

Setting the global standard for investment professionals

2 November 2009

Mr. Robert Herz
Chair, Financial Accounting Standards Board
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06865-5116

Re: Follow up to Meeting with Board 16 October: Consolidation Policy for Investment Companies and Investment Managers

Dear Bob,

The CFA Corporate Disclosure Policy Council (CDPC)¹, appreciated the opportunity to meet with the Board and its staff on 16 October to exchange views on current financial reporting issues.

As part of the discussion of the consolidation project, we informed the Board that we intended to submit a supplementary comment letter to the IASB regarding ED 10. Specifically we planned to urge the IASB (and the FASB) to scope out investment companies from the proposed consolidation requirements. That letter was transmitted to both Boards on 22 October.

As part of that discussion, several FASB members raised the issue of whether investment managers that are deemed to control investees should be required to consolidate those entities. We said that we had not discussed that issue but would transmit our views to the Board as soon as possible. This letter is intended to respond to that question.

Our starting point is our view (which we believe the Board shares) that the objective of financial reporting is to provide information that is useful to present and potential investors, creditors, and other capital market participants in making rational investment, credit, and similar resource allocation decisions. For investment companies, we believe that reporting all of their assets and liabilities at fair value (with transparent reporting of fees and expenses) meets that objective. Consolidation of investees (whose assets and liabilities may be mostly measured at historic cost) would obscure the value of the investment company's investments and make it impossible for investors to evaluate performance.

¹ The objective of the CDPC is to foster the integrity of financial markets through its efforts to address issues affecting the quality of financial reporting and disclosure worldwide. The CDPC is comprised of investment professionals with extensive expertise and experience in the global capital markets, some of whom are also CFA Institute member volunteers. In this capacity, the CDPC provides the practitioners' perspective in the promotion of high-quality financial reporting and disclosures that meet the needs of investors.

The objective of investors in investment companies is to earn a return on their investment. Investors bear all of the upside and downside risk of the investments² and are interested in knowing the investments held by the company and the change in fair value of those investments over time. Net asset value, the change in net asset value (often in comparison with a benchmark), and fee structures are the primary metrics that shareholders use to evaluate the performance of investment companies and to make buy and sell decisions.

When an investment company bears direct or indirect³ (i.e., regardless of the structure and/or nature of the obligation) legal and/or economic responsibility (as general partner or guarantor, for example) for some or all of the liabilities of an investee, then supplementary disclosures should be required to inform shareholders of the additional risk.

Turning to investment managers, they obtain their revenues by charging investment management fees (which may include performance fees) to the funds (investment companies) under their management. They may also have ownership interests in those funds and, in some cases, may co-invest with those funds. We believe that reporting those investments at fair value is most informative to their shareholders.

There are some exceptions to that general rule:

1. When the investment manager guarantees, (explicitly or implicitly) the return to shareholders of the investment company, then the shareholders of the investment company no longer bear the predominant shares of the risk of the underlying investments. In such cases we believe that consolidation by the investment manager is the appropriate accounting model.
2. When the investment manager provides financing to the investee, guarantees (explicitly or implicitly) significant liabilities of the investee, or has legal responsibility (as general partner, for example) for the liabilities of the investment company or an investee, then consolidation by the investment manager is the appropriate accounting model.
3. When an investment company or investee has unusually high financial leverage that may suggest an implicit debt guarantee (because of reputational risk, for example) by the investment manager, requiring consolidation.

In conclusion, we do not support any change to FAS 167 except for its scope as it applies to investment companies.

If you, other Board members or your staff have questions or seek further elaboration of our views, please contact Sandra Peters, CFA, by phone at +1.212.754.8350, or by e-mail at sandra.peters@cfainstitute.org.

² We do not believe that customary performance fees preclude that treatment.

³ We use “indirect and economic” in the same sense as the revised FIN 46 (R).



Sincerely,

/s/ Gerald I. White

Gerald I. White, CFA
Chair, Corporate Disclosure Policy Council

cc: Corporate Disclosure Policy Council