

November 3, 2010

Technical Director
Financial Accounting Standards Board
401 Merritt 7
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Re: FASB Roundtable Meeting on Consolidations

PricewaterhouseCoopers appreciates the opportunity to comment on the proposed FASB Roundtable Meeting Agenda pertaining to the IASB Staff Draft, *IFRS X Consolidated Financial Statements* (the "Staff Draft").

In our comment letter to the FASB on its Proposed Statement of Financial Accounting Standards, *Amendments to FASB Interpretation No. 46(R)*, we expressed our preference for the FASB and IASB (the "Boards") to perform a comprehensive review of all consolidation and derecognition guidance and develop a single principles-based framework that can be consistently applied to all types of entities and transactions. We continue to believe that the consolidation guidance should not be reconsidered separately from a reconsideration of the derecognition guidance. Even if the FASB adopts a consolidation model that is more consistent with the model described in the Staff Draft, convergence, and therefore consistency and comparability, will not be achieved, particularly for securitization entities, unless a converged derecognition model is also adopted. Accordingly, we believe that the FASB should reconsider the consolidation guidance together with the derecognition guidance.

Our responses to the specific questions raised in the proposed agenda are provided in the attached appendix. These responses represent our preliminary thoughts and consequently our views may evolve as we continue to reflect on the Staff Draft. Our most significant observations concerning the Staff Draft are as follows:

- We agree that there may be limited circumstances in the U.S. reporting environment where one dominant shareholder may be deemed to control an entity based on holding significant non-majority voting rights with other holders of voting rights being widely dispersed. We believe that this concept should only be applied in situations where it is readily apparent that the reporting entity has the ability to exert control of the subject entity. We note that this concept already exists in IFRS and would not represent a significant change to IFRS users and preparers. Additionally, we believe it would represent a limited change to U.S. GAAP.
- We believe that potential voting rights should be considered as one of the factors in assessing the nature of the relationship between the reporting entity and the subject entity. Consolidation should only occur in situations where the existence of options and convertible instruments together with other factors provide the reporting entity with the current ability to control the subject entity. We have observed that applying this concept under IFRS has seldom by itself resulted in a conclusion that the holder controls the subject entity. We expect that it in the U.S. reporting environment it will be rare that potential voting rights would result in a reporting entity concluding that it has the current ability to exert control over the subject entity. As a result, we believe that



there would only be limited circumstances whereby consideration of potential voting rights would yield a different consolidation conclusion than is currently the case under U.S. GAAP.

We broadly support an assessment of whether a decision-maker is acting as an agent or as a
principal based on the factors articulated in the Staff Draft. However, our discussions with some
asset managers yielded significant variations in conclusions given the broad parameters within
which judgments need to be exercised. Consequently, we are concerned that the Staff Draft may
not achieve the desired objective of reducing diversity in practice and increasing the consistency
and comparability in the accounting for these relationships. Therefore, we recommend that the
Boards consider performing further outreach to assess whether the application of the guidance
may lead to a lack of comparability.

If you have any questions regarding our comments please contact Paul R. Kepple at (973) 236 5293 or Thomas Barbieri at (973) 236 7227.

Sincerely,

PricewaterhouseCoopers LLP

Pricewaterhouse Coopers L.I.P.



Appendix: Responses to the Questions Contained in the FASB Roundtable Meeting Agenda — Consolidations

1. The Staff Draft provides a single concept of control that is used to evaluate control on a consistent basis for all types of entities (both voting interest entities and variable interest entities).

Do you agree that a single-model approach to assess control will provide more consistent financial reporting for all types of entities rather than providing separate models for voting interest entities and variable interest entities? If not, why not?

Yes, we believe that a single definition of control based on a principles-based framework should provide more consistent consolidation conclusions in the financial reporting for all consolidating entities. However, those principles need to be sufficiently clear and robust in order to achieve broad consistency and comparability in the accounting for similar entities. We believe that the Staff Draft provides additional clarity regarding the current IFRS guidance and the proposals contained in ED 10.

