

February 15, 2012

Technical Director File Reference No. 2011-220 Financial Accounting Standards Board 401 Merritt 7 PO Box 5116 Norwalk, CT 06856-5116

PricewaterhouseCoopers LLP appreciates the opportunity to comment on the FASB's Proposed Accounting Standards Update, *Consolidation (Topic 810) - Principal versus Agent Analysis* (the "Proposal").

We support the FASB and IASB's (the "Boards") efforts to develop an approach for assessing whether a decision maker is using its decision-making authority in a principal or an agent capacity. However, consolidation is only one of two important elements needed to achieve convergence in the recognition of financial assets and liabilities by financial entities. Our preference is for the Boards to work together to reach a converged solution for all aspects of recognition, including considering their respective guidance for derecognition of financial instruments. If the FASB were to adopt the guidance in this Proposal, it would move the consolidation model for many financial entities under U.S. GAAP closer to IFRS 10, *Consolidated Financial Statements*. However, this would not achieve convergence, and therefore would not result in consistency and comparability between entities that report under U.S. GAAP and those that report under IFRS, particularly securitization entities, unless the Boards also adopt a converged derecognition model.

We believe that the Boards intend for this Proposal and IFRS 10 to generally result in consistent consolidation conclusions for similar structures under IFRS and U.S. GAAP, an objective that we wholeheartedly support. However, we are concerned that while the guidance may be similar, interpretations already appear to be diverging on some fundamental matters. For example, published IASB staff views on the application of IFRS 10 to certain structures appear to contradict previous interpretations under U.S. GAAP for similar fact patterns. We encourage the FASB staff and IASB staff to work together to ensure that they have a consistent understanding of how their respective guidance should be applied in certain fact patterns and identify any unintended consequences of their interpretations. This will further educate constituents and promote consistent application of the guidance globally.

We broadly support an assessment of whether a decision maker can use its decision-making authority in a principal or an agent capacity based on the factors articulated in the Proposal. We agree that when a company acts in an agent capacity for other investors, consolidation would negatively impact the ability of financial statement users to understand the company's compensation for serving as a decision maker and distinguish between the company's operating assets and liabilities and those of the consolidated entity. We believe that a factors-based analysis is superior to the current list of required criteria contained in the U.S. GAAP consolidation guidance for variable interest entities. A factors-based analysis allows for more judgment to be exercised, which better enables the economic substance of these relationships to be reported. We also agree that an agent may be remunerated and could invest in a way that aligns its interests with those of other interest holders.



However, we offer a number of recommendations to improve the Proposal. These are summarized as follows and are discussed in more detail in the paragraphs that follow in this cover letter:

- Kick-out rights that are determined to be substantive should be determinative of an agent relationship even if more than one party would need to act to remove the decision maker. The analysis of whether kick-out rights are substantive should consider, among other factors, how widely dispersed those rights are among unrelated investors. The greater the number of parties that would need to act, the less likely that the rights would be substantive.
- Additional clarity should be provided on how to weigh the economic factors in the principal versus
  agent analysis. Four specific factors are listed for consideration in assessing other interests of the
  decision maker. However, limited guidance is provided on when a particular factor should receive
  greater or less weighting in the analysis. The examples contained in the Proposal do not clearly
  articulate how each of these factors has been considered and weighted in reaching the conclusions.
  Without further clarity, diversity is likely to occur in practice.
- Money market funds should not be consolidated by the advisor that manages them. While we have provided a suggestion in the appendix to this letter on how money market funds would not be consolidated by making changes within the overall consolidation model, we believe that it would be challenging to limit the effects of those changes to these funds and not cause unintended consequences for other entities. Therefore, we would also be supportive of an outright exception for these entities on the basis that consolidation would not provide the most decision useful information for financial statement users.
- The reassessment of whether a decision maker is acting in a principal or an agent capacity should be performed when there has been a change in one of the factors in the principal versus agent analysis that could trigger a different conclusion. We are concerned that the proposal to only reassess when the purpose and design of the entity changes will not result in reconsideration even when a substantive change has occurred.

