

International Accounting Standards Board
30 Cannon Street
London
EC4M 6XH

13 January 2012

Dear IASB members

Invitation to comment - Exposure Draft ED/2011/4 Investment Entities

The Global organisation of Ernst & Young is pleased to submit its comments on the above Exposure Draft (ED).

We generally support the proposal of the International Accounting Standards Board ('the IASB') to create an exception to the principle of consolidation in IFRS 10 *Consolidated Financial Statements* and to require a class of entities that, by design invest for purposes of capital appreciation, investment income or both, to measure their controlled investees at fair value through profit or loss.

We note that the proposals in this [draft] IFRS are inconsistent with the concept of control which is fundamental to the preparation and presentation of financial statements. However, the Conceptual Framework also explains that the objective of general purpose financial reporting is to provide decision-useful financial information. Therefore, on balance, we support the exception provided in this [draft] IFRS. Our concerns around the inconsistency with the control concept are outweighed by the fact that the proposed exception offers investment entities the opportunity to provide more decision-useful information to the users of their financial statements. Further, the exception promises convergence with US GAAP.

However, a critical aspect of our support of the proposals would include confirmation of financial statement users' consensus agreement that this provides more decision-useful information. We support the initiative by the IASB and the US Financial Accounting Standards Board ('the FASB')¹ to host roundtables to discuss the implications of the proposals. We strongly urge the IASB to ensure that the users of financial statements and their concerns are the basis for those discussions and any other associated outreach initiatives.

¹ Collectively referred to in this comment letter as 'the Boards'

We do have a number of comments and concerns on the proposals of the ED - these are included in Appendix A, where we answer the specific questions asked. In summary, our key areas of concern are:

- **Accounting treatment by a non-investment entity parent:** We recommend that non-investment entity parent entities should be able to retain the fair value measurement of investees controlled by investment entity subsidiaries in their consolidated financial statements.

The IASB proposed the exception for investment entities in this ED on the basis that fair value measurement provides more useful and relevant information for users of the financial statements. The IASB also acknowledges “that if more useful information is provided by allowing the investment entity to measure controlled investments at fair value it is likely that useful information would also be provided by retaining this accounting in the consolidated financial statements” (paragraph BC 20). We agree with this statement. In terms of the IASB’s concerns around structuring, we think that the criteria to qualify as an investment entity (subsidiary), in particular the criteria limiting the nature of the investment activities, could be sufficiently defined such that there would be limited opportunities for significant structuring or possibilities of abuse. We note that the FASB’s guidance on Investment Companies² does require the retention of the fair value measurement at parent level and does not express the structuring concerns to the same extent, which is particularly relevant considering that the concept of investment entities (companies) is already applied in practice in the US.

Further, not allowing the fair value roll up into the consolidated financial statements of a non-investment entity parent is inconsistent with the proposed accounting treatment non-investment entity parents have to apply for investments in associates and joint ventures held by an investment entity subsidiary.

Finally, this issue creates a GAAP difference with US GAAP in a project that was aimed to achieve convergence.

- **Consequential amendments to IAS 28 *Investments in Associates and Joint Ventures (as amended in 2011)*:** The ED proposes a consequential amendment to IAS 28 such that (i) investment entities would be required to measure investments in associates and joint ventures at fair value and (ii) all other entities not qualifying as investment entities would be required to use the equity method to measure those investments, and would therefore no longer have the option of measuring those investments at either fair value through profit or loss or using the equity method.

² Proposed Accounting Standards Update – *Financial Services – Investment Companies (Topic 946)*

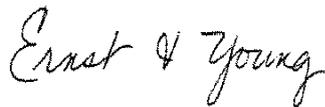
We agree with (i) above; that investments in associates and joint ventures should be measured at fair value through profit or loss in the financial statements of an investment entity. However, we cannot see a reason for (ii) above - why other entities that currently apply the exception in IAS 28, and that may not qualify as investment entities, should be forced to record their associates and joint ventures using the equity method. Therefore, we highly recommend that the IASB retain the current policy choice for the types of entities listed in IAS 28.

We encourage the IASB to reconsider the areas of our key concerns listed here and the other aspects addressed in our answers to the specific questions included in Appendix A, as well as achieving convergence of the final standards which will be issued by the IASB and FASB.

Appendix B to this letter includes other observations about the ED that we would like the IASB to consider in its redeliberations.

Should you wish to discuss the contents of this letter with us, please contact Ruth Picker on +44 20 79513497 or Leo van der Tas on +31 88 4075035.

Yours faithfully



Appendix A - Answers to the specific questions

Question 1:

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?

We agree with the proposal to create an exception to the principle of consolidation in IFRS 10 and to require a class of entities that, by design, invest for purposes of capital appreciation, investment income or both (i.e. investment entities) to measure their controlled investees at fair value through profit or loss in accordance with IFRS 9 *Financial Instruments*.