However, the Staff Draft introduces a number of new concepts that have not been previously applied in the U.S. reporting environment. As currently drafted, these new concepts are likely to result in diversity in application and interpretation, which will negatively impact the level of comparability and consistency that currently exists between companies that report under U.S. GAAP. Therefore, as discussed in our responses to the questions that follow, we believe that further clarity is needed before these principles can be consistently applied in the U.S., particularly on how to evaluate effective control, potential voting rights, and different scenarios of economic interests under the new agency versus principal guidance.

2. The Staff Draft does not incorporate the U.S. GAAP concept of a variable interest entity or a structured entity. Rather, the Staff Draft provides that the way in which control is assessed will vary depending on how the activities that significantly affect the entities' returns are directed. For example, how control is assessed will depend on whether the decisions that significantly affect the returns of an entity are made through voting rights.

Without an explicit definition of a variable interest entity, do you believe that (ignoring the differences when analyzing decision making relationships and the effect related party arrangements have on the analysis) the Staff Draft will produce the same consolidation conclusions as the recently issued U.S. GAAP guidance for consolidating variable interest entities (FASB Accounting Standards Codification™ Subtopic 810-10, Consolidation)? If not, what are the situations that produce a different conclusion and why?

We believe that the consolidation conclusions reached by applying the Staff Draft could differ from the conclusions reached by applying current U.S. GAAP in various situations.

As discussed in our response to Question 1, specific guidance contained in current U.S. GAAP is
not replicated in the Staff Draft. For example, significant guidance exists in U.S. GAAP on the
assessment of an entity's design in determining an entity's variability and variable interests
(including variable interests in specified assets) whereas the Staff Draft provides no guidance in



these areas other than broadly requiring a focus on the design of the entity. For example, "plain vanilla" operating leases (i.e., those that do not include residual value guarantees or purchase/renewal options) are deemed not to be variable interests under current guidance, whereas under the Staff Draft a lessee could be deemed to control a single-asset lessor entity.

- The Staff Draft also does not include guidance on how to evaluate power when multiple parties direct the same or different significant activities. Under the variable interest entity model, the party with the majority of the power over such activities is determined to have power over the entity.
- There are differences in the terminology used in the Boards' respective guidance that is likely to result in differences in interpretation. For example, the "returns" concept contained in the Staff Draft is described in U.S. GAAP as "the obligation to absorb losses of the entity that could potentially be significant to the variable interest entity or the right to receive benefits from the entity that could potentially be significant to the variable interest entity." This concept has been interpreted in practice as meaning irrespective of probability, but the words in the Staff Draft suggest more latitude could be applied.

Do you think it is sufficiently clear how to assess power and control for all types of entities in the Staff Draft?

As discussed in our response to Question 1, the Staff Draft would provide incremental clarity with regard to current IFRS. However, the Staff Draft does not provide sufficient guidance on the application of certain new concepts to be consistently applied in the U.S. reporting environment.

3. The Staff Draft proposes that in order to control an entity, the reporting entity must have the power to direct the activities of that entity. Power is defined as having existing rights that give the reporting entity the current ability to direct the activities that significantly affect the entity's returns.

Do you agree with the control principle as articulated in the Staff Draft?

We broadly agree with the control principle articulated in the Staff Draft. We believe that a reporting entity may possess the power to direct the activities of an entity by different means, including:

- Past actions (such as the establishment of the subject entity, the pre-determination of the scope of
 its activities and decision-making such that the reporting entity, in substance, has the power to
 direct the activities of the subject entity)
- Current voting rights
- The ability of the reporting entity to affect the actions of others because of the existence of rights that are exercisable currently or in the future (such as rights granted through options and convertible instruments)
- Rights to act in the future (such as rights that may be triggered upon the occurrence of certain events of default)

The existence of the above factors may not, in and of themselves, lead to a conclusion that a reporting entity has power by virtue of its ability to gain control. Rather, all of these actions and rights



need to be assessed collectively to determine whether the reporting entity has the power to direct the activities of the subject entity at the balance sheet date. These various means must be considered to inform the decision as to whether the reporting entity presently has the power (or the ability to affect the actions of others) to direct the subject entity's activities.

Do you agree that there are situations when a reporting entity can have control of an entity controlled through voting rights with less than a majority of voting rights? Why or why not?