## Substantive kick-out rights should be determinative

We agree that the ability of others to remove the reporting entity from its capacity as a decision maker indicates that the reporting entity is in an agency relationship rather than a control relationship when those removal rights are substantive. However, we believe that substantive kick-out rights should be determinative in and of themselves, even when more than one party would need to act to remove the decision maker. In our view, this is conceptually more consistent with a consolidation approach where a party with decision-making authority does not have control unless that authority can be exercised unilaterally. The possibility of substantive kick-out rights being exercised affects the actions of a decision maker even if those rights are seldom exercised. Similarly, the ability of others to participate in or veto the key decisions should also be determinative when that ability is substantive. This would appear to be more akin to the shared power concept contained in the variable interest entities consolidation model than unilateral power.

The analysis of whether kick-out and participating rights are substantive requires additional rigor under our preferred approach. This assessment of substance would consider whether the rights granted are part of the purpose and design of the entity and if there are any barriers to exercising those rights. Thus, while we agree with the FASB that the number of unrelated parties that would need to act to exercise those rights is important to the analysis, we believe that this should be considered in determining whether the rights are substantive. That is, the greater the number of parties that would need to act, the less likely that the rights would be substantive. In addition, consideration should be given to the holders of those rights and whether



their interest in the entity is significant to them, considering their own individual circumstances, and proportionate to the rights they hold.

### Weighing the factors in the principal versus agent analysis — further clarity is needed

Our preliminary discussions with some preparers yielded significant variations in conclusions for similar fact patterns under the Proposal given the broad parameters within which judgments need to be exercised under the factors-based principal versus agent analysis. The Proposal lists four individual factors for consideration when assessing the decision maker's other interests in the entity, namely its aggregate economic exposure to the entity, whether it is exposed to more variability than other investors, whether it is exposed only to positive returns or both positive and negative returns, and its maximum exposure to losses of the entity. However, limited guidance is provided on when a particular factor should receive greater or less weighting in the analysis. In reviewing the examples in the Proposal, it appears that greater emphasis was placed on certain factors in certain structures while in other structures other factors are weighed more heavily. The rationale for these different weightings is not always apparent. Consequently, we are concerned that the Proposal may not achieve the desired objective of consistency and comparability in the accounting for these relationships. We recommend that the FASB clarify how the economic factors should be weighed in similar broad fact patterns in order to encourage consistency in application of this guidance.

### Money market funds should not be consolidated

We agree with the FASB's stated intention in the Questions for Respondents section of the Proposal that money market funds should not be consolidated by the investment advisor on the basis that it would not represent an improvement to financial reporting given the unique nature and business purpose of these entities. Consolidation would negatively impact the ability of financial statement users to understand the advisor's compensation, and to distinguish between the advisor's operating assets and liabilities and those of the consolidated money market funds. However, it is difficult to reconcile that conclusion with the guidance and examples in the Proposal. The examples suggest that a decision maker's implied financial responsibility, due to reputational risk concerns, to ensure the entity operates as designed would weigh very heavily in the principal versus agent analysis and would likely lead one to conclude that the decision maker is using its decision-making authority in a principal capacity. While we have provided a suggestion in the appendix to this letter on how money market funds would not be consolidated by making changes within the overall consolidation model, we believe that it would be challenging to limit the effects of those changes to these funds and not cause unintended consequences for other entities. Therefore, we would also support an outright exception for money market funds, which we believe may be the simpler and more effective approach to achieve the intended outcome.

## Reassessment of principal versus agent guidance should occur when a factor changes

We acknowledge that an ongoing reassessment of the principal versus agent guidance may be challenging to perform for a large number of entities. However, we question whether reassessing only when the purpose and design of the entity changes is too high a trigger for reassessment. We suggest that the reassessment requirement focus on whether there has been a change in one of the factors in the principal versus agent analysis that could trigger a different conclusion. For example, this could include a situation where a decision maker's other interests change due to its own actions, such as by acquiring additional equity ownership. Actions by unrelated investors would generally not affect the manner in which a decision maker is using its decision-making authority unless they have a significant impact on the decision maker's economic interest, such as due to large redemptions or issuances.



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We have answered the specific questions raised in the Questions for Respondents section of the Proposal in the appendix to this letter. If you have any questions regarding our comments, please contact Paul R. Kepple at (973) 236 5293, John Bishop at (973) 236 4420, or Annette P. Spicker at (973) 236 4088.

Sincerely,

Pricewaterhouse Coopers LIP

PricewaterhouseCoopers LLP



### Appendix - Responses to Questions for Respondents contained in the Proposal

Question 1: When determining whether a decision maker is a principal or an agent, the proposed amendments require the analysis to consider the decision maker's overall relationship with the entity and the other parties involved with the entity. This analysis would be based on a qualitative assessment. Do you agree with this approach? If not, why?

