



International Organization of Securities Commissions
Organisation internationale des commissions de valeurs
Organizaç o Internacional das Comiss es de Valores
Organizaci n Internacional de Comisiones de Valores

11 January 2012

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Our Ref: 2012/JE/TCSC1/IASB/2

RE: Exposure Draft: *Investment Entities*

Dear IASB Members:

The International Organization of Securities Commissions Standing Committee No. 1 on Multinational Disclosure and Accounting thanks you for the opportunity to provide our comments regarding the International Accounting Standards Board (IASB or the Board) Exposure Draft: *Investment Entities*, which was part of a joint project by the IASB and the US Financial Accounting Standards Board (the Boards).

IOSCO is committed to promoting the integrity of international markets through promotion of high quality accounting standards, including rigorous application and enforcement. Members of SC1 seek to further IOSCO's mission through thoughtful consideration of accounting and disclosure concerns and pursuit of improved transparency of global financial reporting. The comments we have provided herein reflect a general consensus among the members of SC1 and are not intended to include all of the comments that might be provided by individual securities regulator members on behalf of their respective jurisdictions.

General Observation

SC1 members support the Board's undertaking of this project to try to improve the quality of information provided to investors about investment entities. We welcome the potential to converge the Boards' respective requirements for investment entities. One SC1 member does not, however, support the Board's efforts to define investment entities and provide them with an exemption from consolidation accounting for controlled investments and believes that this results in incomplete information provided to investors. Our feedback on certain aspects of the proposal is provided below.

Responses to the Board's Questions

Question 1—Exclusion of investment entities from consolidation

Do you agree that there is a class of entities, commonly thought of as an investment entity in nature, that should not consolidate controlled entities and instead measure them at fair value through profit or loss? Why or why not?

Calle Oquendo 12
28006 Madrid
ESPAÑA
Tel.: + 34 91 417.55.49 Fax: + 34 91 555.93.68
mail@oicv.iosco.org - www.iosco.org



OICV-IOSCO

International Organization of Securities Commissions
Organisation internationale des commissions de valeurs
Organização Internacional das Comissões de Valores
Organización Internacional de Comisiones de Valores

Most SC 1 members agree that entities that qualify as investment entities should not consolidate controlled entities but instead should measure them at fair value through profit or loss. These members believe that fair value provides the most meaningful information to investors in investment entities. They believe that most investors in an investment entity are primarily concerned with the investment entity's net asset value per share and that consolidation of controlled entities does not provide this information. Several of the SC1 members supportive of the exposure draft currently have local regulatory requirements for investment entities to measure controlled entities at fair value through profit or loss.

One SC1 member believes that IFRS should not exempt investment entities from the consolidation requirements and that all controlled entities should be required to be consolidated. This member believes that consolidation provides investors with the most complete and meaningful information, including the exposures to different classes and types of assets, financial instrument disclosures, and key ratios (e.g., gearing). This member notes that certain jurisdictions require parent company financial statements, in addition to consolidated financial statements, which already provide investors multiple ways of viewing their investment. In cases where only consolidated financial statements are presented, fair value information can be provided by means such as: (i) notes disclosure; or (ii) by allowing investment entities to recognise a separate asset on consolidation for the excess of the market value of a controlled entity over the book value of its net assets (i.e., for internally generated goodwill and undervalued individual assets). The proposed standard would also allow possible abuse by investment entities interposing a 100%, 99% or 51% owned controlled entity to hold all of their investments.

Question 2—Criteria for determining when an entity is an investment entity

Do you agree that the criteria in this exposure draft are appropriate to identify entities that should be required to measure their investments in controlled entities at fair value through profit or loss? If not, what alternative criteria would you propose, and why are those criteria more appropriate?

If the Board is going to define investment entities as a separate class of entities, then we generally agree with the proposed criteria for identifying investment entities. However, we think that there is a need to include an overarching requirement that the *business model* of the entity be that of an investment entity (i.e., its only business is to make investments for capital appreciation and / or investment income). Whilst we understand that paragraph 2(a) addresses this to a large degree, we think that this criterion is in fact the key principle which must be clearly met for an entity to potentially qualify as an investment entity. We think elevating this criterion to a key principle would give the appropriate emphasis to the fact that the exemption to the consolidation requirements in IFRS is only appropriate where it appropriately reflects the economic substance of the entity. In addition to including an overarching principle, we also believe that it is important to retain the criterion in paragraph 2(a), because it is our understanding that some preparers place more focus on specific criteria in accounting standards than they place on the principles in the standards.

