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Matthew L. Schroeder Managing Director Global Head of Accounting Policy



February 15, 2012

Ms. Leslie Seidman FASB Chairman 401 Merritt 7 PO Box 5116 Norwalk, CT 06856

Re: File Reference No. 2011-200 - Proposed Accounting Standards Update: Financial Services – Investment Companies (Topic 946) Amendments to the Scope, Measurement, and Disclosure Requirements

Dear Ms. Seidman:

Goldman Sachs appreciates the opportunity to provide comments on the Financial Accounting Standards Board's ("FASB" or the "Board") exposure draft on the amendments to the scope, measurement, and disclosure requirements for Investment Companies (the "Exposure Draft" or the "ED"). We manage approximately 1,000 funds and are one of the largest global investment managers with approximately \$828 billion of assets under management.

Accordingly, we have followed this project, along with three other related projects (Consolidation: Principal versus Agent Analysis, Financial Services – Real Estate – Investment Property Entities¹, and Leases), with much interest. We appreciate the FASB's efforts to provide clarifying guidance to financial statement preparers, users and other stakeholders in identifying entities that meet the requirements to qualify as an investment company under Topic 946.

We are not aware of any significant issues or problems with Topic 946; that guidance has been applied for decades. In our view, there needs to be a compelling improvement in financial reporting to justify changing accounting standards that are not viewed as problematic and that have stood the test of time.

We do not think the ED passes that test. Specifically, we believe that the criteria used to identify an investment company should be a principles-based approach as it is today, and not

¹ See separate letters to the Board with reference to Consolidation: Principal versus Agent Analysis and Real Estate – Investment Property Entities.

a rules-based checklist as proposed by the ED; the six criteria should be presented as indicators of whether an entity is an investment company. We believe that the evaluation of whether an entity qualifies as an investment company should be an overall judgement that considers the six criteria in their totality in the context of the purpose and design of the entity.

We agree that, in general, an investment company should have no substantive activities other than its investing activities, that the express business purpose should be investing to provide returns from capital appreciation, investment income, or both, and that substantially all of the investment company's investments are managed, and their performance evaluated, on a fair value basis. Factors such as the number of investors, the asset classes in which a fund invests, or the number of investments in a fund, are less persuasive factors and should not be determinative in assessing whether an entity qualifies as an investment company.

We do not support the requirement that an investment company would consolidate another investment company in a fund-of-funds structure. Consolidated financial statements do not present meaningful information to investors in investment companies; investors in an investment company invest capital for the purpose of capital appreciation, investment income, or both, and investments are managed, and performance is evaluated, on a fair value basis. An investment company should therefore be exempt from consolidating investments that it controls and instead recognize its investments at fair value.

We strongly support the continued retention of investment company accounting by the parent of an investment company subsidiary. Consolidation of an investment company by a parent does not change the purpose and design of the investment company; further, we believe that reporting the investment activities of the investment company at fair value is also relevant to the ultimate investors in the parent and thus fair value information should survive consolidation.

Our detailed comments on selected questions in the ED and other additional comments are included in the Appendix to this letter. If you have any questions or would like to discuss any of these comments further, please contact Israel Snow at 212-357-5730 or me.

Sincerely,

Matthew L. Schroeder

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Appendix-- Responses to Selected Questions

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?

Response: Overall, we believe that the six criteria outlined in paragraph 946-10-15-2 of the Exposure Draft represent appropriate attributes to be considered in determining whether an entity is within the scope of Topic 946. However, we do not agree that an entity be required to meet all six criteria to qualify as an investment company. We believe that the evaluation of whether an entity qualifies as an investment company should be a substance-based, qualitative approach that considers the six criteria in their totality in the context of the purpose and design of the entity.

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?

Response: As discussed in our comments on Proposed Accounting Standards Update: Real Estate – Investment Property Entities (Topic 973), we do not understand the benefits of creating a new entity type for investment property entities (IPEs). We believe that the existing reporting differences between Real Estate Investment Trusts (REITS) and Real Estate Opportunity (REO Funds) should not be eliminated and the scope exception in Topic 946 for REITs should be retained. The business strategies of REITs and REO Funds often differ; consequently, the investor community and its reporting needs are dissimilar. These differences in business strategy and investor base necessitate different financial reporting. Since REITs focus on cash flows and real estate operations, there is a clear necessity to provide detailed information regarding rental revenues and operating expenses in the statement of operations. This is also consistent with reporting properties and the related debt on a "gross" basis. This contrasts with REO Funds. Private equity investors are focused on net asset value and capital appreciation and therefore, REO Fund reporting should continue to be conformed to Investment Company Accounting under Topic 946.

