Financial Accounting Standards Board

IFRS™

Investment Entities / Investment Companies
Joint Public Roundtable Meeting
27 March 2012
Kuala Lumpur, Malaysia
4:30 p.m.-6:30 p.m.

AGENDA

Time (MST)	Topic
4:30 p.m.	Introductions (5 minutes)
4:35 p.m.	*Issue 1:* The form of an exception to consolidation guidance (15 minutes)
4:50 p.m.	*Issue 2:* Criteria to be an investment entity (40 minutes)
5:30 p.m.	*Issue 3:* Investment entity accounting for controlled investees and related disclosure (40 minutes)
6:10 p.m.	*Issue 4:* Accounting by a noninvestment entity parent of an investment entity subsidiary (20 minutes)

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Participants

Sharon Eng	Jones Lang LaSalle
Manoj Fadnis	Institute of Chartered Accountants of India (ICAI)
Mohammad Faiz Azmi	Malaysian Accounting Standards Board
Mazhairul Jamaludin	Ekuiti Nasional
Suzanna Kassim	Malaysia Venture Capital Management Berhad (MAVCAP)
Sue Ludolph	South African Institute of Chartered Accountants (SAICA)
Norsharizal Mashahrin	Khazanah Nasional
Patricia McBride	New Zealand Accounting Standards Board
Nor Azian Mohd Noor	Employees Provident Fund (KWSP)
Suan Chin Ong	Standard Chartered Bank
Sadi Podevijn	Belgian Accounting Standards Board
Tham Sai Choy	Singapore Accounting Standards Council
Tomo Sekiguchi	Accounting Standards Board of Japan
Kevin Stevenson	Australian Accounting Standards Board
Leo van der Tas	Ernst & Young
Nik Mohd Hasyudeen Yusoff	Audit Oversight Board Malaysia

IASB Participants

Ian Mackintosh	Vice Chairman
Takatsugu Ochi	Board Member
Sue Lloyd	Senior Director, Technical Activities
Alan Teixeira	Senior Director, Technical Activities
Rachel Knubley (via telephone)	Technical Principal
Sarah Geisman	Assistant Technical Manager

FASB Participants

Russ Golden	Board Member
Tom Linsmeier	Board Member
Upaasna Laungani (via telephone)	Project Manager

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The investment entities project[1] is a joint effort between the IASB and the FASB to converge the financial reporting by investment entities. The objective of this project is to provide consistent and comprehensive guidance for assessing whether an entity is an investment entity and to provide an exception from consolidation guidance for investment entities. The project was added to the boards' agendas to address the views of many investors that fair value is the most relevant measurement attribute for their investments in entities that are in the business of pooling funds and providing professional investment management services.

As part of this project, in August 2011 the IASB published the exposure draft *Investment Entities*, which proposes an exception to the consolidation principle in IFRS 10 *Consolidated Financial Statements* for a particular class of entities—investment entities. In addition to providing criteria for determining whether an entity is an investment entity, the exposure draft also provides accounting and disclosure guidance for those entities.

In October 2011, the FASB issued proposed Accounting Standards Update *Financial Services—Investment Companies (Topic 946): Amendments to the Scope, Measurement, and Disclosure Requirements*, which proposes amendments to the existing guidance in US generally accepted accounting principles (GAAP) for investment companies.

During the comment period for those exposure drafts, the boards and staff have engaged in outreach to obtain feedback on the proposals from constituents, including investors, preparers, auditors, and regulators. Constituents have provided feedback through multiple channels, including public comment letters, in-person meetings, and conference calls.

This public round-table meeting is not only another way for the boards and staff to receive feedback on the proposals, but it also provides an opportunity for constituents to interact with each other and discuss their views on the proposals.

[1] The investment entities project is called the 'investment companies project' on the FASB agenda because similar entities are referred to as investment companies in the United States and current US generally accepted accounting principles (GAAP) provides guidance for investment companies. For the purpose of these round table materials, *investment entity* and *investment company* are used interchangeably.

The staff will provide a summary of feedback to the boards, including feedback received from this public round-table meeting, which will be used to guide the boards in their redeliberations.

Today's discussion focuses on the most commented upon areas of the exposure drafts, and it is organised as follows:

- Issue 1. The form of an exception to consolidation guidance
- Issue 2. Criteria to be an investment entity
- Issue 3. Investment entity accounting for controlled investees and related disclosure
- Issue 4. Accounting by a noninvestment entity parent of an investment entity subsidiary.

Issue 1: The form of an exception to consolidation guidance

The IASB's exposure draft represents the first time that an exception from the consolidation principle in IFRS 10 (and its predecessor, IAS 27, *Consolidated and Separate Financial Statements*) has been proposed for investment entities. The exposure draft would require an investment entity to measure its controlled investees at fair value rather than apply consolidation guidance. That exception is not new to US GAAP. An exception from consolidation guidance for investment companies has existed in US GAAP for many years.