With regard to the business purpose criterion as drafted in paragraph 2(b), we believe that an entity may be able to address it by actively changing its business purpose in its marketing materials to meet the definition of an investment entity when it is opportunistic. We view this criterion as tantamount to

Calle Oquendo 12
28006 Madrid
ESPAÑA
Tel.: + 34 91 417.55.49 Fax: + 34 91 555.93.68
mail@oicv.iosco.org - www.iosco.org



International Organization of Securities Commissions
Organisation internationale des commissions de valeurs
Organização Internacional das Comissões de Valores
Organización Internacional de Comisiones de Valores

a fair value option. We do not believe that the criteria should provide an entity with an option to measure controlled investments at fair value through earnings. This concern could be mitigated if an overarching principle were included in the proposal, as suggested above.

The criterion in paragraph 2(e) requires an investment entity to manage and evaluate the performance of “substantially all” of its investments on a fair value basis. This criterion conflicts with the application guidance in paragraph B17 which indicates that “[a]ll controlled investments” must be managed on a fair value basis. We believe that the Board intended the “substantially all” requirement to allow an investment entity to hold ancillary assets (e.g., a building serving as the headquarters for the investment entity to conduct its operations) that are not managed and evaluated on a fair value basis. We suggest that the application guidance explain what types of assets an investment entity is permitted to hold that need not be managed and evaluated on a fair value basis.

The criterion in paragraph 2(f) of the exposure draft indicates that an investment entity can be a legal entity but it is not required to be a legal entity. All potential investment entities would either be a legal entity or they would not. Therefore, this statement about legal entity status should be included in the application guidance as it is not a criterion.

Question 3—Nature of investment activity

Should an entity still be eligible to qualify as an investment entity if it provides (or holds an investment in an entity that provides) services that relate to:

- (a) Its own investment activities?
- (b) The investment activities of entities other than the reporting entity?

Why or why not?

We agree with the exposure draft’s proposal that an investment entity should have no substantive activities other than its investing activities and that it should not have any significant assets or liabilities other than those relating to investing activities. We believe it would be helpful to explain the types of arrangements that the Board envisioned as meeting and not meeting this criterion to better enable readers to understand the types of abuse that this guidance is intended to prevent.

Question 4—Pooling of funds

- (a) Should an entity with a single investor unrelated to the fund manager be eligible to qualify as an investment entity? Why or why not?
- (b) If yes, please describe any structures/examples that in your view should meet this criterion and how you would propose to address the concerns raised by the Board in paragraph BC16.

Those SC1 members that support the Board’s proposal to provide investment entities an exemption from consolidation believe that an entity that is owned by an unrelated single investor should still be eligible to qualify as an investment entity. These members believe a single investor does not change the nature of the entity, but rather the unique characteristic of a single investor is that it allows the single investor to require the investee to provide certain information that may not otherwise be accessible to a noncontrolling shareholder.

Calle Oquendo 12
28006 Madrid
ESPAÑA
Tel.: + 34 91 417.55.49 Fax: + 34 91 555.93.68
mail@oicv.iosco.org - www.iosco.org



OICV-IOSCO

International Organization of Securities Commissions
Organisation internationale des commissions de valeurs
Organizaç o Internacional das Comiss es de Valores
Organizaci n Internacional de Comisiones de Valores

These SC 1 members provide two single investor examples that they believe should be considered investment entities but will not meet the definition proposed in the exposure draft. State owned funds (i.e., sovereign wealth funds) typically have a single investor but would not have investors unrelated to the parent that hold a significant ownership interest in the entity. Additionally, in certain jurisdictions it is common for a state owned financial institution to establish and invest in an investment fund and sell interests in the fund to other state owned agencies. Because both investors in the fund would be considered related parties due to their common governmental parent, the fund would not meet the pooling of funds criterion.