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?

Response: We agree that the determination of whether an entity is an investment company should only be reconsidered when there is a significant change in the purpose and/or design of the entity. We believe that the proposed requirement is operational, as we would expect that significant changes in the purpose and/or design of an investment company would be rare.

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?

Response: We agree that an entity that obtains returns from sources other than from capital appreciation or investment income should not qualify as an investment company. However, the conditions in paragraphs 946-10-55-7(a)-(f) should be presented as indicators and not as a rules-based checklist. Having one of the stated conditions should not, in and of itself, preclude qualification as an investment company. We recommend paragraph 946-10-55-7 be modified as follows:

An entity would not meet the nature-of-the-investment activities criterion if the entity or its affiliates obtain or have the objective of obtaining returns from its investments other than capital appreciation or investment income in entities other than an investment company or an investment property entity as defined in Topic 973. Examples of relationships and activities between (1) the entity or its affiliates and (2) an investee or its affiliates (other than an investment company or investment property entity as defined in Topic 973) that demonstrate that an entity is investing for other than capital appreciation or investment income include the following²:

[...]

The examples of relationships and activities included in paragraphs 946-10-55-7(a)-(f) are not exhaustive but are indicative of the types of activities that should be considered when evaluating the nature of the investment activities of the entity. Additionally, the existence of a condition in paragraphs 946-10-55-7(a)-(f) does not preclude an entity from qualifying as an investment company; rather, the determination should be made after considering all relevant facts and circumstances, including the purpose and design of the entity.

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?

Response: As illustrated in the examples below, we do not believe that the criterion to have multiple substantive investors that are not related to the entity's parent (if there is a parent) is appropriate. We note the Board's concern discussed in paragraph BC24 that an entity "could be inserted into a larger corporate structure to achieve a particular accounting outcome." However, we believe inappropriate conclusions can be avoided if management faithfully applies the "Nature of the Investment Activities" and "Express Business Requirements" criteria.

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² Because we have suggested that the Board abandon the IPE project (see separate letter the Board) we have also suggested striking the reference to IPEs and Topic 973.

³ For example, the Board has expressed concern that a corporate parent could create an investment subsidiary that is engaged in research and development activities and, by accounting for the investment subsidiary as an investment company, account for those activities at fair value instead of recognizing research and development expenses as incurred.

The following are examples of where a fund has a single investor but has the same investment objectives as a fund with multiple investors:

- Single investor funds are frequently established for pension funds, sovereign wealth funds, and other institutional investors for a variety of reasons (e.g., to target a very specific investment strategy that might not be appropriate for a broader fund investor group). These investors often invest in multiple funds sponsored by the same asset manager, sometimes as single investors and other times as an investor in a larger fund, to access a variety of investment strategies (e.g., private equity, distressed debt, and real estate). Each investment (whether in a single or multiple investor fund) is managed, and performance evaluated, on a fair value basis.
- Employee funds are generally created to align the financial interests of the employees of the investment manager with the financial interests of fund investors; employee funds generally invest along-side third-party investors in a main fund or across multiple funds managed by an investment manager. The proposed amendments would preclude a consolidated employee fund from qualifying as an investment company, as the employees would be considered related to the entity's parent and thus not meet the requirement to have multiple unrelated investors.

We note that if single investor funds as those described above did not qualify as investment companies, the investment manager would be required to prepare financial statements under two separate bases of accounting for the same investors. The separate financial statement presentations would confuse investors and would impose a significant operational burden on the preparer.

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.

Response: We do not agree with the proposed unit-ownership criterion that would require an entity to have ownership interests in the "form of equity or partnership interests" because it adds an unnecessary level of complexity to the analysis and should not be relevant to the determination of whether an entity is an investment company. We believe that the relevant consideration is whether the beneficial ownership is allocated a specifically identifiable portion of net assets. Analyses of whether investments are debt or equity for GAAP purposes or represent "equity investment at risk" under subtopic 810-10 do not appear relevant to determining whether an entity is an investment company. Additionally, investment companies incorporated in certain jurisdictions receive favorable tax treatment for issuing ownership interests in the form of debt instead of equity; this should not cause a difference in the application of investment company accounting.