The guidance in both exposure drafts would provide an exception to consolidation guidance at an entity level. That is, the boards have proposed a set of criteria to define a limited set of entities that would be investment entities and that would be required to measure their controlled investees at fair value rather than apply consolidation guidance.

Some constituents have suggested that the exception to consolidation guidance should be provided in a different form (for example, at an asset or portfolio level). Those constituents believe that the guidance in the exposure drafts is too rule-based or industry-specific.

<u>Question 1.</u> If an exception to consolidation guidance is provided, which of the following forms do you believe that exception should take and why?

a) An entity-level approach with a set of criteria that must be met to be an investment entity?
b) A general principle that describes an investment entity, with an accompanying set of indicators, rather than a set of criteria?
c) An asset-level or portfolio-level approach? Please explain how you would define the exception to consolidation guidance under such an approach.

Question 2. If you believe that an exception to consolidation guidance should be provided, do you believe that fair value measurement should be a requirement or an option for a controlled investee? Why?

Issue 2: Criteria to be an Investment entity

The guidance in both exposure drafts would require an entity to meet six criteria to be an investment entity. The six criteria are similar under both exposure drafts. For purposes of these round-table materials, the criteria under the IASB's exposure draft are listed below.

Nature of the investment activity: the entity's only substantive activities are investing in multiple investments for returns from capital appreciation, investment income, or both.

Business purpose: the express business purpose of the entity is investing to provide returns from capital appreciation, investment income, or both.

Unit ownership: ownership in the entity is represented by units of investments, to which proportionate shares of net assets are attributed.

Pooling of funds: the funds of the entity's investors are pooled so that the investors can benefit from professional investment management. The entity has investors that are unrelated to the parent (if any) and collectively hold a significant ownership interest in the entity.

Fair value management: substantially all of the investments of the entity are managed, and their performance is evaluated, on a fair value basis.

Reporting entity: the entity provides financial information about its investment activities to its investors. The entity can be, but does not need to be, a legal entity.

In addition, under the proposed amendments in the FASB's exposure draft, an entity that is regulated under the Securities and Exchange Commission's (SEC) *Investment Company Act* of 1940 would be an investment company for accounting purposes.

Some constituents have commented that the criteria proposed would capture the appropriate population of investment entities. Other constituents have raised concerns about aspects of the proposed criteria, because they believe that the criteria may inappropriately include or exclude certain entities from the scope of the amendments in the exposure drafts. The questions below focus first on some of the most frequently expressed concerns and then request feedback on general considerations regarding the criteria.

<u>Nature of the investment activity and business purpose</u>

Common concerns raised by constituents regarding the *nature of the investment activity* and *business purpose* criteria include the following:

- Additional guidance for the *nature of the investment activity* criterion should be provided to clearly identify which business activities and services an investment entity would be able to provide. For example, constituents questioned whether participating in the operations of a controlled investee would constitute a permissible activity for an investment entity.
- The requirement to hold multiple investments would inappropriately exclude certain entities from being investment entities.
- Additional guidance regarding the *exit strategy* component of the *business purpose* criterion should be provided, and the *exit strategy* component should be included in the main criteria rather than in application guidance.

<u>Question 3.</u> Do you believe that the *nature of investment activities* criterion clearly articulates permissible business activities and services? What other business activities or services should be permitted, if any?

<u>Question 4.</u> Do you believe that an investment entity should be permitted to hold only a single investment? Why or why not?

<u>Question 5.</u> Do you believe that the *exit strategy* component is clearly articulated? Should it be given greater prominence? Why or why not?

<u>Unit ownership and pooling of funds</u>

Common concerns raised by constituents regarding the *unit ownership* and *pooling of funds* criteria include the following:

- The requirement that an investment entity must have multiple investors unrelated to the fund manager is too strict and is focused on the legal structure of an entity rather than on the economics of the entity. That requirement would inappropriately exclude sovereign wealth funds, certain pension funds, certain insurance investment funds, and other wholly-owned funds from being investment entities.
- The criteria do not permit consideration of interests held by debt holders and would therefore exclude certain securitisation vehicles such as collateralised debt obligations (CDOs) and collateralised loan obligations (CLOs) from being investment entities.

Question 6. Do you believe that an entity with a single investor unrelated to the fund manager should be an investment entity? If the requirement that an investment entity must have multiple investors was removed, how would you address the boards' concern that an entity could be inappropriately inserted into a larger corporate structure to achieve a particular accounting outcome?

Question 7. Do you believe that CDOs and CLOs are entities that pool investor funds to avail investors of investment management services with investors that focus on assessing the fair value based performance of the CDO/CLO structure as a whole (and therefore should be investment entities), or do you believe CDOs and CLOs are pass-through entities with debt holders that are focused simply on earning interest income?