We believe that the situations where a reporting entity controls another entity through voting rights by holding less than a majority of those rights will be rare in the U.S. reporting environment. We believe the most likely scenario in which that may occur is when a large block is held by a single investor and all other shares are widely dispersed. We anticipate few circumstances in which convertible or exchangeable securities will result in a reporting entity concluding that it has the current ability to exert control over the subject entity prior to exercise.

A reporting entity should only be required to consolidate a subject entity where it is readily apparent that it currently controls the subject entity as evidenced by its actions and with consideration of all relevant facts and circumstances. Relevant facts and circumstances could include the subject entity's purpose and design, including whether it is a strategic part or extension of the reporting entity's business, and the benefits to the reporting entity from controlling the subject entity. Where there is doubt about whether the extent of a reporting entity's influence indicates current control, we believe that consolidation is likely not appropriate.

4. The Staff Draft states that if the activities that significantly affect an entity's returns are directed through voting rights, a reporting entity holding less than a majority of the voting rights (assuming no potential voting rights or other contractual rights exits) has power when it can unilaterally direct the activities of the entity that significantly affect the entity's returns. This assessment requires judgment. The Staff Draft provides application guidance to determine when a reporting entity holding less than a majority of the voting rights in an entity controlled through voting rights has power. Specifically, the Staff Draft provides that, in some cases, a determination can be made about whether a reporting entity has power by just considering the absolute size of the reporting entity's holding of voting rights, the size of its voting rights relative to the size and dispersion of holdings of the other vote holders, the voting patterns at previous shareholders' meetings, and other arrangements.

Do you believe that there are circumstances when, considering only these factors, an assessment could be made about whether a reporting entity has power? Why or why not?

Yes, when considering all the facts and circumstances there may be rare fact patterns for U.S. preparers in which these factors alone could provide sufficient evidence to indicate that a reporting entity currently controls the subject entity. However, relying on the future inaction of other vote holders may not always be appropriate because past practices are not necessarily indicative of current or future actions. For example, other vote holders may choose to act if the issue in question is of significant importance to them. It will likely be difficult to ascertain the motivations of other voting interest holders in deciding whether to vote on specific matters. For example, in the U.S., many changes in board governance are being considered (e.g., proxy access, say on pay, etc.) which may have a profound effect on voting patterns. In addition, it is unclear how to think about historical voting



patterns in certain situations, such as for startup or recently formed entities where no trends have been established, or where voting rights were previously held by a diverse group but are now held by one or a few shareholders. Lastly, we acknowledge that there may be fact patterns whereby the reporting entity may not have sufficient access to information or knowledge of the nature of the holdings of other parties (e.g., whether there are other investors that hold blocks of shares, whether other investors are related, or expected holding periods of other investors). Therefore, all relevant facts and circumstances should be considered in the consolidation analysis and there should be no presumption of control based on an assessment limited to only certain factors.

The concept of effective control contained in the Staff Draft has heretofore not been applied under U.S. GAAP. It is unclear to us whether the complexity associated with applying, interpreting, and auditing this new concept can be justified based on the benefits to financial statement users, especially considering the limited circumstances where it is likely to apply. As previously discussed, we believe that consolidation due to effective control could occur in rare situations in the U.S. reporting environment. Some constituents may perceive that greater clarity is afforded under the current contractual rights approach. Therefore, while this concept appears to have conceptual merit, we recommend that the FASB obtain input from financial statement users in the U.S. on whether the resulting financial reporting would be more decision-useful or if they would find the added complexity of such an approach confusing.

5. In other circumstances the Staff Draft provides that additional evidence may be needed in order to conclude that a reporting entity holding less than a majority of the voting rights in an entity controlled through voting rights has power. The Staff Draft includes indicators that may provide additional evidence in these circumstances to assist in determining whether the reporting entity has power.

Do you believe that these indicators provide sufficient guidance to conclude that a reporting entity has power in situations where it is unclear as to whether a reporting entity has power solely based on the absolute size of the reporting entity's holding of voting rights, the size of its voting rights relative to the size and dispersion of holdings of the other vote holders, the voting patterns at previous shareholders' meetings, and other arrangements? If not, what additional indicators should be included or which of these indicators should be removed?