Based on the above, we suggest the following amendments to the ED:

b. Unit ownership. <u>Each unit of Oo</u>wnership in the investment company is representsed a specifically identifiable portion of the net assets of the investment company, although each unit does not have to represent a proportionate interest in all of the underlying investments of the investment companyby units of investments, in the form of equity or partnership interests, to which a portion of the net assets are attributed.

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?

Response: We believe that the Boards concerns outlined in paragraph BC24 are adequately addressed by the faithful application of the "Nature of the Investment Activities" and "Express Business Requirements" criteria (see response to question 7 above). If the Board retains unit-ownership and pooling-of-funds as absolute criteria, we agree in principle with the proposed exception. However, the proposed exception would not apply to single investor funds whose investors are sovereign wealth funds or high net worth individuals that may not prepare financial statements under U.S. GAAP. Consequently, the exception is insufficient and will lead to a lack of comparability because certain single investor funds with U.S. pension funds as a single investor would qualify as investment companies while single investor funds with investors that do not prepare financial statements under U.S. GAAP would not qualify as investment companies.

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?

Response: The Board did not define the term "passive investor" or provide clarifying discussion in the Basis for Conclusion as to how the term should be interpreted; accordingly, we cannot comment on whether the proposed amendments should differentiate between passive and other investors. However, consistent with our response to question 7, we believe that the determination of whether an entity qualifies as an investment company should be made based on the nature and purpose of the activities of the entity being evaluated, not the characteristics of the investors in the entity.

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.

Response: We disagree with the proposed amendments that would require an investment company to consolidate another investment company in a fund-of-funds structure. Furthermore, as discussed in our response to questions 15, 16, and 17, we fail to understand the benefit of such a consolidation requirement when the proposed financial statement presentation and disclosures would effectively reverse the impact of consolidation by excluding the portion related to the noncontrolling interest.

We agree with the premise in existing GAAP and the ED that consolidated financial statements do not present meaningful information to investors in investment companies. This applies to all investments, including fund-of-funds structures. Requiring an investment company in a fund-of-funds structure to consolidate another investment company while other investments are not consolidated would place undue prominence on the consolidated funds and would reduce comparability of fund financial statements.

From an operational perspective, if a fund in a fund-of-funds structure would be required to consolidate an investee fund that is sponsored by a third-party, it likely would not be possible for the consolidating fund to obtain the necessary financial information to prepare consolidated financial statements in a timely manner (or at all). For example, an investee fund might have investments in side-pocket funds that the consolidating fund is not exposed to; thus, the third-party sponsor would likely not provide financial information on those funds to the consolidating fund, making it impossible to prepare comprehensive consolidated financial statements.

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?

Response: Consistent with our response in question 12 above, we disagree with the Board's proposal to require an investment company to consolidate a controlling financial interest in an IPE.

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?

Response: We agree with the proposal to prohibit an investment company from applying the equity method of accounting in Topic 323 to interests in other investment companies and investment property entities. Investment companies invest across a variety of asset classes and at various levels in the capital structure of investees, both directly in the underlying securities and indirectly through other investment companies, for the purpose of providing returns from capital appreciation, investment income, or both. Fair value is the most relevant

measure for the investment company's investments, regardless of whether an investment company is investing directly in securities or indirectly through an investment company.

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?

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?

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?

Response to questions 15, 16 & 17: Consistent with our comments on Questions 12 and 13, we do not believe that it is appropriate for an investment company to consolidate another investment company in a fund-of-funds structure (or an investment property entity, should the Board decide to adopt the proposed rules in Topic 973). Consequently, we do not agree with any incremental disclosure requirements resulting from these proposed amendments.

However, if the Board adopts the proposed amendments to require consolidation by an investment company of other investment companies and investment property entities, we would agree that calculation of the financial highlights and expense ratios should exclude the effects of consolidating those entities.

We also believe that the proposed requirements to exclude the effects of consolidation from the calculation of financial highlights and expense ratios indicates that the Board understands that a requirement to consolidate fund-of-fund entities and investment property entities results in financial statements that do not provide useful information to investors.

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?

Response: We strongly support the view that a noninvestment company parent should retain the specialized accounting of an investment company subsidiary in consolidation. Consolidation of an investment company by a parent does not change the purpose and design of the investment company; further, we believe that reporting the investment activities of the investment company at fair value is also relevant to the ultimate investors in the parent and thus fair value information should survive consolidation.

