February 14, 2012

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

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

Dear Technical Director:

On behalf of the Securities Industry and Financial Markets Association Asset Management Group (the “AMG”) Accounting Committee, we appreciate the opportunity to provide comments on the Financial Accounting Standard Board’s (“FASB” or the “Board”) Proposed Accounting Standards Update (“ASU”) Financial Services – Investment Companies (Topic 946): Amendments to the Scope, Measurement, and Disclosure Requirements (the “Exposure Draft”).

The AMG’s members represent U.S. asset management firms whose combined assets under management exceed $20 trillion. The AMG Accounting Committee includes many of the industry’s major independent asset management firms along with banks and insurance companies with significant asset management businesses. The individuals who serve on the AMG Accounting Committee are senior accounting policy professionals at their respective firms.

The AMG Accounting Committee strongly supports continuation of specialized fair value accounting for investment companies. Overall, we believe the current guidance that exists in ASC 946, Financial Services – Investment Companies (“Topic 946”) has appropriately identified entities that are investment companies, however, we do not object to the FASB issuing clarifying guidance relating to what criteria are required to be an investment company. We will focus our discussion on two areas that we find concerning: first, the rules-based requirement that an entity must meet all of the criteria to qualify as an investment company. We will focus our discussion on two areas that we find concerning: first, the rules-based requirement that an entity must meet all of the criteria to qualify as an investment company and second, the requirement that investment companies consolidate other investment companies in which they have a controlling financial interest.

In addition, we believe there should only be one standard that defines what an investment company is and that single standard should apply irrespective of the type of investments (e.g. property, securities, etc.) it holds.

As discussed in our responses to the Board’s specific questions below, there are several proposals in the Exposure Draft that we do not agree with, and we have proposed alternative approaches in certain cases. We hope the Board finds our comments helpful as it continues to redeliberate the proposed guidance.
**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?

Overall, subject to our comments in this letter, we agree that the six criteria outlined in paragraph 946-10-15-2 of the Exposure Draft generally are relevant criteria to be considered in determining whether or not an entity qualifies as an investment company. However, we do not agree on an approach that mandates satisfaction of all six criteria for entities, such as certain single investor funds, to qualify for investment company accounting. Rather, we propose a qualitative approach, where each of the six indicative criteria would be contemplated in the analysis to conclude whether or not an entity meets the broad definition of an investment company (based on its nature, purpose and design).

As discussed in our response to Question 7, we believe that the Board should eliminate the amendment to the existing paragraph 946-10-15-2 “pooling-of-funds” criterion that requires investors that are “not related to the parent.” We also suggest that the Board state in the “nature of investment activities” criterion that an investment company’s only substantive activities are investing in at least one entity for returns from capital appreciation or investment income and those substantive activities are not designed for strategic business operating purposes (e.g. a research and development investment vehicle).

The combination of moving to a qualitative approach for the six criteria with the modification of two of the six criteria described herein (i.e. nature of investment activities and pooling of funds) could alleviate the Board’s concerns expressed in paragraphs, BC 15, BC 16 and BC 24, while establishing a principles-based approach for determining whether an entity qualifies as an investment company.

Lastly, we think the Board should consider providing greater clarity as to which entities are, or are not, investment companies, as some of the AMG members manage entities that do not currently prepare financial statements as investment companies and the users of those statements find that appropriate. We believe that the criterion on “fair value management” could be refined to consider the nature, purpose and design of the vehicle, and whether such entity is intended to be managed at estimated fair value for NAV purposes or managed at amortized cost for the purpose of collecting contractual cash flows.

**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.

There are several types of entities that are investment companies under U.S. regulatory requirements which may not meet all of the criteria proposed under paragraph 946-10-15-2. We discuss two types of those investment companies, single investor funds and single investment funds in our response to Question 7. In this response, we will address seed funds, money market funds and common (collective) trust funds.