We note however that the proposals in this [draft] IFRS are inconsistent with the concept of control. *The Conceptual Framework for Financial Reporting* ('the Conceptual Framework') identifies control as an essential characteristic of an asset and implicitly as a central concept to determine the boundaries of a reporting entity. On the other hand, we note that the Conceptual Framework explains the objective of general purpose financial reporting to be providing financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity.

The Conceptual Framework does not provide a hierarchy of the different aspects of financial reporting addressed. Therefore, based on the existing guidance in the Conceptual Framework a conclusive view whether the control concept or the concept of decision-useful information should prevail could not be derived.

Given the above, on balance we support the exception proposed in this [draft] IFRS. We believe that our conceptual concerns relating to the inconsistency around the control concept are outweighed by the fact that the proposed exception offers investment entities the opportunity to provide more decision-useful information to the users of their financial statements. Further, the exception promises convergence with US GAAP.

It has however come to our attention that there are mixed views on the proposals. Certain entities that, although they would meet the definition of an investment entity, have users that would prefer to see consolidated information of the controlled investees in the financial statements. These entities believe that the information on the investees' underlying business activities and operating performance is more useful to users than the fair value of the investees. This seems to be particularly relevant for entities in the real estate sector.

The existence of these mixed views is precisely the reason why we recommend that the Boards should perform additional and specific outreach with financial statement users to confirm that fair value provides the most decision-useful information for all entities that may meet the investment entity criteria.

Question 2:

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?

We generally agree with the criteria set out in paragraph 2(a) - (f) of this [draft] IFRS. While certain aspects of the criteria could be improved and clarified (as discussed further below), the criteria broadly capture the appropriate pool of entities that would qualify as investment entities. Nonetheless, we expect the threshold to be high for an entity to qualify as an investment entity.

We have the following specific comments and observations with respect to the criteria of paragraph 2 of this [draft] IFRS and the accompanying Application Guidance.

Para 2 (a) - Substantive activitiesNature of substantive activities

With respect to the guidance in paragraphs B1 and B2, we have the following observations:

- In paragraph B1 the term 'investing activities' is used whereas elsewhere in this [draft] IFRS the term 'investment activities' is used.
- The term 'investing activities' is defined in IAS 7 *Statement of Cash Flows*³, however the terms 'investment activities' and 'investment advisory services' are not defined in the draft IFRS.

To avoid diversity in practice, we believe that constituents would benefit from clarity of the extent and boundaries of services that would be acceptable to for the entity to qualify as an investment entity by providing definitions.

³ The acquisition and disposal of long-term assets and other investments not included in cash equivalents

Interaction between an investor and an investee

- Active management by investor of its controlled investee

Based on the proposed guidance, it is unclear to what extent an investment entity may or may not be involved in the active management of a controlled investee in order to still qualify as an investment entity. We think this point should be clarified.

We note that the FASB's Proposed Accounting Standards Update Financial Services - Investment Companies (Topic 946) ('FASB's proposed ASU') provides some insight into this issue in paragraphs BC17 and BC18, which indicate that day-to-day management of an investee for the purposes of maximising value could be consistent with the activities of an investment company. That perspective is consistent with our outreach and research, which has indicated that an investor's involvement in the affairs of a controlled investee is common within the industry, including among entities that currently apply investment company accounting under US GAAP.

Examples of investor involvement would be investor representation on the board of the controlled investee with responsibilities for setting strategy, budgets and for appointing executive staff. These examples can be and are substantively different from the activities described in paragraph B6 (a) - (g), which are intended to indicate where the investor or its affiliates are investing for purposes other than capital appreciation or investment income.

Therefore, we recommend that the IASB should consider providing examples of activities that may or may not be consistent with investing for capital appreciation and/or investment income (note also our comments under 'exit strategy').

- Investment activities between controlled investees

Based on the proposed guidance, we conclude that where relationships or activities as described in paragraph B6 (a) - (g) exist between controlled investees of the entity, the entity may not qualify as an investment entity.

Inter-investee activity is a common feature in the private equity and venture capital sectors, and is often the reason for setting up particular fund structures - to enable the investor to exploit synergies between the investees and/or to "combine/roll-up" the investees to increase the exit value and consequently the capital appreciation (the 'buy and build' investment strategy). In structures where the controlled investee itself is a sub-group with its own subsidiaries, relationships or activities such as described in paragraph B6 (a) - (g) regularly exist in practice between the entities of the sub-group.

Based on the definition of an affiliate in this [draft] IFRS and the guidance in paragraph B6, it seems that it is the intention of the IASB to disallow these kinds of relationships and activities between directly or indirectly controlled investees of the entity. However, we also note that comparable relationships and activities between directly and indirectly held associates and joint ventures of the entity would not preclude the entity from being an investment entity because the respective interests are not defined as affiliates.

We believe that as long as relationships and activities *occur between directly or indirectly controlled investees of the entity* and are consistent with the entity's investment activities, the entity should still meet this criterion.

Therefore, we would suggest that the relationships and activities as described in paragraph B6 (a) - (g) should not be considered to be non-investment activities when they *occur between directly or indirectly controlled investees of the entity* and are consistent with the entity's investment activities.