We agree that the purpose and design of the entity should be considered, including the decision maker's overall relationship with the entity and other parties. However, we believe that further guidance is needed on the manner in which this assessment is reflected in weighting the individual factors in the principal versus agent analysis. See our response to Question 3. In addition, while we acknowledge that the assessment is broadly qualitative in terms of determining the weight assigned to the various factors, the Proposal does retain a number of quantitative considerations, such as the continued focus on expected losses. We believe that the FASB should clarify that many of the factors may require quantitative analysis, particularly in situations where the outcome is less certain.

Question 2: 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 interests that it holds in the entity.

Are the proposed factors for assessing whether a decision maker is a principal or an agent appropriate and operational? If not, why? Are there any other factors that the Board should consider including in this analysis?

We agree that these factors are the appropriate considerations in the analysis. A factors-based analysis allows for more judgment to be exercised, which better enables the economic substance of these relationships to be reported. We agree that an agent may be remunerated in a way that aligns its interests with those of other interest holders. Recent experience has shown that certain regulators and other constituents believe that a decision maker should be required to hold an economic interest in some types of entities in order give them an incentive to act in the best interests of investors.

We also agree that the ability of others to remove the reporting entity from its capacity as a decision maker indicates an agency relationship, not a control relationship, when those removal rights are substantive. However, we believe that substantive kick-out rights should be determinative in and of themselves, even when more than one party would need to act to remove the decision maker. In our view, this is conceptually more consistent with a consolidation approach where a party with decision-making authority does not have control unless that authority can be exercised unilaterally. The possibility of substantive kick-out rights being exercised affects the actions of a decision maker even if those rights are seldom exercised. Similarly, the ability of others to participate in or veto the key decisions should also be determinative when they are substantive. This would appear to be more akin to the shared power concept contained in the variable interest entities consolidation model than unilateral power.



On the specific factors, we believe that additional clarification would be helpful as discussed below.

### Rights held by others:

- An assessment of whether rights are substantive should consider whether those rights are granted as part of the purpose and design of the entity and if there are any barriers to exercising those rights. We agree that the number of unrelated parties that would need to act to exercise those rights is important to assessing the substance of those rights, and that generally the greater the number of parties that need to act the less likely the rights would be substantive. In addition, consideration should be given to the holders of those rights and whether their interest in the entity is significant to their own individual circumstances. For example, the magnitude of a holder's economic interest in relation to the entity may be less relevant because they are less likely to take an active interest in the decision maker's performance unless they have economic exposure that is significant to them.
- It is unclear to us what criteria should be applied in determining whether a board of directors or equivalent would be considered substantive and a mechanism for the purpose of exercising removal rights. In the one example that includes a substantive board, reference is made to the board conducting certain activities beyond its ability to exercise removal rights on behalf of investors, but it is unclear whether these other activities are necessary in order for the board to be considered substantive. It would also be helpful to include in the codification updates the guidance that is contained in paragraph BC 24 noting that the board's authority and composition needs to be assessed.
- It is not apparent to us why the role of the board of directors is only discussed in the variable interest entity subtopic. The concept of a board of directors or equivalent could equally apply in partnerships that are voting interest entities and subject to the same principal and agent analysis as variable interest entities.

## Compensation of the decision maker:

We understand that in certain performance-based fee arrangements, a catch-up period exists when
returns exceed a predetermined level that causes the decision maker to receive more than its
proportional share of returns for a period. We do not believe that the FASB intends for these types of
arrangements to preclude an agent conclusion (despite the fact that the decision maker could absorb
more variability than other investors in a given period) and recommend that the FASB address this in
the guidance.

## Other interests:

- We recommend that the FASB clarify how the four factors for consideration should be weighted in similar broad fact patterns in order to encourage consistency in the application of this guidance. See our response to Question 3.
- It is unclear to us how economic interests, including compensation of the decision maker, should be assessed in the aggregate given that the Proposal requires fees to be considered differently than other direct interests. Specifically, the Proposal calls for exposure to positive and negative returns to be viewed differently than exposure to only positive returns. Therefore, we recommend that the FASB clarify how this assessment should be performed.
- While the guidance calls for a consideration of whether the decision maker is exposed to more variability than other investors (has a plurality of the variability), the examples do not appear entirely



consistent with this concept. For example, in the CDO example (Case E) the one other investor that holds the majority of the equity appears to be exposed to more variability than the decision maker who holds a significantly smaller portion of the equity interest. The example appears to make reference only to the fact that the decision maker has more variability than the more senior interest holders and does not address the one other equity investor. It is therefore unclear if this consideration of variability is conducted relative to all other investors as a group, to each of the other individual investors, or to only holders of more senior interests.

