



Technical Director
Financial Accounting Standards Board
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RE: Comment Letter on the FASB's Proposed Accounting Standards Update—Investment Companies

The International Private Equity and Venture Capital Valuation Board (IPEV Board) appreciates and welcomes the opportunity to respond to the Board's Proposed Accounting Standards Update Financial Services—Investment Companies (Topic 946). As we have stated with our responses in the past, there is great importance for the private equity¹ investment community to provide investors with useable financial information prepared using reliable and consistently determined fair value estimates. Virtually all investors who undertake investments in the debt or equity of private companies, directly, through a fund, or through an account managed by others, are required to report such investments at fair value. Therefore, it is critical that such investors receive fair value reporting of underlying investments.

The IPEV Board is responsible for issuing and periodically updating International Private Equity and Venture Capital Valuation Guidelines (IPEV Guidelines). The IPEV Guidelines were launched in March 2005 and revised in September 2009. They provide the private equity industry with best practice in consistently estimating the fair value of investments compliant with IFRS and US GAAP accounting principles. The IPEV Board expects to make minor revisions to the IPEV Guidelines in 2012 to ensure consistency with ASU 2011-04 and IFRS 13. Valuation guidelines are used by the private equity industry to consistently value private investments and provide a framework for fund managers and investors to monitor the value of existing investments. Further the IPEV Board has been tasked with providing supplemental Investment Reporting Guidelines which provide a framework for reporting information beyond the financial statements which is important to investors. A draft of the IPEV Investor Reporting Guidelines will be released for public comment during the first quarter of 2012.

Our responses to the Proposed ASU – Investment Companies are presented with the objective of providing the Board with practical input on the impact of the proposed changes on the global private equity industry. Because of the unique nature of the private equity industry, in particular the need to regularly estimate the fair value of illiquid or infrequently traded assets, we can provide the Board with our experience and insight of the challenges faced by both private equity investors and managers.

¹ For ease of reading, the term private equity as used in this document means: buy-out funds, mezzanine debt funds, venture capital funds, and certain fund-of-funds.

Overall Comment

We have not responded to the Board's Investment Property Entities Proposed Accounting Standards Update. We strongly believe that there should be one standard for "investment entities" that does not distinguish between investment companies and investment property entities, and that the US GAAP Standard should be substantially identical to IFRS guidance.

All investment entities have common characteristics in that they buy, manage and may sell investments with the broad objective of realizing an investment return. Investors in such entities are required to report their investments at fair value. As such, it makes little sense to create artificial distinctions between investment companies and investment property entities. Therefore, we believe that there should be a single accounting standard for investment entities and that all such entities should report all of their investments at fair value.

Responses to Specific 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?

IPEV Response to Question 1:

Private Equity is a dynamic industry; continually changing to meet investor needs. We do not agree that the six criteria articulated in the exposure draft are flexible enough to cover the full spectrum of existing and anticipated investment entities. We recommend that FASB focus on principles and not be rule driven as is included in the proposal. An investment company should be defined by the preponderance of the available evidence. We recommend that *an investment entity* be defined as an entity that substantially meets the majority of the following criteria:

- a. *The entity's ~~only~~ substantive activities are investing in ~~multiple investments~~ for capital appreciation, investment income (such as dividends or interest), or both.*
- b. *The entity makes an explicit commitment to ~~a group of investors~~ one or more investors that the entity's purpose is investing to earn capital appreciation, investment income (such as dividends or interest), or both. [Increasingly, investors are contracting with managers on a "managed account basis". Therefore, an investment entity should also include situations where there is a single investor.]*
- c. *Ownership in the entity is represented by units of investments, such as shares or partnership interests, to which proportionate shares of net assets are attributed.*
- d. *The funds of an entity's investor or investors are pooled so that the investor or investors can benefit from professional investment management. The entity has an investor or investors that are unrelated to the parent (if any). ~~and collectively hold a significant ownership interest in the entity.~~*
- e. *Substantially all of the investments of the entity are managed, and their performance is evaluated, on a fair value basis.*
- f. *The entity provides financial information about its investment activities to its investor or investors. The entity can be, but does not need to be, a legal entity.*

From a principle perspective, we believe that an investment entity should be defined as an entity that substantially meets the majority of the characteristics above, with a potential additional characteristic being that the entity has an investor or investors who must report their investment in the investment entity at fair value.