**Seed Funds** - Investment managers often are the sole investor in a fund regulated under the Investment Company Act of 1940 for a period of time to establish a track record for the fund before actively marketing the fund. It is unclear how the exception to the pooling-of-funds criterion in paragraph 946-10-55-13(a) and (b) should be applied. For example, for exception a, we are unclear whether the investment period to establish a track record is part of the “initial offering period.” We are also unclear for exception (b), whether this time period would be part of “actively identifying suitable investors.” Depending on how
these factors are interpreted, a fund regulated under the Investment Company Act of 1940 might not attain investment company status. In addition, we are concerned that the lack of clarity could result in inconsistent application of these exceptions upon adoption.

*Money Market Funds* - We agree with the FASB’s conclusion in paragraphs BC 28 and BC 29 that money market funds should continue to meet the investment company definition. Therefore, we recommend that the Board consider adding these clarifications to the authoritative guidance rather than leaving them within the Basis for Conclusions which is not codified.

*Common (Collective) Trust Funds* - Although, perhaps not contemplated by this Question 2, the Board should consider the “U.S. regulatory requirements” of the Office of the Comptroller of the Currency (OCC), of the U.S. Treasury Department. Any bank that sponsors “common (collective) trust funds” (see kinds of investment companies in ASC 946-10-05-3) is required to conform to OCC Regulation 9 which provides guidelines on what such fund can/should do (e.g. valuation, audits, reporting, etc.). Such "common (collective) trust funds" may have “single investor” trust relationships like those described in Question 1 above, and therefore may not meet all of the proposed criteria to be an investment 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?

We believe that creating a new entity type with criteria similar to those of an investment company as outlined in the proposed ED Topic 973 is overly complicated and will not provide useful information for financial statement users. We encourage the Board to combine the models and include the concept of investment property entities in the investment company framework proposed. Please refer to our comment letter on ED Topic 973 for further details on our views.

**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?

As we discussed in our response to Question 1, we believe that the Board should begin the investment company principle with a qualitative approach for evaluating each of the six criteria. We also suggested that the Board state in the nature of investment activities criterion that an investment company’s activities not be designed for strategic business operations purposes. Paragraph 946-10-55-7 is consistent with our suggested modification of the criterion. We believe that the heading to paragraph 946-10-55-7 should be changed from “Returns” to “Investing for Strategic Business Operations Purposes” as the six examples (a-f) are indicators of investing for those purposes. Additionally, we believe the paragraph under the heading should be edited 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 strategic benefits from its investments other than capital appreciation or investment income....."
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?

We do not support the proposed amendment to require an entity to have investors unrelated to the entity’s parent (if there is a parent). We believe that the Board should eliminate the amendment to the existing paragraph 946-10-15-2 pooling-of-funds criterion that requires multiple unrelated investors and that a robust nature of investment activities criterion would prevent non-investment companies, such as research and development companies, from qualifying as investment companies. As discussed below, we believe it should be acceptable to have entities with a single investor and/or a single investment. Further, we believe that the Board should clarify that employees would only be viewed as related parties when their interest is “financed by the entity” or has recourse to the parent.

Single investor investment companies have substantially the same or identical “nature of investment activities” as those of multiple investor investment companies; the elimination of the amendment to the existing paragraph 946-10-15-2 pooling-of-funds criterion would ensure consistent preparation of financial statements in accordance with investment company accounting among similar entities with a similar “express business purpose.”

Single investor funds - The Exposure Draft indicates that single investor funds, such as sovereign wealth funds, pension funds and other institutional single investor funds, would not meet the investment company definition due to the pooling-of-funds criterion. Frequently a non-corporate entity (e.g., a sovereign wealth fund, a pension plan, endowments and foundations or others commonly referred to as institutional investors) selects a fund manager to obtain market exposure to new and/or unique market indices or sectors. The fund manager will design investment products and/or strategies at the investor’s request to meet their specialized investment goals. In some cases, the fund manager will set up a single client fund for specific investor-mandated restrictions. In other cases, investment companies are set up if the fund manager believes the particular investment strategy would appeal to other investors. Accordingly, the investor may be the first and only investor in an investment company for a period of several years if the fund manager does not obtain additional investors in the entity. In the above cases, we believe that investment company accounting is still appropriate assuming the other investment criteria are met.