The indicators in paragraphs B14 to B16 provide helpful guidance for consideration in determining whether a reporting entity with less than a majority of the voting rights has the power to direct the most significant activities. However, we believe that the circumstances where a reporting entity with less than a majority of the voting rights will have the power will be rare in the U.S. reporting environment.

6. The Staff Draft requires a reporting entity to consider its rights to obtain additional voting rights of another entity, as well as such potential voting rights (options or convertibles, for example) held by other parties, to determine whether the reporting entity has power.

Do you believe the guidance in the Staff Draft is appropriate and operational? Specifically, do you believe that the guidance for determining when potential voting rights are considered substantive is operational? If not, what additional guidance would you suggest?



We agree that consideration of options and convertible instruments is relevant to determining the substance of the relationship between the reporting entity and the subject entity and whether those potential voting rights give rise to control. The existence of options or other convertible instruments may enable the reporting entity to affect the actions of those directing the activities of the subject entity. However, it is important for situations in which options and convertible instruments that together with other factors provide the reporting entity with the current ability to control the subject entity to be distinguished from those situations where the reporting entity can only influence but not control the subject entity, or only has the ability to obtain control over the subject entity. We believe that only the former situation should result in consolidation and that these circumstances are likely to be rare in the U.S. reporting environment.

Options and convertible instruments need to be assessed along with other factors, such as the purpose and design of the subject entity, when the option or convertible instrument was obtained versus when any equity interests were acquired, the consequences of exercising the options (for example, the cost and potential undesirable consequences of taking control), and whether the current holder(s) of the voting rights would follow the directions of the option holder as it relates to the subject entity such that the reporting entity actually has control. The analysis should also consider who the parties to the option are, the option's economics and exercisability, and whether the current holder of the voting rights has reasons (economic or other) to ignore the option holder.

However, it is not always clear how to factor in potential voting rights under the Staff Draft and how much weight to place on these rights. It would not seem appropriate to always place equal weight on substantive potential voting rights versus currently having the voting rights.

For example, one party may currently hold 40 percent of the voting rights and have an option to acquire a further 20 percent from one party that holds the remaining 60 percent. The majority shareholder would currently control the subject entity unless there is persuasive evidence that the majority shareholder would follow the directions of the option holder.

Consequently, we expect that there would be very limited circumstances where the need to consider potential voting rights would yield a different consolidation conclusion than is currently the case under U.S. GAAP. We recommend that it be clarified that potential voting rights be considered as one of the factors in the overall analysis but are not necessarily determinative on their own.

We agree that in most cases potential voting rights need to be currently exercisable in order to be substantive but that there may be situations when they are relevant in the analysis despite not being currently exercisable. We also believe that temporary changes in the value of potential voting rights, such as if a right becomes in-the-money or less out-of-the-money, should not by themselves affect the consolidation conclusion.

- 7. When determining whether a reporting entity acts as an agent, the reporting entity must consider the overall relationship between it and other parties involved with the entity, considering the following factors:
 - a. The scope of its decision-making authority over the entity
 - b. The rights held by other parties
 - c. The remuneration the reporting entity is entitled to in the arrangement



d. The reporting entity's exposure to variability in returns as a result of other interests that it holds in the entity.

Do you believe the guidance related to assessing decision-making arrangements in the Staff Draft is appropriate and operational? Do you believe the Staff Draft would lead to appropriate consolidation conclusions?

Yes, we believe that a "factors-based" analysis for determining whether a reporting entity is acting as a principal or an agent is superior to the current analysis contained in the U.S. GAAP guidance for consolidating variable interest entities (FAS 167). A factors-based analysis allows for more judgment to be exercised, which enables a better reflection of the economic substance of these relationships. Subsequent to the issuance of FAS 167, the asset management industry and their financial statement users expressed concern over the decision usefulness of financial reporting if asset managers were required to consolidate many funds that they manage in a fiduciary capacity. We believe that any model designed to evaluate such asset management relationships should limit the situations in which an asset manager consolidates a fund entity it manages to those where its overall role and the extent of its economic relationship with the fund entity clearly indicate that it is acting in a principal capacity.