Para 2 (b) - Business purpose

Exit strategy

With respect to the exit strategy and the guidance in paragraphs B9 - B11, we have the following comments and observations:

- It is unclear whether a documented exit strategy is required for *each individual investment*, and whether it would be acceptable to have an exit strategy for *most, but not all*, investments? Further, would it be acceptable for an exit strategy *to apply to a portfolio of investments* as is often seen in practice?
- It is unclear whether an exit strategy is required only for those investments where the entity intends to realise capital appreciation, or for all investments? It may be useful to note that the FASB has acknowledged the point by clarifying in its exposure draft (paragraph 946-10-55-10) that entities investing solely for investment income would not be required to have an exit strategy for those investments. While the FASB's clarification is useful, many entities have a mix of investments held individually for both capital appreciation and investment income purposes. We believe that the IASB should consider whether or not the guidance for exit strategy should be applicable only to investments held for capital appreciation purposes.

Refer also to the discussion of the scope of the [draft] IFRS in Appendix B.

Based on these observations we would encourage the IASB to provide more guidance and clarity around the exit strategy to avoid divergent interpretations of this aspect in practice.

Para 2 (c) - Unit ownership

Paragraph 2 (c) requires that each ownership unit must represent 'a proportionate share of the net assets' of the entity. We have the following observations:

- Paragraph B12 refers to a 'specifically identifiable portion of the net assets'. Did the IASB intend for these terms to mean the same thing?
- Paragraph B12 states that different classes of ownership units that provide different rights with respect to different parts of net assets (e.g. silos or cell entities) could exist. Paragraph B13 states that different classes of equity instruments with preferential rights do not preclude an entity from being an investment entity. However, it is not clear whether these preferential rights relate to different shares of net assets.

We recommend that the IASB should consider developing and adding guidance with respect to the points raised above.

Para 2 (d) - Pooled funds/significant ownership interests of others

Refer to our comments under Question 4.

Para 2 (e) - Managed and evaluated on a FV basis

We think it would be helpful to include some further guidance such as that included in the FASB's proposed ASU in paragraphs BC26 - 29, as to why fair value management and evaluation is required.

Refer also to the discussion of the scope of the [draft] IFRS in Appendix B.

Para 2(f) - Financial information provided to investors

We have no specific comments on this criterion.

Question 3:

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 generally agree that an investment entity that provides (or holds an investment in an entity that provides) services that relate only to its own investment activities should be eligible to qualify as an investment entity.

We agree that where the investment entity provides investment services outside the reporting entity, the nature of the investment activity criterion would not be met.

However, we also refer to our comments around the criterion 'substantive activities' noted in our answer to question 2.

Question 4:

- (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 Boards in paragraph BC16.

4 (a) Single unrelated investor⁴

We are concerned that the requirement to have multiple investors that are unrelated to the entity's parent (if any) could have an unintended consequence of scoping out many funds that would otherwise fall into the definition of an investment entity. It is common for non-investment entities (such as pension funds) to be the sole investor in an investment fund. These investment funds are generally designed to provide the investor additional levels of control over the investment strategy while still having an express purpose of investing for capital appreciation, investment income or both.

Consider the following simple example where parent entity P holds a 60% interest in entity A, and consider the following two scenarios:

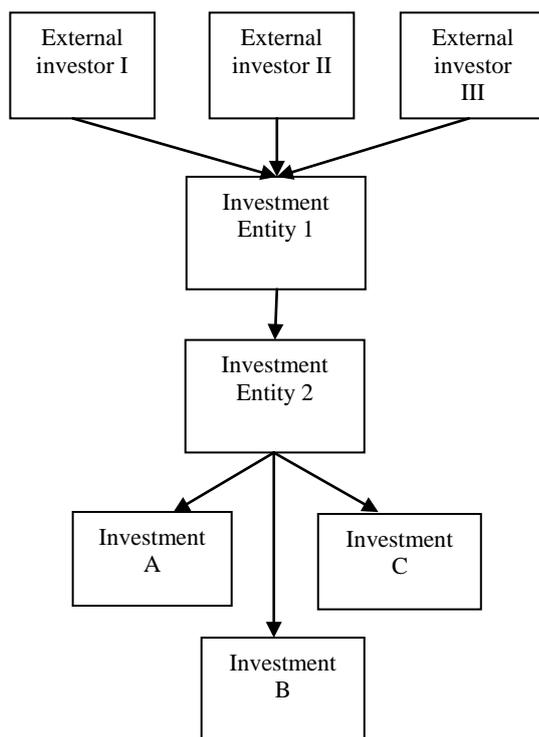
- Scenario 1: two investors unrelated to P each hold a 20% interest in A.
- Scenario 2: only one investor unrelated to P holds 40% in A.

We would be interested to understand why in scenario 1, entity A may qualify as an investment entity but may not qualify as an investment entity in scenario 2? We would encourage the IASB to provide additional guidance on this criterion. This is a further example of where user feedback would be critical.