• Certain examples seem to focus on whether the decision maker's other interests are disproportionate versus other investors but the guidance calls for one to focus on whether the decision maker is exposed to more variability. Whether a return is disproportionate could be interpreted differently than having exposure to more variability than other investors. For example, some could suggest that holding a portion of every tranche would cause one to not be disproportionate to the investors as a whole. We recommend that consistent terms be used throughout the guidance if that is the intent.

It is unclear how to weigh the decision maker's economics versus the rights held by other parties under the Proposal, and what the Boards intend in applying the guidance in the examples to broader fact patterns. Some may look to the examples as providing the outside parameters for the conclusions reached. Yet others could argue that the kick-out rights held by a small number of parties would nearly always receive greater weight than the decision maker's level of economics. It is also unclear how to think about rights held by others when they are held by tranches of instruments that differ from that held by the decision maker. As further discussed in our response to Question 2, we believe that substantive rights should be determinative in the analysis. We also recommend that the FASB clarify the outside parameters within which judgments need to be exercised in order to encourage consistent application.

Question 3: The proposed Update would require judgment in determining how to weigh each factor in the overall principal versus agent analysis. Do you agree that the proposed amendments, including the related implementation guidance and illustrative examples, will result in consistent conclusions? If not, what changes do you recommend?

We are concerned that the Proposal may not achieve the desired objective of consistency and comparability in the accounting for these relationships. The Proposal lists four individual factors for consideration when assessing the decision maker's other interests in the entity, namely its aggregate economic exposure to the entity, whether it is exposed to more variability than other investors, whether it is exposed only to positive returns or both positive and negative returns, and its maximum exposure to losses of the entity. However, the guidance is not clear on how to weight the individual factors or what circumstances would cause one factor to receive more weight than another would. The examples provide some insight into the Board's intent where greater emphasis is placed on certain factors in certain structures while in other structures other factors are emphasized. The rationale for these different weightings is not always apparent. We recommend that the FASB clarify how the economic factors should be weighted in similar broad fact patterns in order to encourage consistency in the application of this guidance.

# For example:

• In the CDO example (Case E), despite the residual interest only constituting four percent of the overall capitalization of the entity, the manager that holds thirty-five percent of the residual (1.4 percent of overall capitalization) is deemed to be the principal. The analysis suggests that the decision maker's thirty-five percent is disproportionate versus the more senior interests and its maximum exposure to loss is considered on the basis that it absorbs first dollar risk of loss. In the commercial mortgage-backed securitization example (Example 5, Case A), the decision maker holds all of the equity, which



constitutes only six percent of the overall capitalization. The conclusions in these examples appear to place the greatest weighting on whether the decision maker has more variability than other investors do and seem to ignore the limited downside risk or the fact that one other investor in the CDO example holds sixty-five percent of the residual. The downside risk in these examples could be considerably less than in Cases A, C, and D where the focus seems to be on the aggregate interests and downside exposure.

• In several examples, the focus of the conclusion shifts to maximum exposure to loss due to the existence of a guarantee or credit enhancement, or implicit financial responsibility by the decision maker to ensure the entity operates as designed. Those examples entail a commercial paper conduit (Case F), a structured investment vehicle (Example 5, Case C), a guaranteed mortgage-backed securitization (Example 5, Case E), a property lease entity (Example 5, Case G), and a furniture manufacturer (Example 5, Case I). It appears from the examples that a significant maximum exposure to loss — without considering probability — always trumps the other factors in the analysis. This heavier weighting on maximum exposure to loss is not evident in the guidance section of the Proposal, which appears to suggest that it is just one of the factors for consideration in the analysis.

These examples seem to suggest that the Board is more focused on whether the decision maker is exposed to significant variability as it relates to expected losses (rather than residual returns) where there is any tranching of issued securities or other forms of credit enhancement. If that is the intent, it would be helpful to clarify that in the guidance in order to give constituents a frame of reference for weighting the economic factors. As previously noted, we recommend that the FASB clarify how the economic factors should be weighted in similar broad fact patterns in order to promote consistency in the application of this guidance.

