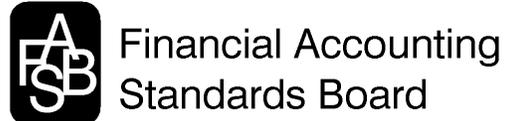


MINUTES



To: Board Members

From: Consolidations Team: Farber (ext.282),
Handy (ext. 466), Andrews (ext.354),
Raichilson (ext. 443)

Subject: Minutes of the November 22
Roundtable on the IASB Consolidations Staff Draft **Date:** January 4, 2011

cc: Mechanick, Bielstein, Chookaszian, Posta, Klimek, Gabriel, Lott,
Donoghue, Glotzer, Farber, Catalano

Topic: Consolidations: Policy and Procedures – Voting Interest
Entities

Basis for Discussion: Agenda

Length of Discussion: 12:00 p.m. to 3:00 p.m.

Attendance:

Board members present: Golden, Linsmeier (via phone), Seidman, Siegel,
Smith

Board members absent: None

IASB Board Members: Scott (via video)

Staff in charge of topic: Farber, Handy

Other staff at Board table: Stoklosa (via phone), Raichilson

IASB Staff: Teixeira, Buchanan (via video), Streckenbach (via
video)

Outside participants: See Participant Listing

Summary of Decisions Reached

The FASB held this public roundtable discussion with constituents to discuss the IASB staff draft on consolidations. No decisions were reached during this discussion.

Objective of the Meeting

The objective of this meeting was to provide information to help the Board determine how to proceed with the consolidations project. This particular meeting focused on the views of users, preparers and practitioners of asset-management companies regarding the agent/principal guidance included in the IASB staff draft.

Matters Discussed

Agent versus Principal Analysis

Users of Asset Manager Financial Statements

1. The one user participant described information that he utilizes when assessing asset managers. This participant stated that his focus is on an investment manager's ability to grow the assets under management, the types of products the manager manages, and the fees the asset manager is generating relative to the assets under management. The user noted that asset managers generally provide information regarding assets under management in quarterly or monthly financial statements. Performance information also may be obtained from third party providers, such as Morningstar. This participant noted that enhanced granularity regarding the nature of the assets under management and the revenues earned on the assets under management would be useful, but sympathized with the potentially over-burdensome amount of disclosures this could result in for large asset managers.

Qualitative Analysis

2. Overall, participants were more supportive of the qualitative assessment contained in the IASB staff draft, compared to the analysis required in the FASB *Accounting Standards Codification*TM Variable Interest Entities Subsection of Subtopic 810-10, Consolidations-General.¹ Participants representing the asset management

¹Originally issued as FASB Statement No. 167, *Amendments to FASB Interpretation No. 46(R)*.

industry, in particular, believe a principles-based qualitative approach is appropriate due to the complexity and uniqueness of asset structures within the industry. Specifically, this type of qualitative model allows for consideration of the different types of fee arrangements, the different types of interests that asset managers hold in particular funds, portfolio restrictions, etc. when evaluating these features and determining their purpose within particular structures.

3. Although participants agreed with the factors set out in paragraph B55 of the staff draft (factors used to identify an agency relationship) many requested additional guidance regarding the application of different weightings to each of these factors. Paragraph B56 of the staff draft states that, with the exception of a single party holding substantive rights to remove the decision maker, the conclusion of whether a decision maker is an agent requires an evaluation of all of the factors listed in paragraph B55. However, depending on the particular situation, some of the factors may be a stronger indicator of an agency relationship than others. As a consequence, different weight should be applied to each of the factors on the basis of particular facts and circumstances.
4. Participants believe more guidance would be valuable, particularly given that a qualitative approach is different from the approach currently in U.S. GAAP. Several participants noted the need for illustrative examples to assist with consistent application of the model, similar to the examples in paragraph 21 of Agenda Paper 8C from the March 2010 joint Board meeting. One participant also commented that, in the absence of guidance on weighting these factors, it may be possible for entities to manipulate these factors in order to achieve a desired consolidation conclusion.
5. Several participants also noted that the staff draft is unclear as to how preparers would navigate through the guidance in the staff draft when performing their consolidation analysis. Specifically, some participants believe that the staff draft is unclear as to whether a decision maker would first determine whether it is an agent or a principal, or whether it has power over the relevant activities. Some participants suggested that the agent/principal analysis should be considered prior