Other concerns

Question 8. Do you have any comments or suggestions regarding the other criteria? Do you believe that any specific criteria should be added or removed?

Question 9. Are there any entities not captured by the proposed criteria that you believe should be investment entities? A re there an entities captured by the proposed criteria that you believe should not be investment entities?

Question 10. Are you aware of any entities that would be investment entities under existing regulatory requirements but would not be investment entities for accounting purposes based on the proposed criteria? If so, how could the proposed criteria be amended to include these entities?

Issue 3: Investment entity accounting for controlled investees and related disclosure

The IASB's and the FASB's proposals to account for controlled investees of an investment entity are broadly similar but do contain differences, especially for fund-of-fund structures. The proposals are presented in the following table:

Type of subsidiary	IASB proposed accounting	FASB proposed accounting
Operating entity	Fair value*	Fair value*
Investment entity	Fair value	Consolidate (fund-of-funds only)

* Consolidation required if the investment is in an operating entity that provides services to the investment entity.

Some constituents believe that it is inappropriate to provide an industry-specific or entity-specific exception from consolidation requirements. Those constituents believe that controlled investees should be consolidated, regardless of the nature of the parent entity or the subsidiary entity, because they believe that consolidation of controlled investees results in more relevant information that is consistent with the boards' conceptual frameworks. Those constituents are also concerned about possible structuring opportunities that could result from providing an exception from consolidation guidance to a particular group of entities.

Other constituents believe that fair value measurement provides the most useful information to investors, whether or not the investment entity controls an investee. Most constituents agree with the proposals regarding an investment entity's measurement of controlling financial interests in operating entities. However, feedback is mixed regarding an investment entity's controlling financial interest in another investment entity. Some constituents believe that consolidation provides the appropriate level of transparency to underlying assets, liabilities, income, and expenses of the investment entity subsidiary, while other constituents believe that fair value is the most relevant measurement attribute for all investments, regardless of the nature of the subsidiary's business activities.

<u>Question 11</u>. Do you believe that an investment entity should be required to measure controlling financial interests in an operating entity at fair value, unless the operating entity provides services to the investment entity parent? Why or why not?

<u>Question 12.</u> Do you believe that an investment entity should be required to measure controlling financial interests in another investment entity at fair value? Why or why not? Does your answer change depending on the structure of the investment entity (a fund-of-funds structure versus a master-feeder structure) or the business purpose for the controlled investment entity (such as a blocker fund set up to invest in a particular type of asset)?

<u>Question 13.</u> If you believe that consolidation should not be required for an investment entity, do you believe that specific disclosures about assets, liabilities, income, and expenses held by the investee should be required? If so, what should those disclosure requirements be? Should those disclosures be limited to controlled investees or should they be provided for significant investments held by the investment entity?

Issue 4: Accounting by a noninvestment entity parent of an investment entity subsidiary

Currently, both IFRSs and US GAAP require a noninvestment entity parent to consolidate controlled investees. However, the IASB's exposure draft has proposed different guidance from the guidance in US GAAP about whether the fair value accounting used by an investment entity subsidiary would be retained by a noninvestment entity parent in consolidation. The IASB's exposure draft would not permit a noninvestment entity parent to retain the fair value accounting used by an investment entity subsidiary. Consequently, under the IASB's exposure draft, the noninvestment entity parent would consolidate controlled investees held by the investment entity subsidiary. Under both current and proposed US GAAP, however, a noninvestment entity parent would retain the fair value accounting used by the investment entity subsidiary in its consolidated financial statements.

Some constituents believe that retaining the fair value accounting used by the investment entity subsidiary in the consolidated financial statements of a noninvestment entity parent is not appropriate. Those constituents are concerned that a noninvestment entity parent could avoid consolidation of a controlled investee by holding the controlled investee in an intermediary investment entity subsidiary. Some of those constituents also believe that fair value measurement of controlled investees is relevant for investment entity financial statements but may not always be relevant for the financial statements of a noninvestment entity parent.

Other constituents believe that fair value measurement for the investment entity subsidiary's controlled investees will result in more relevant information, even in the financial statements of a noninvestment entity parent. Those constituents also believe that the proposed criteria to be an investment entity are adequate to address the concerns about the noninvestment entity parent avoiding consolidation of controlled investees, because fair value accounting would be used by a subsidiary only when it is appropriate. Some of those constituents are concerned that any cost savings gained by providing an exception to consolidation guidance for investment entity subsidiaries would be removed if the fair value accounting was not retained by the noninvestment entity parent.

<u>Question 14</u>. Do you believe that a noninvestment entity parent should retain the fair value accounting used by an investment entity subsidiary? Why or why not?

<u>Question 15.</u> If you believe that a noninvestment entity parent should retain the fair value accounting used by an investment entity subsidiary, how would you propose to address the IASB's concerns about structuring opportunities for a noninvestment entity parent? Please respond considering any changes suggested for the criteria to be an investment entity.