February 13, 2012

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

Via email: director@fasb.org

Re: Proposed Accounting Standards Update, Consolidation (Topic 810): Principal versus Agent Analysis

Dear Technical Director:

State Street Corporation ("State Street") appreciates the opportunity to comment on the FASB’s Proposed Accounting Standards Update, Consolidation (Topic 810): Principal versus Agent Analysis (the “Proposed ASU”). With $21.8 trillion of assets under custody and administration and $1.9 trillion in assets under management at December 31, 2011, State Street is a leader in providing financial services and products to meet the needs of institutional investors worldwide. This comment letter is written from State Street’s perspective as both an asset servicer and manager, and the preparer of its own consolidated financial statements.

We commend the Board in its efforts to develop guidance for determining whether a decision maker over a variable interest entity or a voting interest entity is using its power as a principal or agent and whether it should consolidate the entity. We appreciate that the Board understood and acknowledged the concerns of the asset management industry by granting the deferral under ASU No. 2010-10 from the provisions of ASC 810 (codification of FAS 167) for reporting entities with interests in investment companies.

We continue to believe that the financial statements of investment managers will not be meaningful if investment managers are required to consolidate all investment funds they manage. We support recognizing investment managers’ pro-rata investments in investment companies at their net asset value calculated in accordance with the accounting provisions of ASC 946. We believe that this is a more relevant presentation for the users of the investment managers’ financial statements.

State Street supports a model for qualitatively assessing whether a decision maker is a principal or an agent. We believe that a holistic qualitative assessment based on the purpose and design of the entity and overall relationship between the decision maker, the entity, and other interest holders allows for more professional judgment to be exercised, which enables a better reflection of the economic substance of
these relationships. Overall, we believe the proposed guidance is operational and will yield financial reporting results that the Board and users of financial statements will find appropriate.

The balance of our letter addresses specific comments with respect to the Proposed ASU that we believe propose actions necessary to achieve the proper balance between improving comparability across entities, while giving financial statement users more relevant and reliable information to evaluate an entity’s financial performance. We hope the Board finds our comments helpful as it continues to re-deliberate the proposed guidance.

Principal / Agent Determination

We believe the three proposed factors\(^1\) for assessing whether a decision maker is a principal or an agent are appropriate and operational. However, in a model that requires a qualitative assessment with the weighting of factors, we recommend that “the purpose and design of the entity” be another explicit factor to consider in the principal-versus-agent analysis to help ensure that the proposed guidance will produce consistent accounting conclusions. Paragraph 810-10-25-39C states “This assessment also shall consider the entity’s purpose and design, including the risks that the entity was designed to create and pass through to its interest holders.” We interpret this to mean that the Board’s intent is for the purpose and design of the entity to be considered along with the proposed factors. We are concerned that by not making it an explicit factor to consider in the evaluation of a decision maker’s capacity, some may interpret the language to suggest that it is not of equal importance in the evaluation, whereas we feel that the purpose and design of the entity is critical to the analysis.

We also believe that the governance structure and the related source from which the power to direct the entity’s activities emanates should be a factor to consider in assessing whether a decision maker is a principal or an agent. Specifically, we believe that the existence of an independent board of trustees/directors (i.e., a board governed by the Investment Company Act of 1940) should be a determinative indicator the investment manager is acting as an agent. An investment company board generally has the power to direct the activities of the entity by establishing the operating policies with which the investment manager must comply. Similar to a board for typical operating corporations, an investment company board provides a centralized body with the ability to control significant decisions on behalf of investors. The investment manager typically is responsible for the day-to-day asset management activities, but the investment company board nevertheless retains ultimate responsibility for all decisions undertaken by the investment manager. The investment company board may also be responsible for retaining or terminating the investment manager’s contract.

\(^1\) Pursuant to paragraph 810-10-25-39C, the evaluation of a decision maker’s capacity would consider the following factors:

a. The rights held by other parties
b. The compensation to which the decision maker is entitled in accordance with its compensation agreement(s)
c. The decision maker’s exposure to variability of returns from other interest that it holds in the entity.
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The Proposed ASU requires that the level of equity interest held by the decision maker in an entity be considered in the determination of principal versus agent, and suggest, via the examples provided, that the greater the equity interest, the more weight that factor should carry in the assessment. We believe that the level of equity interest is only one factor to consider, and needs to be evaluated in the context of all the factors taken as a whole, including the overall purpose and design of the entity. The purpose and design of the entity is extremely important in understanding why the decision maker is holding an equity interest (i.e., to align its interests with equity investors versus to give the decision maker exposure to the entity for its own proprietary risk taking).