Another case in point that is more difficult to reconcile is the potential inconsistency between the examples in the Proposal and application of the guidance to money market funds such that the manager would not consolidate these funds as suggested in Question 10. In particular the existence of implied financial responsibility to ensure that the entity operates as designed in the structured investment vehicle example (Example 5, Case C) would seem equally applicable in many money market fund situations. We are concerned that the Board could not achieve such an outcome (i.e., non-consolidation) for money market funds within this consolidation framework. See our response to Question 10 for our recommendations to address these funds.

Question 4: Should substantive kick-out and participating rights held by multiple unrelated parties be considered when evaluating whether a reporting entity should consolidate another entity? If so, do you agree that when those rights are held by multiple unrelated parties, they should not in and of themselves be determinative? If not, why? Are the guidance and implementation examples illustrating how a reporting entity should consider rights held by multiple unrelated parties in its analysis sufficiently clear and operational?

Yes, we believe that substantive kick-out and participating rights held by multiple unrelated parties should be considered in the evaluation of whether a decision maker is acting as an agent. However, we believe that when they are substantive, they should be determinative of an agency relationship. Removal rights are important and many investment managers today would consider the existence of removal rights when assessing whether they control funds that they manage. The ability of others to remove the manager from its capacity as a service provider/decision maker indicates an agency relationship rather than a control relationship when those removal rights are substantive.

As discussed in our response to Question 2, an assessment of whether rights are substantive should consider whether those rights are part of the purpose and design of the entity and if there are any barriers to



exercising those rights. Thus, while we agree with the FASB that the number of unrelated parties that would need to act to exercise those rights is important to the analysis, we believe that this should be considered in determining whether the rights are substantive. That is, the greater the number of parties that would need to act, the less likely that the rights would be substantive. In addition, consideration should be given to the holders of those rights and whether their interest in the entity is significant to their own individual circumstances. For example, the magnitude of a holder's economic interest in relation to the entity may be less relevant because they are less likely to take an active interest in the decision maker's performance unless they have economic exposure that is significant to them.

Question 5: The proposed Update would not include a criterion focusing on the level of seniority of a decision maker's fees when evaluating the decision maker's capacity. Do you agree that the seniority of the fee relative to the entity's other operating liabilities that arise in the normal course of the entity's activities should not be solely determinative of a decision maker's capacity? If not, why?

Yes, we agree that the level of seniority of a decision maker's fees should not be determinative in the analysis. However, in considering all other interests held by the decision maker in the aggregate, the level of seniority is relevant since it could in effect be providing credit enhancement to the entity and impact the level of exposure to variability.

Question 6: The evaluation of a decision maker's capacity places more emphasis on the decision maker's exposure to negative returns (for example, an equity interest or a guarantee) than interests that only expose the decision maker to positive returns. When performing the principal versus agent analysis, should the assessment differentiate between interests that expose a decision maker to negative returns (or both negative and positive returns) from interests that expose the decision maker only to positive returns? If not, why?

We agree that more emphasis should generally be placed on exposure to negative returns (downside risk) than only positive returns. However, as discussed in our response to Question 3, we have noted examples where this does not seem to be consistently applied in the model. Furthermore, we also believe that a decision maker's exposure to both positive and negative returns through holding direct interests can better align the decision maker's interest with other investors in a manner that makes them likely to be a better agent for those investors. When a decision maker holds a direct investment in the entity because of regulatory or legislative requirements (e.g., securitization risk retention requirements under Dodd-Frank Act), we believe that is less indicative of a principal relationship.

Question 7: A reporting entity would be required to evaluate whether there has been a change in the decision maker's capacity by considering whether there has been a change in the purpose and design of the entity. For example, the purpose and design of the entity may change if the entity issues additional equity investment that is at risk to the decision maker. Do you agree with this proposed requirement? If not, please specify when this relationship should be reassessed and why.

We question whether reassessing only when the purpose and design of the entity changes is too high a trigger for reassessment. Rather, we suggest that the reassessment requirement focus on whether there has been a change in one of the factors in the principal versus agent analysis that could trigger a different conclusion. For example, this could include a situation where a decision maker's other interests change due to its own actions, such as by acquiring additional equity ownership. Actions by unrelated investors would generally not affect the manner in which a decision maker is using its decision-making authority unless they have a significant impact on the decision maker's economic interest, such as due to large redemptions or issuances. This would also seem more consistent with the IFRS 10 approach.