Single investment funds - It is also common for investors to participate in an investment company which has a single investment. We believe that these entities should be classified as investment companies, provided that they meet a weighting of the other criteria of an investment company. These single investment funds are established to provide investors access to professional investment management and the opportunity to participate in the returns of the underlying investment and are not established for other strategic operating purposes such as a research and development vehicle.

We believe that the investors who invest in single investor or single investment funds require financial statement disclosures consistent with investment company guidance even if the entity did not meet the pooling of funds criterion. These disclosures greatly benefit the users of the financial statements as they enable the user to identify the performance of their investment under the most important accounting and financial reporting requirements of Topic 946.

Employees - When evaluating related parties under ASC 850, Related Party Disclosures (“Topic 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 and at their own risk in investment management products managed by their firm. These discretionary investments may be made in retirement pre-tax 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.

When determining whether an employee is a related party, we recommend that the Board align the treatment of investments by employees in the Exposure Draft with the guidance set forth in the FASB’s Proposed Accounting Standards Update, Consolidation (Topic 810): Principal versus Agent Analysis (“ED Topic 810”).

In paragraph 810-10-25-42 of ED Topic 810, the “Effect of Related Parties,” the Board stipulates that when evaluating whether a decision maker entity is a principal or an agent, if an employee of the decision 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 the employee’s interest in the evaluation. To ensure consistency with the Exposure Draft, we suggest that the Board include that same related party criterion set forth in ED Topic 810, with further clarity on the term “financed by the decision maker” whereby only those related party interests that result in recourse to the entity’s parent or sponsor would be considered in the parent/sponsor’s analysis.

**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.

We do not agree with the requirement that the ownership interests held by investors in an investment company should be exclusively in the form of equity. We believe that the relevant factor to consider is whether the units issued by the entity represent a specifically identifiable portion of the net assets of the entity. If the Board requires that it be equity in legal form, this gives rise to an unnecessary level of complexity in evaluating whether the ownership interests satisfy the U.S. GAAP definition of “equity at risk” in accordance with the provisions of ASC Topic 810, Consolidation (“Topic 810”) or whether the legal-form equity is required to be classified as debt in accordance with the provisions of ASC Topic 480, Distinguishing Liabilities from Equity (“Topic 480”). For example, a fund might provide investors with principal protection which would not qualify it as equity at risk pursuant to paragraph 810-10-15-14. We also note there are certain jurisdictions where issuing ownership interests as legal form debt provides tax advantages to a fund. We suggest the following amendments to the ED in 946-10-15-2:

“b. Unit ownership. Each unit of ownership in the investment company represents a specifically identifiable portion of the net assets of the investment company, although each unit of ownership does not have to represent a proportionate interest in all of the underlying investments of the investment company.”

**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?

We believe that the pooling-of-funds criterion should eliminate the amendment to paragraph 946-10-15-2 as we suggested in our response to Question 7. Additionally, we would support applying the exemption from the pooling-of-funds criterion granted to parents of investment property entities. Paragraph BC28 of the Exposure Draft for Topic 973 states that allowing a subsidiary to measure its investment properties at fair value would facilitate the parent entity’s fair value reporting in its financial statements. This provision should equally apply to entities like pension funds and sovereign wealth funds and other entities where the “single investor” is the sole investor in an investment company. The users of these financial statements are interested in the performance of their investments, and thus investment company accounting best represents the financial reporting needs of the users.

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.

We do not believe it is appropriate for an investment company to consolidate a fund-of-funds or other entity that represents an investment, a security, or holding – rather these holdings should be accounted for at fair value which is typically the pro rata portion of the reported net assets of the investee funds. However, there are circumstances where investment companies should consolidate controlled entities. As an example, we believe that an investment company should consolidate structural holding companies that are operationally integral to the investment company’s express business purpose like: a Cayman Island organized commodity holding company established for IRS tax purposes.

We believe that consolidated financial statements of investments, securities or holdings do not provide useful information for investment company investors. We believe that investment company investors are most concerned with the fair value of their fund’s investments, which directly drive the fund’s net asset value and the investor’s ownership interest and investment performance. Therefore, we believe an investment company should not consolidate another investment company when it holds a controlling financial interest and should measure investments in such entities at fair value with changes recognized in earnings.