to the overall consolidation analysis, while other participants questioned whether both of these evaluations should be performed simultaneously. Another participant questioned how the agent/principal guidance fits conceptually with the overall consolidations model and questioned whether specific agent/principal guidance is necessary or whether a decision maker's general assessment of its "power," "returns," and "ability to exercise power to affect returns" (i.e. the control criteria) would yield appropriate consolidation conclusions.

Scope of Decision-Making Authority

6. The staff draft requires a decision maker to evaluate its decision making authority by considering the range of activities it is permitted to direct according to the decision making agreement (including those specified by law), and the discretion it has when making decisions about those activities. All participants agreed that the range of decision-making activity should be considered when determining if a decision maker is an agent. However, participants noted that additional guidance is needed in this area for several reasons.
7. Although the staff draft states that the decisions specified by law should be taken into account, it is not clear how to weight the decision-making authority when it is restricted by law or regulation. One participant identified a situation where there are no ongoing decision-making activities for the fund and the asset manager was involved only in originating the fund (that is, selecting the assets, determining founding documents, etc.). They questioned how the fact that the decision maker was involved only in setting up the fund should be taken into consideration. The participant stated that the treatment of restricted activities in such situations was unclear.
8. Similarly, there were differing views on how a decision maker of a fund registered under the Investment Company Act of 1940 (1940 Act) should be evaluated. Some participants believe that decision makers for 1940 Act funds should automatically be deemed agents due to the significant restrictions on the decision makers' authority in directing the activities of the fund and the strict requirements specified by the 1940 Act. These participants stated that if the significant

restrictions imposed on decision makers by the 1940 Act are ignored within this evaluation, the guidance would be inherently communicating that the 1940 Act requirements are unnecessary and ineffective at protecting investors' rights. On the other hand, several other participants stated that whether a fund is a registered 1940 Act fund should not determine whether the decision maker is an agent or a principal. These participants believe that all funds should be evaluated on the same basis.

9. Several participants reiterated that more guidance surrounding the purpose and design of the entity would be helpful when evaluating this criterion. They stated that, in addition to the range of activities, the level of fiduciary responsibility of the decision maker, its involvement with the Board of Directors, and the entire governance structure should be taken into account.

Rights Held by Other Parties

10. Participants agreed that substantive removal rights held by a single party would be determinative that the decision maker is an agent. This is consistent with the evaluation of removal rights in the Variable Interest Entities Subsections of Subtopic 810-10. Similarly, participants agreed that substantive removal rights held by multiple parties should be considered in the analysis. One participant noted he believes the consideration of kick out rights held by multiple parties is consistent with the concept of effective control. That is, both a voting interest entity and a fund with kick-out rights held by multiple parties would consider whether the respective rights held by other parties provide the ability for those parties to collaborate and exercise those rights.
11. Participants noted that the approach in the staff draft for evaluating removal rights is different than both of the models in Topic 810 (that is, the model for evaluating removal rights for Voting Interest Entities (formerly ETIF 04-5, *Determining Whether a General Partner, or the General Partners as a Group, Controls a Limited Partnership or Similar Entity When the Limited Partners Have Certain Rights*) and Variable Interest Entities (formerly FASB Statement No. 167,

Amendments to FASB Interpretation No. 46(R)), and additional illustrative examples would be needed to reach appropriate and consistent conclusions.