Investment managers are required to make decisions in the best interests of the investors of the entity. This obligation arises in the context of the investment manager’s fiduciary obligation, which is generally defined as a “duty to act for someone else’s benefit, while subordinating one’s personal interests to that of the other person. It is the highest standard of duty implied by law (e.g., trustee, guardian).”2 This fiduciary duty is not affected by the existence of an investment in the entity by the investment manager, regardless of the size its investment. Allowing its equity investment in the entity to alter its investment decisions violates fiduciary law. Laws and regulations are devised to mitigate any apparent conflicts of interest, including conflicts which may arise as a result of holding investments in the entity. We agree that the level of equity interest should be considered for purposes of determining control; however, we disagree that a certain level of ownership should be determinative in the context of the principal versus agent analysis.

Exception of the Consolidation Requirements for Money Market Funds

Given the purpose and design of money market funds, the regulatory requirements to which they are subject, and their fundamental role in the financial markets, where they are relied upon not only by consumers but also by corporate treasurers, financial firms, governmental bodies and other institutional users, we agree with the Board’s intent that the application of the proposed guidance should not result in money market funds being consolidation by their investment manager. Further, we do not believe that consolidation of money market funds by an investment manager is the accounting result that financial statement users desire.

To ensure that the Board’s intent is realized, we recommend that a reporting entity’s interest in an entity that complies with or operates in accordance with requirements that are similar to those included in Rule 2a-7 of the Investment Company Act of 1940 for registered money market funds be explicitly scoped out of the Proposed ASU. We believe that providing such an exemption would be consistent with the position taken by the Board in ASU 2010-10, in which it acknowledged that “the Statement 167 amendments to the Topic 810 consolidation requirements should not result in investment managers having to consolidate money market funds that are required to comply with the Act.”3 The Board also acknowledged in ASU 2010-10 “that the deferral should not be limited to registered money market funds that are required to

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3 Paragraph BC16 of ASU 2010-10
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comply with the Act, but that it should also apply to all funds that operate in a manner similar to registered money market funds that are required to apply the Act.4

Further, given the ongoing deliberations by regulators of the design and operation of money market funds, the Board should consider the potential structural changes to the money market fund type in evaluating whether it should give a blanket scope exception to money market funds. If it is the Board’s intent to not consolidate these fund types, then a blanket scope exception would prevent future consolidation as a result of potential regulatory changes to their structure.

**Kick-Out and Participating Rights**

We agree that substantive kick-out rights and participating rights held by multiple unrelated parties should be considered when evaluating whether a reporting entity should consolidate another entity. Whether these rights are held by a single party or multiple unrelated parties, they should be considered in the principal-versus-agent analysis when they are deemed substantive. The number and/or dispersion of unrelated parties that collectively need to exercise these rights should be considered in the evaluation of whether the rights are substantive. However, once the rights are deemed substantive, they should be determinative in concluding the decision maker is using its power as an agent.

We have noted disparity between the guidance in paragraph 810-10-25-41D and the Board’s view, as noted in the basis for conclusions paragraph BC18, that “kick-out and participation rights should affect only the consolidation analysis when there is a realistic possibility that the other interest holders may exercise those rights.” We believe the likelihood that either kick-out or participating rights will be exercised is irrelevant to determining whether the rights themselves are substantive, consistent with the guidance in paragraph 810-10-25-41D that states “the likelihood that the participating rights will be exercised by the interest holder shall not be considered when assessing whether a participating right is substantive.” We encourage the Board to amend the basis for conclusion provided to allow for consistent application of the fact that probability of exercise is not relevant for determining if kick-out or participating rights are substantive. Furthermore, we believe that these rights are not regularly exercised due to their substance because their existence incents the behavior of the decision maker to prevent the exercise of such rights.

Furthermore, we recommend the Board reconsider its position that redemption rights would not be considered in the principal-versus-agent analysis. The basis for conclusions paragraph BC21 states that “while redemption rights do not provide an investor with the power to remove a decision maker, investors could theoretically withdraw 100 percent of an entity’s capital (assuming there are no restrictions in place) and effectively “kick out” the decision maker. While this scenario may be rare in circumstances with many investors, it might be plausible for an entity that has few investors and, thus, could be seen as increasing the possibility that a decision maker is not a principal in those situations.” We do not believe that this scenario is “rare,” but believe that it is encountered in practice often enough with institutional investors for it to be addressed in the proposed guidance. In fact, it is common for investment funds to

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4 Paragraph BC17 of ASU 2010-10
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liquidate due to the magnitude of redemptions since it becomes increasingly more difficult for an investment manager to obtain additional investors for the entity and it may become more difficult to effectively manage the entity due to lack of appropriate scale. As a result, in some cases, a redemption right can be in substance, the same as a liquidation right.