We do not believe that it is preferable for an investment entity to consolidate a service related subsidiary; rather it would be appropriate to report the service investment at fair value. Investors need fair value, not consolidated financial information.

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.

IPEV Response to Question 2:

While the proposal deviates from the IASB proposal, we are in agreement with the proposed ASU because of special SEC rules. SEC Investment Companies must report fair value. We are not aware of entities that are investment companies under U.S. regulatory requirements that would not meet the adjusted proposed criteria.

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?

IPEV Response to Question 3:

As stated above, we do not believe that there should be separate GAAP for Investment Property Entities. We agree that a real estate investment trust and other investment property entities should be included in the scope of the Investment Company proposal and should report underlying investments at fair value.

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?

IPEV Response to Question 4:

We believe that it is unlikely that such a situation will occur with any regularity. We do not expect that adopting a different accounting model would be overly burdensome.

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?

IPEV Response to Question 5:

As stated above, we believe there should be one standard for all investment entities. The characteristics of an Investment Company should be less restrictive with respect to other activities that an investment entity might perform. To achieve expected returns, some degree of management or other services related to the investments often occurs. Excluding such activities may scope out entities for which investors may need fair value information.

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?

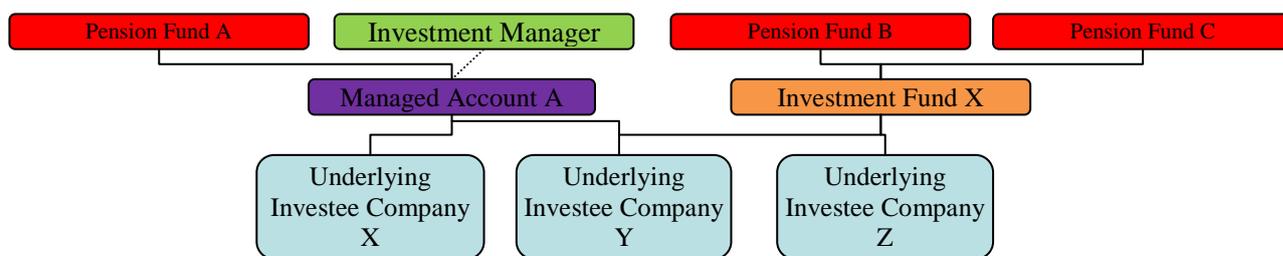
IPEV Response to Question 6:

We understand the examples provided in BC15 and BC 16. However, if the proposal were principle based, rather than including specific rules as is currently the case, we believe the Board's concern would be mitigated. We believe an Investment Company should include situations where the broad objective of the fund is to obtain an investment return. From a principles perspective, it should be clear from the organizational and investment criteria of an entity whether or not it is an investment company. The third party investor criteria combined with the expectation of an investment return will generally ensure that the principles are applied appropriately.

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?

IPEV Response to Question 7:

Yes, with the modification that a single investor third party investor should also demonstrate the characteristics of an investment company. Increasingly, Investors are using a "managed account" strategy with an investment manager. A manager is selected to invest, often alongside other third party investors. Investors need their interest in such "entities" to be reported at fair value. The following diagram better explains this situation.



Assume that the Investment Manager makes all investment decisions:

Managed Account A should be an investment entity which reports at fair value.
 Investment Fund X should be an investment entity which reports at fair value.

Note: “Underlying Investee” is synonymous with “Portfolio Company”.

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.

IPEV Response to Question 8:

We agree with the proposal.

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?

IPEV Response to Question 9:

As described above, we are in strong agreement that a single third party investor should qualify an entity to be an investment company. We do not believe the Board’s concern in BC24 is well founded for two reasons. First, the situation described in BC24 does not seem to anticipate third party capital. Second, even if a corporation recorded underlying investments at fair value, we do not believe that such information would be misleading.

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?

IPEV Response to Question 10:

No, we disagree. We believe the nature of the investors should be a key component in evaluating whether or not an entity is an investment company. Investors generally are required to report their interest in an investment entity at fair value. Therefore, Investors need fair value information. The needs of the investor should be a characteristic, if not the key characteristic, that identifies an investment company that provides its investors with the fair value of underlying investments.

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?