Operationally, preventing a noninvestment company parent from applying the specialized accounting of an investment company would require the parent to prepare parallel sets of books and records, which increases the operational burden on preparers. Additionally, it would likely not be practical for a noninvestment company parent to obtain the information

necessary to convert financial information prepared in accordance with the specialized accounting in Topic 946 to books and records under otherwise applicable U.S. GAAP (especially when the investment company sponsor is an unaffiliated third party).

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?

Response: We agree with the proposed transition for entities that no longer meet the criteria to be an investment company.

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

Response: We believe that the proposed amendments will take approximately 18 months to implement. We manage approximately 1,000 funds with approximately \$828 billion of assets under management; additionally, we make investments through funds, directly and indirectly, in debt securities, loans, public and private equity securities, and real estate. We believe that a time period of 18 months would allow us sufficient time to review of the amended investment criteria for the various investment company products we offer and for our direct and indirect fund investments.

Please note that a timeline for implementing the proposed amendments assumes implementation of only the proposed amendments to Topic 946 and Topic 810 at a specified effective date. A decision made by the Board to adopt the proposed rules in Topic 973 and/or the results of redeliberations on the Leases project could affect our estimate.

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

Response: Given that we offer approximately 1,000 funds to our investors, fact patterns across funds will inevitably vary. Accordingly, we support permitting early adoption where management believes that doing so will be beneficial to investors in the fund.

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?

Response: We believe that the proposed amendments should apply to both public and nonpublic entities. The investment company industry encompasses many different types of investment funds that are subject to various levels of governmental regulation. Certain investment companies are registered under the Investment Company Act of 1940, while others are "non-registered" and thus would generally be considered nonpublic entities. Application of the proposed amendments to both public and nonpublic entities would promote comparability across the entire investment company industry.

Additional Comment – Multiple Investments

The Exposure Draft proposes in paragraph 946-10-15-2(a) that "The investment company's only substantive activities are investing in *multiple investments* for returns from capital appreciation, investment income (such as dividends or interest), or both." [emphasis added]

We do not agree with the proposed amendment that would require an investment company hold *multiple investments* (subject to the exceptions in paragraph 946-10-55-5). We believe that the number of investments is a characteristic of the entity's investment holdings and is not relevant to the nature of the entity's investment activities (investing for returns from capital appreciation, investment income, or both). The following are situations where a fund has a single investment but the same investment objectives as a fund with multiple investments:

- Limitation of liability: Investment managers will often establish separate investment funds for each private equity investment to avoid commingling of assets and limit liability. The underlying economic returns from the private equity investments are the same whether multiple investments are made in a single fund or separated into single investment funds.
- "Overflow funds:" An investment fund's governing legal documents often impose diversification limits with regard to the level of investment in a particular investment, industry, or asset class. For investors that seek additional exposure to a particular investment beyond the investment limits imposed on the primary fund, investment managers will create an overflow fund to invest along-side the primary fund in the selected investment. This single investment entity has the same investment objectives as the related fund.
- "Opportunity Fund:" An investment manager will often identify a favorable investment opportunity that is not within the designated investment strategy of a primary fund. However, to provide access to investors, the investment manager will establish an opportunity fund that invests in the single asset. Again, the single asset is a characteristic of the fund's investment holdings, not the nature of the entity's investment activities.

Therefore, we believe that the number of investments is not relevant to determining whether an entity is an investment company.

Additionally, we note that if single investment funds as those described above did not qualify as investment companies, the investment manager would be required to prepare financial statements under two separate bases of accounting for the same set of investors. The separate financial statement presentations would confuse investors and would impose a significant operational burden on the preparer.

Finally, to the extent that single investment funds would not qualify as investment companies, they would not report a net asset value per share in accordance with investment company guidelines. Consequently, funds that invest in a single investment fund as part of a fund-of-funds structure would lose the ability to apply the practical expedient in ASC 820-10-35-59. This would create a significant operational burden on the fund-of-funds industry.

Additional Comment – Funds in the Process of Liquidation

When a fund is in the process of liquidation, it can be left with a single investment that, because of certain legal restrictions (e.g., a bankruptcy claim), cannot be liquidated within one year. Accordingly, the fund does not meet the criteria to qualify for the liquidation basis of accounting. We request that the Board clarify the guidance in paragraph 946-10-55-5(d) to indicate that a fund is not required to prepare financial statements under the liquidation basis of accounting in order to meet the proposed exception in paragraph 946-10-55-5(d). We suggest the following revision:

d. The entity is in the process of <u>liquidation_liquidating its remaining investment(s)</u>. The entity does not need to meet the requirements to prepare financial statements under the liquidation basis of accounting to meet this requirement.