Question 8: The Board decided to include the principal versus agent assessment as a separate analysis within the overall consolidation assessment, rather than replacing the current guidance for evaluating whether a decision-making arrangement is a variable interest (and accordingly, a principal) with the revised principal versus agent analysis. The Board believes that if an entity's fee arrangement does not meet the definition of a variable interest (for example, a nominal performance-based fee), the decision maker should not be required to continue the consolidation assessment. Do you agree? If not, why?

We agree that if a decision maker's fee does not represent a variable interest, then it should not need to perform the variable interest entity assessment. While some of the criteria appear duplicative when compared with the principal versus agent analysis, retaining this guidance may provide some relief for preparers from performing the potentially more complex principal versus agent analysis in situations where they do not have significant economic exposure to the entity. In addition, this guidance is also helpful for establishing the applicability of the disclosure requirements for variable interest entities.

Question 9: The Board expects the proposed principal versus agent guidance may affect the consolidation conclusions for entities that are consolidated as a result of the decision maker having a subordinated fee arrangement (for example, collateralized debt obligations). However, the Board does not otherwise expect the proposed amendments to significantly affect the consolidation conclusions for securitization entities, asset-backed financing entities, and entities formerly classified as qualifying special-purpose entities. Do you agree? If not, why?

It is unclear to us whether the Board also intends to increase the acceptable level of economics that a decision maker can have in an entity while still being considered an agent. Application of current guidance for assessing whether a decision maker's fee represents a variable interest has resulted in a benchmark in practice for what is generally considered to be a significant interest, resulting in a "principal" conclusion. The examples in the Proposal could be inferred to suggest a higher level of economics would not preclude an agent conclusion depending on the nature of the entity.

We are also unclear if the Board intends on changing practice with the proposed changes to the primary beneficiary criterion to require consideration of whether a reporting entity could have an obligation to absorb losses or right to receive benefits of the variable interest entity. In particular, removing the reference to "could potentially be significant," that was interpreted in practice to mean irrespective of probability, may lead some to view this criterion to now require a consideration of probability. While the principal versus agent analysis does require a probability-weighted consideration of economic exposure, it also requires probability to be ignored when thinking about maximum exposure to loss. However, there is no similar requirement to consider maximum exposure to benefits irrespective of probability. This change could therefore impact previous consolidation conclusions, albeit in limited circumstances.

In addition, while the primary beneficiary examples have been updated for the principal versus agent analysis and reflect no changes in the overall consolidation conclusion, we note that this requires greater weight to be placed on certain of the factors. As discussed in our response to Question 3, we believe that further guidance is needed to help constituents understand when to place greater or less weight on individual factors.

Finally, the Proposal makes some changes to the guidance in ASC 810 as it relates to kick-out and participating rights that could cause a change in practice. In particular:

• The proposed changes to the consideration of non controlling rights in ASC 810-10-25-11 through 14 would apply to all entities, not only to variable interest entities. This guidance is often utilized for voting interest entities. The Proposal would delete the guidance in ASC 810-10-25-11 defining two



specific participating rights as being substantive, namely (1) selecting, terminating, and setting compensation of management and (2) establishing operating and capital decisions, including budgets. Some could interpret this to mean that these two rights may no longer always be substantive.

• The previous guidance in ASC 810-20-25 would be removed by the Proposal. While the Proposal retains much of this guidance for assessing whether there are barriers to the exercise of kick-out rights, other aspects of this subtopic would be removed entirely. For example, there would no longer be a reference to requiring removal by only a simple majority of unrelated holders in order to be substantive. Some could interpret this as allowing rights that require more than a simple majority of the vote (e.g., a super-majority vote) to be substantive.

We recommend that the FASB clarify whether such changes and the potential implications were intended in the proposed updates.

Question 10: Update 2010-10 was issued to address concerns that some believe that the consolidation requirements resulting from Statement 167 would have required certain funds (for example, money market funds that are required to comply with or operate in accordance with requirements that are similar to those included in Rule 2a-7 of the Investment Company Act of 1940) to be consolidated by their investment managers. The amendments in this proposed Update would rescind the indefinite deferral in Update 2010-10 and would require money market funds to be evaluated for consolidation under the revised guidance. The Board does not intend the application of the proposed Update to result in money market funds being consolidated. Do you agree that the application of the proposed Update will meet this objective? If not, why and what amendments would you recommend to address this issue?