⁴ In answering this question, we assume that 'fund manager' means 'parent' of the investment entity, as per the guidance in paragraphs 2(a) and B14 that requires an investment entity to have "investors that are unrelated to the parent (if any)".

Clarifying paragraph B16

Paragraph B16 refers to situations where a single investor investment entity could qualify as an investment entity. In our understanding the IASB is referring to situations where an investment entity has a single investor that itself qualifies as investment entity, as illustrated in the example below:



Therefore, we understand B16 to mean that Investment Entity 2 could qualify as an investment entity even though it has only Investment Entity 1 as single investor. We recommend that the IASB reconsider the wording in paragraph B16 of the Implementation Guidance as the proposed wording is very confusing. As a suggestion, we think the wording in the FASB’s proposed ASU, included below, is clearer than that proposed in B16:

‘An entity with a single investor parent may be formed (for legal, regulatory, tax or other business reasons) in conjunction with its parent (for example, a master feeder structure or a blocker fund). In some cases, the parent entity may have its own investors that are not related and that hold significant ownership interests in the parent entity. Provided that the entity meets all the other criteria for an investment company, having a single investor that is itself an investment company would not preclude the entity from meeting the definition of an investment company.’

4 (b) Structures/examples and concerns of the IASB

In paragraph BC16 of the Basis for Conclusions the IASB raised the concern “that an investment entity could be inserted into a larger corporate structure to achieve off-balance sheet accounting for some assets, while the parent could own almost all of that investment entity”.

In practice, the following situations and structures may occur where (temporarily or permanently) only a single investor unrelated to the parent exists:

- Structures where the intent is for there to be multiple investors (e.g. start-up entities) or where there have previously been multiple investors but for some reason there is currently only a single investor, but the business purpose of the entity still is to have multiple investors.
- Entities with a single investor that have been organised and set up in contemplation of a related investment entity (e.g. co-investment vehicle) which invests in a number of investments alongside another investment entity.
- Sovereign wealth funds, pensions funds or feeder funds which are likely to have only a single investor but fulfil all the other criteria for an investment entity.

We believe that these situations and structures on their own should not lead to an entity disqualifying as investment entity. In particular, the IASB should focus on the business purpose when evaluating circumstances where there is a single investor. Likewise, when certain structures are used solely to facilitate the investing strategies but do not otherwise alter conclusions about the express business objective and investing activities, the existence of such structures should not be the sole reason why an entity does not qualify as an investment entity.

While we appreciate the IASB’s concern around structuring, we think the focus should be on business purpose when evaluating circumstances where there is a single investor. We are not convinced by the fact that an entity with only one investor would necessarily lead to structuring abuse.

Therefore, we encourage the IASB to focus its concerns around abuse by clarifying the types of structures and activities that would call into question whether an entity is investing for capital appreciation, investment income or both, rather than using a bright-line approach based on the number of investors.

Question 5:

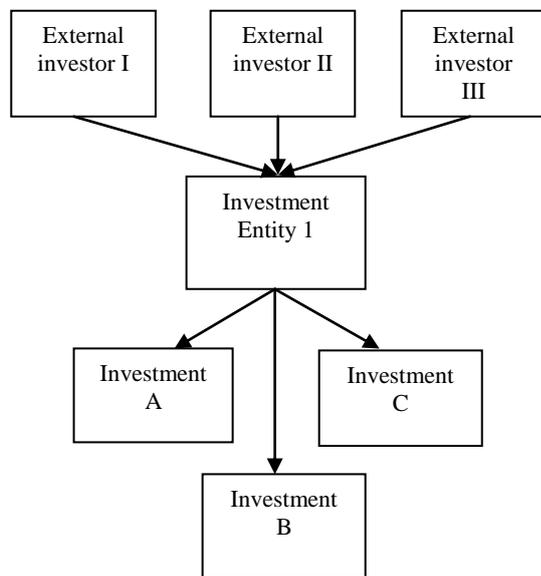
Do you agree that investment entities that hold investment properties should be required to apply the fair value model in IAS 40, and do you agree that the measurement guidance otherwise proposed in the exposure draft need apply only to financial assets, as defined in IFRS 9 and IAS 39 Financial Instruments: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

We do agree that investment entities that hold investment properties should be required to apply the fair value model in IAS 40 *Investment Property*. We observe that this corresponds with the accounting treatment currently applied by real estate funds and other real estate entities that may qualify as investment entities.