However, we are concerned that based on the factors provided, the analysis of whether a decision-maker is acting as an agent will often hinge on the level of the economics of the relationship, as is the case under U.S. GAAP and reflected in criterion c. and d. above, particularly in evaluating asset management arrangements. While we support the need to apply judgment when assessing the economics and agree that bright lines should not be prescribed, we believe that further clarification is needed on how to evaluate different scenarios of economic interests in order to promote greater consistency and comparability in application. Clarification is also needed on how to consider the weight assigned to each of the factors in the analysis under different scenarios. For example, the relative weight placed on the level of economics in a scenario where there are no substantive removal rights versus a scenario where substantive removal rights are held by a relatively small number of investors. Without a clearer principle, bright lines are likely to develop in practice.

We agree with the Staff Draft in its acknowledgement 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 agents who are required to hold a principal interest are likely to be better agents because they have an incentive to act in the best interests of all interest holders (e.g., risk retention requirements being considered for servicers of securitization vehicles). However, the Staff Draft provides no guidance on how to assess when an economic interest no longer indicates an agency relationship. We believe that consideration should be given to the parties that benefit from the entity, the reason for the manager holding other interests, and the business substance for the manager's resulting exposure to variability. For example, a manager may be required to provide seed capital in order to attract investors to a new fund or be required by investors to invest in a fund in order to demonstrate its commitment to act in the best interest of investors. These investments appear more indicative of an agency relationship than a principal relationship.

Consistent with the U.S. GAAP guidance on consolidation of variable interest entities, we believe that interests held by employees and benefit plans for employees should not be included in the assessment of the reporting entity's exposure to variability due to other interests held in the entity. This exception was responsive to constituent concerns that certain managers may not be deemed to



be an agent of the fund entity solely due to interests held by employees of the manager or their benefit plans.

Further, in considering criterion a., it is unclear how to think about the amount of latitude afforded when decision making is limited by agreement or law, and the level of influence the decision-maker had in determining the restrictions on its decision making authority. Oftentimes, the asset manager has limitations imposed on them but the extent to which they have discretion in selecting the assets for investment can vary significantly. In the absence of further guidance, it is likely that constituents would have a broad range of interpretations of this new concept.

8. When evaluating a decision-maker's role, rights held by other parties are considered when determining whether a decision-maker is an agent. Specifically, situations in which a single party holds substantive removal rights and can remove the decision-maker without cause, in isolation, would be sufficient to conclude that the decision-maker is an agent. However, if numerous parties hold such rights, those rights would not, in isolation, be conclusive in determining whether a decision-maker is an agent. In such a situation, those rights would be considered together with the other factors included in question 7 above, to determine whether the decision-maker is an agent.

Do you believe that removal rights held by numerous parties should be a factor when evaluating whether a decision-maker is an agent? If so, do you agree that it should be one factor but not in and of itself determinative, when evaluating whether a decision-maker is an agent?

Yes, we believe that substantive removal rights held by multiple parties should be considered in the evaluation of whether a decision-maker is acting as an agent, as they represent a key indicator of an agency relationship. Removal rights are important and many investment managers today would consider the existence of removal rights when assessing if they control funds that they manage. The ability of others to remove the reporting entity from its capacity as a service provider/decision maker indicates an agency relationship, not a control relationship when those removal rights are substantive.

Questions on the role of boards of directors and their interaction with the decision-maker arose during the implementation of the recent changes to the consolidation guidance for variable interest entities. The most significant question was whether a substantive board of directors should be viewed as a single party for the purposes of considering its ability to remove the decision-maker. Substantive boards often exist for financial entities, such as in the case of mutual funds established under the Investment Company Act of 1940 or those established in a manner that is fairly consistent with those requirements. We believe that removal rights held by boards of directors should be considered an important factor in making a principal versus agency determination as a substantive board of a financial entity should be viewed similarly to the board of a typical operating entity. We believe that the role of boards should be addressed before finalizing the new agent versus principal guidance.

The Staff Draft requires a reporting entity to reassess whether it controls another entity if facts and circumstances indicate that there are changes to one or more of the three elements of control.



Do you believe this principle, and the related guidance in the Staff Draft, is sufficiently clear and operational?

Yes, we believe that the assessment of control should be performed on an ongoing basis when facts and circumstances indicate that there are changes to one of the elements of control.