We agree with the FASB's stated intention that money market funds should not be consolidated by the investment advisor on the basis that it would not represent an improvement to financial reporting given the unique nature and business purpose of these entities. Consolidation would negatively impact the ability of financial statement users to understand the advisor's compensation, and to distinguish between the advisor's operating assets and liabilities and those of the consolidated money market funds. However, it is difficult to reconcile that with the guidance and examples contained in the Proposal. The Proposal does not address whether managers of money market funds would have an implied financial responsibility to ensure the funds operate as designed so as not to "break the buck." The structured investment vehicle (Example 5, Case C) and commercial paper conduit (Case F) examples in the Proposal include implied variable interests with fact patterns that may be considered similar to many money market fund situations where the manager has "reputational risk" and wants to ensure the entity is "operating as designed." The examples suggest that a decision maker's implied financial responsibility to ensure the entity operates as designed due to reputational risk concerns would weigh very heavily in the principal versus agent analysis and would likely lead one to conclude that the decision maker is using its decision-making authority in a principal capacity.

One possible approach to dealing with this would be to place increased emphasis on the purpose and design of the entity in the principal versus agent analysis. This would require the purpose and design of the entity to be a separate and distinct factor in that analysis. That would be more consistent with IFRS 10, which already recognizes a similar fourth factor. Money market funds that are registered under the Investment Company Act of 1940 are designed to operate within tightly defined parameters and are subject to rigorous oversight by an independent board of directors that can remove the advisor without cause. The decision-making ability of the advisor is significantly limited by these parameters. For example, there are limits on the types and term to maturity of investments that the fund can hold. An independent board of directors that is actively involved in the oversight of the advisor is a strong indicator of an agency relationship and is not simply a mechanism for the exercise of kick-out rights.



The purpose of the investment limitations and governance structure in a registered money market fund is to minimize investors' exposure to risk. While neither eliminates the risk that the fund may experience a loss, they indicate that the purpose and design of the fund is to limit the risk of a loss of principal on investments. Therefore, under this approach, the greatest weight would be placed on the purpose and design of the money market fund in the principal versus agent analysis, rather than emphasizing economics where the maximum exposure to loss ignores the probability of financial support being provided. We acknowledge that this approach carries the risk that some may seek to analogize other types of structures to these funds more broadly than the FASB intends. Consequently, sufficient guidance would be necessary to prevent this factor from being over-emphasized where inappropriate.

A simpler and more effective approach may be for the FASB to provide an outright exception for money market funds. It would be important to define the scope exception appropriately. One approach would be to define it in a manner consistent with ASU 2010-10, *Consolidation (Topic 810) Amendments for Certain Investment Funds*, as follows: "a reporting entity's interest in an entity that is required to comply with or operate in accordance with the requirements that are similar to those included in Rule 2a-7 of the Investment Company Act of 1940 for registered money market funds." That scope specification is already well understood and applied in practice.

Question 11: For purposes of applying the proposed principal versus agent guidance, the proposed amendments would require a reporting entity to include the decision maker's direct and indirect interests held in an entity through its related parties. Do you agree with the requirement that a decision maker should include its proportionate indirect interest held through its related parties for purposes of applying the principal versus agent analysis? Why or why not?

We agree. This approach for the principal versus agent assessment relative to a decision maker would be an improvement over the current guidance requiring all related party interests to be considered as if they are held by the reporting entity directly. In particular it appears to better reflect the relationship between the reporting entity, its related party, and the entity. However, we are concerned that economic interests held by an entity under common control would not be captured in the consideration of a decision maker's direct and indirect interests. As a result, a group would appear to be able to achieve a non-consolidation outcome by directing any significant economic interests in the entity to be held by companies within the group that are not themselves under the direct or indirect control of the decision maker. The related party group assessment would consider these interests but only with respect to variable interest entities. We recommend that such interests also be considered in the principal versus agent analysis for determining if the entity is a variable interest entity and also in the partnership model.