IPEV Response to Question 11:

We agree in principle with the proposal. However, because of the tendency by some to focus on individual words of accounting standards and not on the overall principles, we are concerned that the current proposal could be misunderstood or misinterpreted. This is because investment company management responsible for making investment decisions, monitoring investments, and ultimately selling underlying investments, do not necessarily use terms such as "managed and performance evaluated" on a fair value basis. The update should be clearer in its intent and wording. For example, it may be clearer to say investments are "monitored" on a fair value basis.

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.

IPEV Response to Question 12:

We do not agree. We fundamentally believe that all investments of an Investment Company should be reported at fair value. We do not believe any purpose is served or any useful information is provided by requiring an investment company to consolidate underlying investments. Investors need fair value information, not consolidated historical cost information.

We also recommend that more work be done to determine how best to report investments in tiered structures. Fund-of-funds structures, master-feeder structures and alternative-investment vehicles are much more prevalent today than when the original master-feeder structures were set up. With the changes being put forward in the Consolidations ED (which is directly related to this ED and which specifically addresses partnerships) there is a particular need for this topic to be looked at in detail. Current practice is diverse, but appears to be meeting investors' needs. Often the need for transparency is met by including the separate financial statements for each entity in a tiered structure. Since this maintains integrity of the unit of account of each legal entity, it may be preferred by investors to consolidated financial statements. Much as the examples in the Consolidations ED and this ED are necessary to support consistency in practice and avoid unintended consequences, we recommend that there should be similar examples that apply the definitions in the Consolidations ED to common fund-of-fund structures.

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?

IPEV Response to Question 13:

As stated above, we do not believe that there should be a distinction for investment property entities. Further we believe that all underlying investments should be reported at fair value to provide investors with relevant information.

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?

IPEV Response to Question 14:

Yes, we strongly agree.

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?

IPEV Response to Question 15:

Current disclosure requirements provide more information that is needed or used by investors. Incremental disclosure requirements are not necessary. At the appropriate time, current disclosure requirements should be reconsidered to eliminate information not needed or used by investors.

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?

IPEV Response to Question 16:

We do not agree. The proposal is overly complex and would not provide useful information to investors. Investors need fair value information related to the "fund" in which they have invested. Providing underlying fees would be of limited, if any, use.

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?

IPEV Response to Question 17:

Most investors believe that current disclosures are excessive and are not decision useful. Additional disclosures are not needed.

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?

IPEV Response to Question 18:

Yes, we agree that fair value accounting should be retained.

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?

IPEV Response to Question 19:

No comment as we do not expect such a situation to occur with any degree of frequency.

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

IPEV Response to Question 20:

Because most investment entities already report fair value, time for implementation should not be excessive. For certain real-estate investment companies, that have not historically provided regular fair value updates, some amount of time, likely less than a year, may be necessary to implement internal processes to estimate fair value.

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

IPEV Response to Question 21:

Yes, early adoption should be encouraged because investors need fair value information.

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?

IPEV Response to Question 22:

Yes. Most investment companies are nonpublic entities. There should be no difference between public investment companies and nonpublic investment companies.

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We appreciate the opportunity to provide the Boards with our feedback. We would be pleased to discuss any questions you may have with you. We would also be happy to provide one or more IPEV Board members to participate in the upcoming Roundtable discussions on this mater.

Very truly yours,

/s/ William J. Hupp

The International Private Equity and Venture Capital Valuation Board

William J. Hupp
Vice Chairman of the IPEV Board

The International Private Equity and Venture Capital Valuation Guidelines

The International Private Equity and Venture Capital Valuation Guidelines (IPEV Guidelines) were launched in March 2005 and revised in September 2009 to reflect the need for greater comparability across the industry and for consistency with IFRS and US GAAP accounting principles. Valuation guidelines are used by the private equity and venture capital industry for valuing private equity investments and provide a framework for fund managers and investors to monitor the value of existing investments. The IPEV Guidelines are based on the overall principle of 'fair value' in order to be consistent with IFRS and US GAAP.

The International Private Equity and Venture Capital Valuation Board (IPEV Board) reports and is accountable to a general assembly composed of all the endorsing associations to manage the evolution of the guidelines going forward. The IPEV Guidelines have been endorsed by 40 national and regional trade associations.

For more information: <http://www.privateequityvaluation.com>.