Also, when substantially all of an entity's shares are held beneficially by an agent, it may be difficult to determine the extent of underlying unrelated investors. If there are periodic changes in the entity's shareholders, it could be operationally difficult, or impractical, to continually ascertain the information necessary to evaluate the pooling of funds criterion.

The SC1 member that does not support the Board's proposal to provide investment entities an exemption from consolidation believes that even if such an exemption exists, an entity with an unrelated single investor should not be eligible to qualify as an investment entity. This member believes that if an entity has a single investor then the entity should not qualify as an investment entity because the single investor will receive the information necessary to evaluate their investment. That is, the single investor can request the information to measure their investment in the entity at fair value and does not require that a net asset value per share be calculated by the entity.

Question 5—Measurement guidance

Do you agree that investment entities that hold investment properties should be required to apply the fair value model in IAS 40, and do you agree that the measurement guidance otherwise proposed in the exposure draft need apply only to financial assets, as defined in IFRS 9 and IAS 39 *Financial Instruments: Recognition and Measurement*? Why or why not?

We agree that if an investment entity holds investment properties that they should be measured at fair value through profit or loss. This approach results in a consistent measurement basis for both investments in other entities as well as investment properties. We believe that the exposure draft should be clear that items such as accrued interest and dividends receivable would not be measured at fair value through profit or loss. Additionally, while the exposure draft is explicit on the measurement basis for financial assets for which the entity has a controlling financial interest and investments where the entity has significant influence, the standard should also be explicit as to the measurement basis (i.e., fair value through profit or loss) for investments without significant influence (e.g., a 5% ownership in a public company).

Question 6—Accounting in the consolidated financial statements of a non-investment entity parent

Do you agree that the parent of an investment entity that is not itself an investment entity should be required to consolidate all of its controlled entities including those it holds through subsidiaries that are investment entities? If not, why not and how would you propose to address the Board's concern?

Calle Oquendo 12
28006 Madrid
ESPAÑA
Tel.: + 34 91 417.55.49 Fax: + 34 91 555.93.68
mail@oicv.iosco.org - www.iosco.org



OICV-IOSCO

International Organization of Securities Commissions
Organisation internationale des commissions de valeurs
Organização Internacional das Comissões de Valores
Organización Internacional de Comisiones de Valores

Some SC1 members support the Board's proposal to require a non-investment entity parent to consolidate the investments of its investment entity subsidiaries as they believe that it prevents potential structuring abuses. Other SC1 members believe that an investment entity's specialized accounting should be retained in consolidation. They believe that if it is more useful to provide fair value information about an entity's investee in the investment entity's financial statements then it is likely useful to retain this accounting in consolidation. We also note that how to handle the issue of retention of specialized accounting in consolidation is driven by one's view of the purpose served by the consolidated financial statements, and thus the thinking behind how to handle it is not unique to the application here for investment entities. Regardless of their individual beliefs on the retention of investment entity accounting in consolidation, all members of SC1 encourage the Board to work with the FASB to arrive at a converged solution on this matter. On the matter of convergence, we note that the FASB proposal on investment entities requires a parent investment entity to consolidate a subsidiary investment entity while the IASB proposal requires a parent investment entity to measure its investment in its subsidiary investment entity at fair value through profit or loss.

We note that in some jurisdictions there are leverage restrictions placed on investment entities by regulatory authorities. If a parent investment entity does not consolidate its subsidiary investment entity, this could allow the subsidiary to be highly leveraged for the benefit of the parent, and the parent would not consolidate the subsidiary's liabilities under the IASB proposal, thus masking the parent investment entity's consolidated leverage. Some SC1 members believe that the parent investment entity should consolidate the subsidiary investment entity because consolidation would better reflect the parent's consolidated leverage. One of these members (the member who does not support the proposed consolidation exemption) believes that investment entities should not be provided an exemption from consolidation in any circumstances, while the other SC1 member believes that requiring investment entities to consolidate other investment entities would prevent a misunderstanding by investors and also allow for a more meaningful presentation of the underlying investments of the investment entity. Most SC1 members, all of which support the Board's proposal to provide investment entities with an exception to consolidation, do not support an investment entity's consolidation of another investment entity.