12. Participants held differing views regarding whether removal rights held by multiple parties should be determinative that a decision maker is an agent, rather than merely being a factor in the evaluation. Several participants stated that substantive removal rights should always be determinative, regardless of whether they are held by a single party or multiple parties. These participants explained that, within the asset management industry, removal rights are granted to multiple parties in response to investors' demands or regulatory requirements, rather than for accounting arbitrage purposes. They argued that the lack of significant precedence in the industry for exercising removal rights should not be viewed as evidence that the rights are not substantive. Additionally, one participant equated the evaluation of removal rights to the evaluation of voting rights. That is, if investors have the right and ability to remove the decision maker (or vote, in the case of the control model), those rights should be determinative.
13. Other participants agree with the staff draft that removal rights should not be determinative when held by more than a single party, but should be a factor in the overall principal agent analysis. These participants noted that removal rights should be weighted differently, depending on the number of parties holding those rights (agreeing with the guidance in paragraph B57 of the staff draft, which states "...if a small number of parties hold substantive rights to remove a decision-maker, that factor would receive a greater weighting ... than if a large number of parties hold such rights"). However, participants agreed that illustrative examples should be included to help preparers with the evaluation.
14. Several participants also noted the need for additional guidance surrounding liquidation and redemption rights. Specifically, participants stated that it is unclear when such rights should be equated to removal rights. One participant questioned whether such redemption or withdrawal rights would be akin to removal rights, would hold more weight than removal rights, or how these rights otherwise should be evaluated in situations in which investors could easily 'vote with their feet.'

15. Lastly, many participants requested guidance on how to evaluate removal rights held by an entity's board of directors. Specifically, constituents referred to the evaluation of removal rights held by a board of directors established in accordance with the requirements in the 1940 Act. Participants noted that, typically, no single investor controls the board of directors' decisions, and the rights delegated to the board of directors and the investors can differ significantly between different types of funds. Participants suggested removal rights held by an entity's board of directors could be a strong indicator that the decision maker is an agent, especially if the board of directors is independent from the asset manager.

Remuneration

16. Participants agree with the staff draft that a decision maker's exposure to the economic performance of another entity should be considered when determining whether a reporting entity is acting as an agent or a principal. In addition, there was support for separating the evaluation of economic performance into two factors: one focusing on remuneration (which has only positive returns) and another focusing on other interests (which can have both positive and negative returns or negative returns only).
17. Participants believe that when evaluating the factors related to the decision maker's returns, exposure to variability in returns through other interests (which includes negative returns) should have a stronger weight than the decision-maker's fee structure. A number of participants noted that investment managers receive fees that are market based and include market-related terms only. Accordingly, they believe that the purpose and the design of the fee, including if it is market based, should be evaluated as opposed to engaging in a purely quantitative analysis relying on thresholds to determine whether fees are indicative of an agent or principal relationship.
18. Participants noted many variables taken into consideration when negotiating a decision maker's fee. For example, one participant noted a common fee arrangement where an asset manager receives a subordinated fee with a target rate of return. This participant stated that while he believes this arrangement is market

based and indicative of an agency relationship, Statement 167 would often deem that entity to not be an agent because of the fee's subordination. Another participant noted that fee structures are often tailored to align an asset manager's interest with those of the investors' and, therefore, are highly dependent on the nature of the assets under management. Likewise, standards should be principles-based in order to accommodate management fee structures for future products that are currently not in existence. Another participant noted that the market would require an asset manager to adjust its fee for its level of experience. Participants noted that regardless of the purpose of the fee's structure, if it is market based, the evaluation regarding the economics should focus on whether the entity has exposure to negative returns.

Other Interests

19. Participants were concerned that the staff draft does not provide guidance as to the level of economic exposure that would result in consolidation. They believe that, unless additional guidance is provided, constituents will not consistently interpret how much exposure is required in order to reach a consolidation conclusion. When asked what level of economic exposure should be required, participants agreed that it is difficult to establish a specific level of exposure that should result in consolidation, as the level could vary depending on the type or nature of the fund. Indeed, when asked, participants did not support specifying a particular 'bright-line' threshold. A number of participants believe that providing examples in this area (including traditional asset manager arrangements) is necessary, in order to avoid practice issues similar to those that developed subsequent to the issuance of Statement 167.
20. The participants also agree with the staff draft that when a decision maker's other interests are subordinate to interests held by other parties, and the decision maker's interest absorbs a greater level of the entity's variability, this would lead to a conclusion that the decision maker is acting as a principal. One participant noted that he applies this concept to interests that are both on and off the balance sheet. For example, downside exposure from derivatives, such as written puts, is