In addition, no guidance is provided on how to consider related parties for the purposes of assessing whether the related party group is acting in a principal or an agent capacity, and is therefore the primary beneficiary. It is therefore unclear when the related party tiebreaker provisions would apply. The previous guidance referencing the need to consider all interests held by related parties as its own would be deleted entirely in the Proposal. Based on the flowchart contained in the Proposal, we believe that the Board intends for the related party group to be analyzed in situations where a party within that group has power over the variable interest entity but concludes that it is acting as an agent on a standalone basis. When all interests held by the related party group are considered and the group as a whole is deemed to be a principal, then the related party tiebreaker would be applied to determine who within the group is the primary beneficiary. If that is the Board's intent, we recommend that it clarify how all related party and de facto agents' interests should be considered for the purposes of assessing whether the group is the primary beneficiary where no party is deemed the primary beneficiary on a standalone basis.



Question 12: The amendments in this proposed Update would require a general partner to evaluate its relationship with a limited partnership (or similar entity) by applying the same principal versus agent analysis required for evaluating variable interest entities to determine whether it controls the limited partnership. Do you agree that the evaluation of whether a general partner should consolidate a partnership should be based on whether the general partner is using its decision-making authority as a principal or an agent?

Yes, we agree that the approach for partnerships should be broadly consistent irrespective of whether they are voting or variable interest entities.

Question 13: Do you agree with the proposed transition requirements in paragraph 810-10-65-4? If not, how would you propose to amend those requirements, and why? Please provide an estimate of how long it would reasonably take to implement the proposed requirements.

While we generally agree with the proposed transition requirements, we question the decision not to provide a practicability exception where a reporting entity deconsolidates an entity on adoption of this guidance. We foresee instances where it could be equally challenging for the reporting entity to establish the carrying amount of the retained interests, particularly where the equity method of accounting would now be applied.

We have also heard concerns from preparers about potential effective dates for the proposal. We therefore encourage the FASB to obtain input from preparers on the amount of time and effort that would be required, and the potential operational challenges to implement these requirements, before establishing an effective date for the final standard.

# Question 14: Should early adoption be permitted? If not, why?

Yes, reporting entities should be able to early adopt the Proposal as this will enable them to apply a consistent consolidation approach for all their entities, including those that previously qualified under the FAS 167 deferral. We recommend that the Board consider whether entities should be required to adopt the other consolidation related proposals (i.e., investment companies and investment property entities) at the same time.

Question 15: Should the amendments in this proposed Update be different for nonpublic entities (private companies or not-for-profit organizations)? If the amendments in this proposed Update should be applied differently to nonpublic entities, please provide a rationale for why.

No, we do not see a need to have different guidance for public and private entities. The benefit of eliminating the current deferral in order to enable all entities to be subject to the same consolidation guidance would be reduced if nonpublic entities were to be excluded.

## Other matters

### Control over a decision maker

The proposed principal versus agent guidance has been developed from the perspective of evaluating the capacity of a party that has decision-making authority. However, while paragraph BC 8 of the Basis for Conclusions notes that "the party or parties that actually control the entity should not avoid consolidating the entity by delegating its decision-making authority over that entity to another party," the proposed guidance does not explicitly address how control should be considered by a party that has delegated its



decision-making authority to an agent. We recommend that the FASB clarify in the guidance that consideration must also be given as to whether a party has control over the decision maker.

### Application to certain fund structures

As discussed in our comment letter on the FASB's Proposed Accounting Standards Update, *Financial Services - Investment Companies (Topic 946)*, we do not believe that an investment company should be required to consolidate another investment company unless it was formed in conjunction with the parent investment entity for specific regulatory, tax, legal, or other business reasons, such as financing. If the FASB continues to pursue such an approach, we believe that additional guidance is needed on how the consolidation guidance should be applied in fund-of-funds structures where the decision maker is acting in an agent capacity.

In addition, many investment companies registered under the Investment Company Act of 1940 organize their funds in a series structure, which raises questions as to whether these entities are variable interest entities and, if so, how the primary beneficiary analysis should be performed. Under this structure, a corporation or a trust is established with a board of directors or trustees for the purpose of holding assets through multiple investment companies (series funds) formed within that trust or corporation. The board of directors is elected by the shareholders of all of the series funds, and the board is responsible for overseeing the activities of each fund within that trust. As a result, the shareholders of an individual fund in the series are generally unable to elect the board members independent of the other series funds. However, the independent directors have authority over the most important activities of each of the funds and can remove the investment advisor without cause on a fund by fund basis. We recommend that the FASB clarify whether these types of structures should be considered variable interest entities and, if so, how the consolidation guidance should be applied.