Question 7—Disclosure

(a) Do you agree that it is appropriate to use this disclosure objective for investment entities rather than including additional specific disclosure requirements?

(b) Do you agree with the proposed application guidance on information that could satisfy the disclosure objective? If not, why not and what would you propose instead?

We generally agree with the disclosure objective provided for investment entities. The SC1 member that does not support the Board's proposal to provide investment entities an exemption from consolidation would like to require an investment entity to provide a pro forma footnote disclosure as if the investment entity had consolidated its controlled investments. Another SC1 member believes that it would be beneficial to require disclosure of a schedule of the investment entity's investments detailing the type of security, industry classification, percentage of the fund that the industry

Calle Oquendo 12
28006 Madrid
ESPAÑA
Tel.: + 34 91 417.55.49 Fax: + 34 91 555.93.68
mail@oicv.iosco.org - www.iosco.org



OICV-IOSCO

International Organization of Securities Commissions
Organisation internationale des commissions de valeurs
Organização Internacional das Comissões de Valores
Organización Internacional de Comisiones de Valores

represents, par amount, and fair value. This disclosure would provide additional detail around the investment entity's investments in a standardized manner.

We believe that the requirement in paragraph 10(b) to disclose whether the investment entity has provided financial or other support, that is not contractual, to one of its controlled investees should be either clarified regarding how providing support to an investee is consistent with meeting the definition of an investment entity in the first place or, if it is not consistent, then this proposed disclosure should be eliminated as it is unnecessary since the support would not occur. We are particularly concerned that providing support to an investee may be incompatible with the activities of an investment entity. When an investment entity provides support to an investee, this may change the nature of the relationship from one of investment to more of a strategic relationship where the parent is involved in the operating and financing activities of its subsidiary. As an example, if an investment entity provided financial support in the form of a guarantee on the investee's debt, this would seem to be an activity other than investing for the purpose of capital appreciation or investment income. Additionally, we are concerned that the concept of "support" is not well defined. For example, if an investment entity held an equity interest in an investee and subsequently provided debt financing to the investee, would this be considered "support"?

Question 8—Transition

Do you agree with applying the proposals prospectively and the related proposed transition requirements? If not, why not? What transition requirements would you propose instead and why?

Some SC1 members agree that the guidance in the exposure draft should be applied prospectively for the reasons the Board set forth in paragraph BC26. Other SC1 members do not support the Board's proposal for prospective application as they believe that retrospective application enhances comparability. They further note that they would expect investment entities to already possess the fair value measurements that would be needed for a retrospective application in most situations.

Question 9—Scope exclusion in IAS 28

(a) Do you agree that IAS 28 should be amended so that the mandatory measurement exemption would apply only to investment entities as defined in the exposure draft? If not, why not?

(b) As an alternative, would you agree with an amendment to IAS 28 that would make the measurement exemption mandatory for investment entities as defined in the exposure draft and voluntary for other venture capital organisations, mutual funds, unit trust and similar entities, including investment-linked insurance funds? Why or why not?

We agree that IAS 28 should be amended so that entities that meet the definition of an investment entity would be required to follow the accounting prescribed in the exposure draft. We are supportive of the Board's decision because we believe that eliminating the current optionality in IAS 28 relating to measurement will enhance comparability.

Calle Oquendo 12
28006 Madrid
ESPAÑA
Tel.: + 34 91 417.55.49 Fax: + 34 91 555.93.68
mail@oicv.iosco.org - www.iosco.org



OICV-IOSCO

International Organization of Securities Commissions
Organisation internationale des commissions de valeurs
Organização Internacional das Comissões de Valores
Organización Internacional de Comisiones de Valores

We appreciate your thoughtful consideration of the comments raised in this letter. If you have any questions or need additional information on the recommendations and comments that we have provided, please do not hesitate to contact me at 202-551-5300.

Sincerely,

Julie A. Erhardt
Chair Standing Committee No. 1
International Organization of Securities Commissions

Calle Oquendo 12
28006 Madrid
ESPAÑA
Tel.: + 34 91 417.55.49 Fax: + 34 91 555.93.68
mail@oicv.iosco.org - www.iosco.org