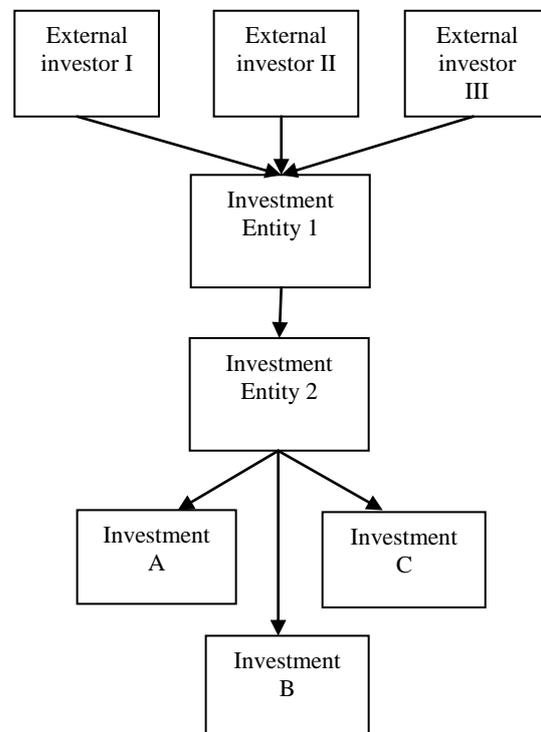
Other observations relating to measurement

We would like to address the measurement in so called fund-of-funds structures based on the following simplified examples:

Example 1:



Example 2:



- In Example 1, Investment Entity 1 meets all investment entity criteria and controls the investments in A, B and C. Therefore, Investment Entity 1 would measure all investments separately at fair value through profit or loss.

- In Example 2, Investment Entity 1 has inserted Investment Entity 2 between itself and the controlled investments in A, B and C. Based on our understanding of paragraph B16 (as discussed under question 4), Investment Entity 2 could also qualify as an investment entity. Therefore in this example, Investment Entity 1 would recognise its interest in the controlled Investment Entity 2 at fair value through profit or loss.

The FASB sees this differently - that Investment Entity 1 consolidates Investment Entity 2 and measures the investments in A, B and C separately at fair value through profit or loss.

We urge the IASB and FASB to develop converged guidance for these kinds of structures. We recommend that the Boards request user views on this issue as part of the planned round table discussions, to ensure that the final guidance results in a clear principle that is consistently applied.

Question 6:

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 IASB's concerns?

We strongly disagree that non-investment entity parent entities should not retain the fair value measurement of investees controlled by investment entity subsidiaries in their consolidated financial statements. Our reasons are as follows:

- In BC20 the IASB expressed the view that, in most cases, investment entities would have investment entity parents and therefore investment entity accounting would be available when needed. However, we understand that there are many situations in practice where investment entities are controlled by a parent that does not satisfy the investment entity criteria (e.g. insurance company controlling unit-linked funds; funds controlled by financial institutions, private equity/venture capital entities providing investment services to third parties).
- The IASB proposed this [draft] IFRS on the basis that fair value measurement provides more useful and relevant information for users of the financial statements of investment entities. In BC20, the IASB also acknowledges "that if more useful information is provided by allowing the investment entity to measure controlled investments at fair value it is likely that useful information would also be provided by retaining this accounting in the consolidated financial statements". We agree with this statement, and we do not think the IASB provides a compelling reason why the more useful and relevant information should not be retained in the consolidated financial statements of a non-investment entity parent.

- Further, not allowing the fair value roll up into the consolidated financial statements of a non-investment entity parent is inconsistent with the proposed accounting treatment of the parent for investments in associates and joint ventures held by an investment entity subsidiary. The [draft] IFRS requires that all parents of investment entities (regardless of whether they are investment entities themselves) must retain the fair value measurement in the consolidated financial statements of the investment entity's associates and joint ventures.
- The proposed accounting treatment in the non-investment entity parent's financial statements creates a GAAP difference with US GAAP in a project that was aimed to achieve convergence. The FASB's proposed ASU requires non-investment entity parents to retain the accounting of the investment entity subsidiaries in their consolidated financial statements.

The IASB's concerns

We understand from BC19 - 20 that the IASB is concerned about "potential accounting inconsistencies and possibilities for abuse". Our comments on this concern are as follows:

1. A non-investment entity parent holds investments in the investees of its investment entity subsidiary, for purposes other than capital appreciation and/or investment income.

We acknowledge that the following accounting issues arise when, for example, the investment entity subsidiary holds a 60% controlling interest in an investee and the non-investment entity parent holds a 30% interest in the same investee. In this instance, should the non-investment parent entity consolidate the controlled investee? How should the non-controlling interest relating to the controlled investee be determined? How could double-counting (i.e. recognition of 100% of the assets and liabilities of the controlled investee *as well as* the fair value of the interest in the controlled investee held by the investment entity subsidiary) be avoided?

One view may be that the non-investment parent has to consolidate the (indirectly) controlled investee in accordance with IFRS 10. However, this would then lead to double-counting effects which need to be resolved.

Another view may be that the investments in the controlled investee represent two different units of account, held for different purposes, and which have to be accounted for separately (in this example: equity accounting for the interest directly held by the non-investment entity parent and fair value accounting for the controlling interest held by the investment entity subsidiary).