In addition, we suggest the Board consider the existing US GAAP disclosure requirements for separate disclosure of investments in securities or holdings (including fund-of-funds) that exceed 5% of total net assets. Further, consideration could be given to industry practice that has evolved in US GAAP today for 1940 Act funds, which is when an investment exceeds 25% of the investing funds net assets, and the investment is not registered, the investing fund typically includes the most recent publicly available full set financial statements for investments in securities or holdings (including fund-of-funds) – it should be noted that the availability of such unregistered financial statements may be challenging to preparers, particularly for unaffiliated and/or private issuers. The Board could determine whether any such requirements are sufficient to meet its goals around providing transparency of investments.
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?

For the reasons discussed in our response to Question 12, we similarly disagree with the Board’s proposal to require an investment company to consolidate a controlling interest in an investment property entity.

We believe that consolidation of an investment property entity in the financial statements of an investment company would add unnecessary, and arguably confusing, information to the presentation and would not be cost beneficial. We believe that an investment in “real estate” is simply an asset allocation within the investment fund and the information required should be the same for all investments, regardless of the nature of the underlying investment.

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?

We support the proposed requirement to prohibit the use of equity method accounting for interests in other investment companies. We believe that fair value is the most relevant measure for these investments given the nature of an investment company’s activities is to invest in these entities for capital appreciation and investment income.

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?

We agree that amounts attributable to the noncontrolling interests should be excluded from the calculation of financial highlights. This should be done in order to ensure the financial highlights present meaningful information to investors.

We believe that the exclusion from the financial highlights exemplifies why consolidating investments in other entities does not provide meaningful information to investors. These noncontrolling interests should be excluded from the financial highlights as they generally have no relationship to the investment company’s interest in investees. Accordingly, these noncontrolling interests should not be included within the investment company’s balance sheet or income statement.

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?

We support the view that a parent of an investment company should retain the specialized accounting of an investment company subsidiary in consolidation. We agree with the Board’s view that, as long as
specialized industry accounting principles are appropriately applied at the subsidiary level, those principles should be retained at the parent level. Consolidation by a parent does not change the substance of the investment company’s activities or the relevance of reporting its inventory at fair value.

**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?

Generally, we do not believe that it will be practicable for an entity that no longer meets the criteria to be an investment company to 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. As such, we believe entities will apply the proposed amendments as of the beginning of the period of adoption.

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

We believe the Proposed Update should be effective at the beginning of the first calendar year at least one year after the standard has been issued. We believe implementing the proposed amendments will take at least 12 to 18 months depending upon the nature and complexity of investment company products offered by the organization. We believe this time period would include identification and review of the amended investment criteria for each investment company product offered and the related implementation, including addressing financial reporting for entities that no longer qualify as investment companies and financial reporting for fund-of-funds now deemed to have a controlling financial interest in investee funds.

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

We support an option for early adoption for those entities that wish to do so where management believes that providing the information 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?

The proposed amendments should apply equally to both public and nonpublic entities. We believe that the proposed amendments would be most impactful to existing investment companies that are not regulated under the Investment Company Act of 1940. These "non-registered" entities are generally deemed to be nonpublic entities. We believe U.S. GAAP should be consistent between public and nonpublic entities to better allow for comparability between entities. Investors are often comparing investment options that include both public and nonpublic investment companies.
The AMG Accounting Committee would be pleased to discuss our response with the FASB staff. If you have any questions, please contact me at (617) 664-8213.

Sincerely,

Sean P. Newth
Chairman
SIFMA Asset Management Group Accounting Committee

cc: Michael Stewart, Director of Implementation Activities, International Accounting Standards Board
cc: Timothy W. Cameron, Esq., Managing Director, SIFMA Asset Management Group
cc: Mary Kay Scucci, PhD., CPA, Managing Director, U.S. Business Policy and Practices
cc: SIFMA Asset Management Group Accounting Committee