Under current consolidation guidance for limited partnerships, the general partner is presumed to control the limited partnership, regardless of the extent of its ownership. This presumption is overcome if the limited partners hold substantive removal or participating rights. If the presumption of control by the general partner was overcome, a limited partner would only consolidate the limited partnership if it could unilaterally control the entity. We encourage the Board to provide guidance that clarifies when an investor in a limited partnership (or similar entity), who is unrelated to the decision maker acting in an agent capacity, would be deemed principal, and therefore consolidated the entity.

For example, when analyzing the limited partnership investment company structure under the proposed guidance, the general partner often will be considered an agent. Limited partners in such investment companies often have no substantive rights and are limited in their decisions to those that pertain only to their own partnership interest. However, because in a typical fund the level of equity is considered sufficient, there are no single investors that constitute substantially all of the capital, and the decision maker is determined to be an agent, the fund would not be a variable interest entity and would be determined to be a voting interest entity. In such situations, it is unclear how a limited partner, given its lack of explicit rights, would evaluate its interest to determine whether to consolidate the limited partnership.

**Interests Held by Related Parties**

We believe that a decision maker should include all direct and indirect interests held in an entity through its related parties to prevent misuse or abuse of the consolidation accounting standards in its principal versus agent analysis. We understand the Board’s concern that decision makers could structure entities through their indirect interests in an effort to avoid consolidation and achieve an outcome that would result in dilutive financial statements.

We are concerned with the guidance for evaluating a decision maker’s indirect interest held by employees and employee benefit plans. Paragraph 810-10-25-42 states “...if an employee of the decisions maker is a related party and owns an interest in the entity being evaluated and that employee’s interest has been financed by the decision maker, the decision maker shall include its indirect interest in the evaluation.” We believe the Board’s proposed guidance is unclear, and suggest that the Board clarify what constitutes an “employee’s interests financed by the decision maker”. In addition, there is no reference to treatment of interests held by employee benefit plans. We believe that there are legitimate reasons when an employee benefit plan, such as a participant-directed 401(k) plan, of the decision maker invests in an entity sponsored by a related party. We suggest that the Board retain the proposed deleted exclusions in paragraph 810-10-55-37A subparagraphs a and b, which specifically excludes from a related party an employee and employee benefit plan of the decision maker, except if they are used in an effort to circumvent the provisions of the proposed principal versus agent guidance.
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When evaluating related parties under ASC 850, certain employees of an investment manager meet the related-party definition, including owners or partial owners and management of the entity. Employees of investment managers often invest at their own discretion using their funds (i.e., not deferred compensation) and at their own risk in investment management products managed by their firm. These discretionary investments may be made in pre-tax retirement products, such as participant-directed 401(k) plans, certain vested deferred compensation plans and taxable products such as registered investment funds. In these situations, the firm has no economic exposure to the employee investments, and vice versa, and we believe these employee investments should not be included in the indirect interests of the decision maker.

Application to Investments by One Investment Company in another Investment Company

If the guidance in the FASB’s proposal for investment companies\(^5\) is finalized in its current form, an investment company will be required to consolidate another investment company if it holds a controlling financial interest. As discussed in our comment letter on that proposal, investment companies often do not invest in another investment company in order to control them. Instead, they seek an efficient mechanism to gain exposure to expertise within a specific sector or asset class or as a mechanism to efficiently develop an asset allocation strategy. As such, we believe that in most instances consolidation of one investment company by another would not be appropriate and would not provide financial statement users with meaningful information. We believe that the Board should provide additional implementation guidance to address situations in which an investment company would consolidate another investment company and how a controlling financial interest is evaluated for an investment company, as we believe investment companies generally do not exhibit “controlling” financial interests in other investment companies. This will be particularly necessary if the Board’s proposal for investment companies is finalized in its current form.

Fees Paid to Decision Makers

We believe that the principal-versus-agent analysis should replace the current guidance for evaluating whether a decision-making arrangement is a variable interest\(^6\). A decision maker must evaluate whether it is using its power as a principal or an agent after evaluating qualitative factors. Accordingly, then requiring an assessment of a decision maker’s remuneration as a variable interest seems redundant.

\(^5\) Proposed Accounting Standards Update, Financial Services – Investment Companies (Topic 946): Amendments to the Scope, Measurement, and Disclosure Requirements

\(^6\) In accordance with paragraph 810-10-55-37 (formerly paragraph B22 of FIN 46(R), Consolidation of Variable Interest Entities)
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We appreciate your consideration of our points described above prior to the issuance of a final standard, and we welcome the opportunity to discuss them with you.

Sincerely,

[Signature]

James J. Malerba  
*Executive Vice President and Corporate Controller*