Overall, we believe that situations where an investment entity subsidiary holds a controlling interest in an investee and the non-investment entity parent holds a non-controlling interest in this investee are rather rare. In such situations, careful consideration should be given to whether the subsidiary meets all the criteria required for

classification as an investment entity. If it does, we think that specific application guidance should be provided to resolve the specific accounting issues. Following the changes made to paragraph 19 of IAS 28 when IFRS 10 was issued, the IASB acknowledges that interests in associates could be held for different purposes. In our view, the same rationale may be used as a starting point to develop specific application guidance to avoid the accounting issues described above.

We would like to highlight that the proposals will already lead to similar accounting issues as described above, for example in the following situations (both examples assume the non-investment company parent is holding its investment for capital appreciation or investment income only and there are no other arrangements that may disqualify the investment entity subsidiary from meeting the definition of an investment entity):

- Non-investment entity parent holds a controlling interest of 60% in an investee and the investment entity subsidiary holds an interest of 30% in the same investee.
- Non-investment entity parent holds an interest of 30% in an investee and the investment entity subsidiary holds an interest of 30% in the same investee and both interests together provide control.

By requiring retention of the fair value measurement of associates and joint ventures of the investment entity subsidiary in the consolidated financial statements of the non-investment entity parent, the IASB does not seem to have the same concerns about accounting anomalies.

2. The accounting by the entity's parent could differ as a result of the parent selectively making investments within an investment entity subsidiary that are similar to investments held by non-investment-entity members of the consolidated group.

This concern seems to indicate that an entity needs to make investments in similar entities for the same purposes. We do not see a basis in IFRSs for this notion.

3. Accounting inconsistencies and possibilities of abuse e.g. when a non-investment entity parent issues its equity to an investee of an investment entity subsidiary and thereby appears to have a stronger capital base.

We believe that the example the IASB is referring to is rather rare in practice and that it does not adequately support the disallowance of the fair value roll-up into the non-investment entity parent's consolidated financial statements. We think that this specific situation may be addressed in additional application guidance.

We believe there is a danger of the IASB over-emphasising the possibilities of abuse. As stated in our cover letter, we note that the FASB's guidance on Investment Companies⁵ does not express the structuring concerns to the same extent, which is particularly relevant considering that the concept of investment entities (companies) is already applied in practice in the US.

Therefore, we urge the IASB to reconsider this point. We believe that a converged approach in this area is preferable and that the Boards should work together on this issue.

Question 7:

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

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

We agree with the concept of having a disclosure objective for investment entities rather than a detailed list of specific disclosures.

However, we believe that the disclosure objective included in paragraph 9 of the exposure draft is too general. As the term "investment activities" is not defined in this [draft] IFRS, uncertainty may exist as to whether the disclosures should relate to the activities of the investment entity itself, or to the actual investments held by the investment entity.

With respect to paragraph B19, we are concerned about the phrase "may be appropriate to meet the disclosure requirement". We think that the IASB should clarify whether the examples given are sufficient to achieve the disclosure objective, or if these examples are meant as a non-exhaustive list of possible disclosures. The way it is proposed, we think that entities may interpret that by providing the information listed in paragraph B19, the disclosure principle is met. We do not agree - we think that the disclosure principle in paragraph 9 that "an investment entity shall provide information to enable users of its financial statements to evaluate the nature and financial effects of the investment activities it engages" may not be met by solely providing the mainly quantitative information listed in paragraph B19.

⁵ Proposed Accounting Standards Update – *Financial Services – Investment Companies (Topic 946)*

Regarding the disclosure requirements in other standards, we have the following observations:

- IFRS 7 *Financial Instruments - Disclosures* paragraph 3(a) scopes out those investments in subsidiaries, associates or joint ventures accounted for in accordance with IAS 27 *Consolidated and Separate Financial Statements*/IFRS 10, IAS 28 or IAS 31 *Interests in Joint Ventures*/IFRS 11 *Joint Arrangements*, except for those that are **accounted for under IAS 39/IFRS 9**, as permitted in some cases.
- IFRS 12 *Disclosure of Interests in Other Entities* paragraph 6(d) scopes out interests in another entity that are **accounted for in accordance with IFRS 9**. However, IFRS 12 shall be applied when that interest is an interest in an associate or joint venture that, in accordance with IAS 28 is measured at fair value through profit and loss.
- Paragraph 6 of this [draft] IFRS and the consequential amendment to IAS 28 refer to the **measurement** of controlled investees and interests in associates and joint ventures **at fair value through profit or loss in accordance with IFRS 9**.

It is our understanding from paragraphs BC24 - BC25 that the IASB does not intend the information required by IFRS 12 (e.g. summarised financial information) to be disclosed for investments of an investment entity in controlled investees, associates and joint ventures. We agree with this approach. We think, however, that this should be clarified in the guidance. To achieve this, we think that the IASB should consider adjusting

- the current guidance in IFRS 12.6 (d) which requires IFRS 12 disclosures for the investments in associates and joint ventures measured at fair value through profit or loss, and
- the scope paragraphs in IFRS 7 and IFRS 12 which currently refer to the accounting and not the measurement in accordance with IFRS 9.