combined with other direct interests in order to make the determination of whether the manager is an agent or a principal. While this participant noted that he would be the principal of the individual derivative, the derivative is only one factor included in the overall assessment of whether total interests held indicates a principal relationship. Alternatively, if the decision maker's interests are pari passu with the interests held by other parties and those other parties take the majority of the risk of the asset class, it is less likely that the decision maker is managing for reasons other than to receive a return that is aligned with other investors. One participant noted that certain subordinated interests may be pari passu with other subordinated interests in that tranche and that this should be less indicative of a principal relationship than having sole ownership of all subordinated interests.

21. However, some participants did not believe that other interests in the form of a guarantee (that may expose the decision maker up to a specified amount) should be considered in the same way as a subordinated investment that also provides protection to other interest holders. They thought that a guarantee (that is, an obligation to fund losses that could result in potential cash outflows) was different from a subordinated investment because the subordinated investment may have more upside than the guarantee. One participant noted, however, that guarantees might only apply to a small range of potential losses, rendering the guarantee insignificant when compared to the expected returns of the entire fund. Others thought guarantees and subordinated interests should be treated in a similar way because, in both cases, the reporting entity is exposed to the performance of the entity and may lose assets that belong to the reporting entity (either in the form of cash outlays from written guarantees or the loss of subordinated financial instruments).
22. As noted above, the participants believe that examples illustrating how other interests would factor into the consolidation conclusion are required in order to ensure consistent application.

Other Items

23. One participant suggested including, as one of the factors for determining whether a decision maker is a principal or an agent, whether the fund being evaluated qualifies as an investment company. In situations in which the entity being evaluated by the decision maker qualifies as an investment company, the decision maker would be more likely considered an agent, while another participant believes this would determine that the entity is an agent.

Related Party Guidance

24. Participants also noted that they agree with the treatment in the staff draft of interests held by related parties of the decision maker. One participant illustrated an example where a general partner manages multiple funds, including Fund A, and the other funds under management have an interest in Fund A. FAS 167's related party guidance might deem the other funds to be related parties of the general partner. As a result, the general partner could be required to consolidate Fund A while not consolidating the other funds. This participant does not agree with this conclusion and believes the staff draft's related party guidance, which requires the interests of related parties under common control be considered together with the reporting entity, would lead to a more appropriate conclusion.
25. One participant recommended including guidance regarding whether an entity's pension plan would be considered a related party under the guidance in the staff draft and whether an employee benefit plan would be included as interest held in an entity.

Continuous Reassessment

26. Finally, the participants agreed with the requirement to continuously reassess whether the decision maker is acting as an agent or a principal. However, some participants believe guidance should be provided addressing whether changes in the economic factors should result in a different consolidation conclusion. These participants noted that the difficulty of including market factors in a continuous reassessment is determining whether the changes are short term or permanent. One

participant noted that market factors should not be included in the continuous reassessment because of the potential for frequent deconsolidation and consolidation. This participant believes the model should only incorporate changes in the elements of control in the reassessment. One participant noted that the effective control model incorporates market factors and actions or inactions of others within the factors for control. Therefore, this issue concerns the effective control model in the context of a continuous reassessment as opposed to a continuous reassessment in isolation.

Effective Control

27. One of the participants stated his support for a contractual rights model that relies on legally enforceable arrangements, including arrangements other than voting rights, in a reporting entity's assessment of control. This participant noted that this would often result in the same consolidation conclusions of the effective control model that is incorporated within the staff draft. In essence, one of the fact patterns participants disagree with is a scenario in which a reporting entity holding a less than 50% voting interest with no other contractual rights is determined to have control. Another fact pattern participants are in general disagreement with is where a reporting entity has out-of-the-money options that are currently exercisable, and whether this should indicate control.
28. Participants discussed the implications of the staff draft on private company constituents and noted that many private companies are more closely held than public companies. This would indicate that it is less likely for voters to remain passive, decreasing the likelihood of a reporting entity controlling an entity with less than 50% of the voting interest.