlying funds for similar reasons that they purchase investments directly – for capital appreciation or investment income, or both, in an efficient and cost effective manner. Consistent with the view that it is most appropriate to present non-investment entity interests at fair value, we believe the same principle should be applied to investments in other investment entities. Therefore we propose that both Boards adopt an approach that is consistent with the IASB exposure draft, whereby all investments are accounted for at fair value.

We do, however, suggest expanding the limited circumstances where an investment entity is required to consolidate investees. In addition to situations where the entity is providing investment related services we recommend requiring consolidation of investment entity subsidiaries that were formed in conjunction with the parent investment entity to achieve specific regulatory, tax, legal or other business reasons such as financing.

We believe that this change would result in better and more transparent accounting in the situation where, for example, an intermediate holding company is set up by an investment entity to issue debt in order to acquire interests in investees. Under the IASB proposal the intermediate holding company is measured at fair value, along with the underlying investee and there is no visibility of the investment entity's debt. We believe that such an entity should be consolidated by the investment entity.

We recommend that B2, as referenced from paragraph 7(a), is amended as follows:

“...services that relate only to the investment entity’s own investment activities (e.g. **entities providing** investment advisory services **or entities that are created to facilitate investment strategies for regulatory, tax, legal or other business purposes, such as financing**), even if those activities were substantive...”



Reassessment

The exposure draft requires an investment entity to reassess whether it meets the criteria for an investment entity if the facts and circumstances indicate that there are changes to one or more criteria set out in the exposure draft (para 3). We note that the FASB ED (para 946-10-25-1), requires an entity to reassess its investment entity status only if there is a subsequent change in the purpose and design of the entity.

The IASB and FASB proposals take a different in approach to reassessment. It appears that the IASB sets a potentially significantly lower threshold, which could result in more entities entering and leaving investment entity accounting than would be required by entities reporting under US GAAP. We believe that a consistent approach should be taken by both Boards, and therefore, recommend both Boards to work together to resolve this.

First-time adoption

The exposure draft does not contain any provisions for first-time adopters of IFRS. Accordingly, we recommend that the Board considers whether first-time adopters require any relief from full retrospective application and propose amendments to IFRS 1 as appropriate.