In paragraphs BC22 and BC23 the IASB proposes information that should be disclosed (i.e. disclosures about any explicit or implicit financial support that has been provided to entities it controls and about the nature and extent of significant restrictions with respect to the investee). Currently the respective disclosures are not addressed in this [draft] IFRS. In the event that controlled investees of an investment entity are not included in the scope of IFRS 12 (see above), we recommend that the IASB reconsiders whether these disclosures should be added in this [draft] IFRS.

We encourage the IASB to use its planned outreach activities to confirm whether the proposed guidance will lead to disclosures that will provide decision-useful information to the users of investment entities' financial statements.

Question 8:

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?

We do have the following comments and recommendations:

Date of transition

Paragraph C2 proposes that an investment entity should recognise the effects of applying this [draft] IFRS **at the beginning of the period for which this draft IFRS is adopted for the first time.**

In our understanding that would mean that an investment entity would present in its financial statements, in the period this [draft] IFRS is adopted for the first time, financial information which includes controlled investees at fair value, whereas the respective controlled investees are consolidated in the comparative period(s). This would lead to financial information that only allows limited inter-period comparability.

We generally believe that investment entities should be able to retrospectively apply this [draft] IFRS as they are required to manage and evaluate their investments on a fair value basis.

Therefore, we would suggest that this [draft] IFRS should require retrospective application, unless doing so is impracticable (as defined in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*). In the latter case this [draft] IFRS should be applied prospectively from the beginning of the earliest period for which the application is practicable, which may be the current period.

We believe that our transition suggestions would also better align the transition requirements of this [draft] IFRS with those in IFRS 10⁶.

⁶ We note that the IASB issued the exposure draft *Transition Guidance – Proposed amendments to IFRS 10* in December 2011. Our comments above refer to the proposals in the *Investment Entities* exposure draft. We assume that any amendments to IFRS 10's transition guidance will be carried through to the Investment Entities proposals, where relevant.

Question 9:

- (a) Do you agree that IAS 28 should be amended so that the mandatory measurement exception 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 exception mandatory for investment entities as defined in the exposure draft and voluntary for other venture capital organizations, mutual funds, unit trusts and similar entities, including investment-linked insurance funds? Why or why not?

9(a)

We agree that IAS 28 should be amended to require investment entities to measure their investments in associates and joint ventures at fair value through profit or loss in accordance with IFRS 9.

However, we strongly disagree with removing the measurement exception currently included in IAS 28 for venture capital organisations, mutual funds, unit trusts and similar entities including investment-linked insurance funds.

The IASB also acknowledges in BC28 that it “observed that the criteria developed in the exposure draft and the list of entities currently referred to in IAS 28 (as amended in 2011) have the same objective - to identify those entities for which fair value measurement of their investments provides more relevant information”. However, due to the narrow definition of an investment entity proposed in this [draft] IFRS, we believe that many entities that currently use the measurement exception in IAS 28 may not qualify as investment entities. Therefore, these entities would be required to change their accounting, which the IASB acknowledges in BC29. We find this inconsistent with the IASB’s belief that the fair value measurement basis provides more useful and relevant information. Consequently, we recommend that the existing measurement exception - which is widely used and well perceived by the users/stakeholders - should not be amended.

9(b)

As explained above we agree with this alternative and we recommend that the IASB strongly consider it.

Appendix B - other observations about the ED

1. The scope of the [draft] IFRS:

We are concerned that the scope of the guidance is not clearly defined, and we have the following observations:

- **Type of investments held by the entity:**

Paragraph B11 (referring to paragraph 2(b) *business purpose*) states that 'For investments in debt securities, examples of exit strategies include selling the debt in a private placement, or converting the debt to equity securities and subsequently selling those equity securities.' This seems to clearly indicate that investments other than investments in equity instruments should be within the scope of investment activities of an investment entity.

However, there is no other reference to debt securities in the [draft] IFRS. Regarding the exit strategy, the guidance is silent on whether holding debt instruments to maturity is an acceptable exit strategy for such instruments. We think that holding debt instruments to maturity could be an acceptable exit strategy, for example, a long term fixed income fund (buy-and-hold fund), where the purpose is to earn interest income by holding the fixed income investments until maturity.

Paragraph 2(e) requires that substantially all investments of an investment entity are managed, and their performance is evaluated, on a fair value basis. In practice, an entity's investment activities may be limited to investing in multiple investments for investment income which are not managed and evaluated on a fair value basis, (e.g. from debt instruments). Entities may also have a mixed management approach to a fund, where some investments are managed on a fair value basis, and some on a contract yield basis. It is not clear whether these types of entities would qualify as investment entities. Additional examples of typical structures may be useful to assist entities in determining whether each individual entity, based on its individual purpose and design, manages and evaluates its investments on a fair value basis. These examples could include funds that invest primarily in residential mortgage loans and securities (e.g. mortgage real estate investment trusts, and funds designed to provide investors stable returns).

We note that question 5 asks whether '...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*' (emphasis added). However, the measurement guidance in this [draft] IFRS and its consequential amendments to other IFRSs only relate to investments in controlled investees and interests in associates and joint ventures. Thus the measurement of other financial assets (i.e. debt instruments) is not addressed. Consider also investments in assets such as art, wine, or other classes of assets which are managed and evaluated on a fair value basis. For these types of entities,

a fair value measurement of such assets may also generate more decision-useful information.

We understand that this [draft] IFRS is intended to provide an exception for investment entities to consolidate controlled investees in accordance with IFRS 10. However, we recommend that the IASB considers including measurement guidance in this [draft] IFRS (or a reference to the measurement guidance in other IFRSs) for investments held by investment entities other than real estate and investments in controlled investees, associates and joint ventures. To this end, the IASB may consider the guidance in the FASB's proposed ASU, section 946-325 *Financial Services - Investment Companies - Investments - Other*.

- **Type of instruments issued to the investors of the entity:**

Paragraph 2(c) seems only to cover equity instruments. However in practice, highly leveraged funds exist where investors hold debt instruments issued by the funds, and not equity instruments. It is not clear why these types of funds would be excluded from the scope of this [draft] IFRS solely because its pooled funds are classified as liabilities rather than equity. We recommend the IASB consider investor's views on the appropriate financial reporting where a class of entities may be excluded based solely on the classification of their issued interests.

In summary, we recommend that the IASB consider clarifying the scope of the [draft] IFRS.

2. Unrelated investors:

With respect to the term "unrelated" we would like to draw the attention of the IASB to the following situation which is common in the insurance sector: certain insurance companies will set up an entity/fund to invest policyholder premiums on the policyholders' behalf. The entity/fund is the legal owner of the investments. The entity/fund passes the returns from the investments on to the policyholders through the insurance policies they hold, after subtracting an agreed fund management fee.

The policyholders in this case could be seen as having an 'indirect' investment in the entity/fund through the insurance policies they hold. Where the entity/fund meets all the other criteria to qualify as an investment entity, could such an entity be said to meet the 'unrelated investor' requirement as well?

Therefore, we recommend that the IASB considers if and under which circumstances indirect interests of others in entities could be regarded as unrelated investors for the purposes of qualifying as an investment entity.

3. Previously recognised OCI components relating to controlled investees:

The transition requirements in paragraph C2 state that part of the adjustment to retained earnings is “any changes in the fair value of investees’ net assets previously recognised, and remaining, in accumulated other comprehensive income”. We have the following observations and concerns:

- It is not clear whether the components of OCI relating to previous fair value changes of the investees’ net assets are part of the adjustment to retained earnings or whether they remain in OCI.
- The proposed wording states that only changes in the fair value of the investees’ net assets recognised previously in OCI are part of the adjustment to retained earnings. We understand that this would include, for example, fair value changes of available for sale financial assets and IAS 16 *Property, Plant and Equipment*/IAS 38 *Intangible Assets* revaluations which were previously recognised in OCI.

Thus, it seems that other components of OCI relating to controlled investees (e.g. currency translation reserve, actuarial gains and losses from defined benefit plans) remain in OCI and should be treated in accordance with the guidance in the relevant standards.

We do not see the basis for the different treatments of the various components of OCI relating to controlled investees on transition.

- The proposed amendments to IAS 28 currently do not contain any guidance on how previously recognised components of OCI relating to associates and joint ventures should be treated.

Therefore, we suggest that the IASB re-considers the transition requirements around the treatment of OCI especially with respect to the following matters:

- Which parts of OCI relating to a controlled investee should be included in the transition adjustment to retained earnings? If not all parts of OCI are included in this adjustment, the IASB should provide a rationale why certain parts remain in OCI whereas other parts are included in the transition adjustment.
- Treatment of OCI components relating to investments in associates and joint ventures.

4. Amendments to IAS 27:

We are concerned with the proposed amendment to IAS 27 that requires an investment entity to measure its interests in subsidiaries, jointly controlled entities/joint ventures and associates in its separate financial statements at fair value through profit or loss in accordance with IFRS 9.

In some jurisdictions, separate financial statements provide the basis for taxation and dividend payments. We therefore have concerns that the mandatory requirement to account for the investments at fair value through profit or loss in the separate financial statements may have unintended consequences.

We recommend that the IASB does not change the current measurement guidance for separate financial statements in IAS 27.

5. Hierarchy between business purpose and business activities:

We think it would be helpful for the IASB to clarify the hierarchy of assessing the explicitly stated business purpose versus the actual business activities of the entity. Consider the following - if an entity undertakes investment activities but does not explicitly state investing as its business purpose, would that entity still meet this criterion?

6. Illustrative examples:

Generally, we would recommend that the conclusion/analysis should cross-reference to the paragraphs applied to reach the conclusions.

7. Paragraph B3:

The IASB may consider excluding from this guidance collaterals received which also qualify as investments according to the nature of the investment activities and business purpose of the (investment) entity (e.g. when collateral represent shares in another entity).

8. Paragraph B9:

In sentence three the reference to 'majority interest' should be 'controlling interest'.