

STAFF PAPER

21 May - 24 May 2012

REG FASB | IASB Meeting

Project	Investment Entities / Investment Companies		
Paper topic	Summary of staff recommendations		
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Introduction

1. This paper provides a summary of the staff recommendations included in IASB Agenda Papers 8A and 8B/FASB Memo Nos. 46A and 46B. This paper also includes the questions to the Boards for each of the issues discussed in those agenda papers.

Asset-based versus entity-based guidance (IASB only consideration)

2. This issue is discussed in paragraphs 8-13 of IASB Agenda Paper 8B/FASB Memo No. 46B. The staff recommends that the IASB continue to deliberate an entity-based approach rather than pursue an asset-based approach.¹

¹ The staff believes this issue is not relevant for the FASB because U.S. GAAP for investment companies historically has been entity based. An asset-based approach would be outside the scope of the FASB's investment companies project.

Question 1 – IASB only

Does the IASB agree with the staff recommendation to continue with an entity-based approach to investment entity guidance?

3. If the IASB does not agree with the staff recommendation, the remaining questions in this paper are irrelevant for both Boards. The IASB would need to start deliberations of an asset-based approach at a future board meeting and the FASB would proceed with its investment companies² deliberations separately from the IASB.

Approach to entity-based investment entity guidance

4. This issue is discussed in paragraphs 14-44 of IASB Agenda Paper 8B/FASB Memo No. 46B. The staff recommends Alternative 3 (the definition with factors to consider approach).

Question 2

Do the Boards agree with the staff recommendation that a definition of an investment entity along with a list of factors to consider should be provided to determine whether an entity is an investment entity?

5. If the Boards agree with the staff recommended approach (Alternative 3), they also must answer Questions 3 and 4 in this paper.
6. If the Boards decide to proceed with a qualitative assessment (Alternative 2), they also must answer Question 4 in this paper.
7. If the Boards decide to retain the approach in the EDs (Alternative 1), they also must answer Question 5 in this paper.

² This paper uses the terms *investment entity* and *investment company* interchangeably.

Alternative 3 only: Definition of an investment entity

8. The definition of an investment entity under Alternative 3 is discussed in paragraphs 45-51 of IASB Agenda Paper 8B/FASB Memo No. 46B.
9. All staff members recommend that the definition of an investment entity include aspects of the following criteria proposed in the EDs:
 - (a) Nature of the investment activities
 - (b) Express business purpose
 - (c) Pooling of funds.
10. All staff members recommend that the definition of an investment entity generally be described as follows:

An investment company is an entity that does both of the following:

- a. Pools funds from an investor or investors and provides the investor(s) with professional investment management services
- b. Commits to its investor(s) that its business purpose and only substantive activities are investing the funds for returns from capital appreciation, investment income, or both.

An investment company and its affiliates do not obtain, or have the objective of obtaining returns or benefits from their investments that are either of the following:

- a. Other than capital appreciation and investment income
- b. Not available to other noninvestors or are not normally attributable to ownership interests.

Alternative 3 only: Factors to consider

11. The factors to consider for an entity to determine whether it is an investment entity under Alternative 3 are discussed in paragraphs 52-58 of IASB Agenda Paper 8B/FASB Memo No 46B.
12. The staff recommends that in addition to meeting the definition described in paragraph 10, an entity should consider the following three factors to determine whether it is an investment company. The three factors to consider described

below should be treated as indicators, rather than requirements, to determine whether an entity is an investment company.

- a. *Number of investments and investors*: Investment companies typically have multiple investors and hold multiple investments. However, an entity is not precluded from being an investment company because it has a single investor or holds a single investment, provided it demonstrates how it meets the definition of an investment company. It would be rare for an investment company to have both a single investor and hold a single investment because it would be very difficult but not necessarily impossible for such an entity to meet the definition of an investment company.
- b. *Related investors*: Typically investment companies have multiple investors with a significant ownership interest held by an investor or investors that are not related to the parent (if there is a parent). However, an entity is not precluded from being an investment company because it has multiple related investors provided it demonstrates how it meets the definition of an investment company. For this assessment, investors related to the parent should be combined and treated as a single investor, along with the parent.
- c. *Ownership interests*: Ownership interests in an investment company are typically in the form of equity or partnership interests to which a specifically identifiable portion of the net assets are attributed. However, an entity that has significant debt ownership may still qualify as an investment company provided that it demonstrates that its ownership interests represent a specifically identifiable portion of the net assets.

Alternative 3 only: Inclusion of the fair value management concept

13. This issue is discussed in paragraphs 59-63 of IASB Agenda Paper 8B/FASB Memo No. 46B. There is a split staff recommendation regarding the inclusion of the fair value management concept that was proposed as a criterion in the EDs. The IASB staff recommends that this concept be included as part of the definition of an investment entity (and thus be mandatory for all investment entities). The FASB staff recommend that this concept be included as a factor to consider.

Question 3 - Alternative 3 only

- a) Do the Boards agree with the staff recommendation for the definition of an investment entity as set out in paragraph 10?
- b) Do the Boards agree with the staff recommendation for the factors to consider in addition to the definition as set out in paragraph 12?
- c) Do the Boards prefer that the fair value management concept proposed in the EDs be included as part of the definition or as a factor to consider?

Alternatives 2 and 3: Application guidance

14. In addition to the definition and factors to consider under Alternative 3, the staff recommends that the Boards include relevant application guidance that was included in the EDs and relevant additional application guidance that is recommended in IASB Agenda Paper 8A/FASB Memo No. 46A to assist entities in determining whether they are investment companies. The background and staff analysis underlying those recommendations are contained in Agenda paper 8A/FASB Memo No. 46A.
15. Also, if the Boards decide on Alternative 2 (the qualitative assessment), the staff believes the same recommendations regarding changes to application guidance are relevant. However, if the boards decide on Alternative 2, the staff would not recommend any changes be made to the criteria proposed in the EDs.
16. The staff recommendations for the application guidance are described below, grouped by the concept to which the application guidance relates.

Nature of the investment activity (paragraphs 9-40 of Agenda paper 8A)

17. The staff has the following recommendations regarding the application guidance accompanying the nature of the investment activities concept:
 - a. The application guidance should not include a definition of *substantive*.

- b. The application guidance should clearly state that an investment entity would be allowed to provide investment-related services to third parties only if those services are not substantive. (IASB only)
- c. The application guidance should clearly state that day-to-day management of investees should not disqualify an entity from investment entity status. (IASB only)
- d. The application guidance should state that transactions between controlled investees would not be prohibited.

Express business purpose: Exit strategy (paragraphs 41-59 of Agenda paper 8A)

- 18. There is a split staff recommendation regarding the exit strategy requirements in the application guidance:
 - a. The IASB staff recommends that the application guidance should require an investment entity to have an exit strategy for substantially all of the investments in its portfolio. The IASB staff thinks that the application guidance should indicate that an investment entity should not hold a significant amount of its portfolio only for returns from investment income. The application guidance should also contain a statement that allows an investment entity to hold debt investments without an exit strategy only if those instruments do not form a significant part of the investment entity's investment portfolio and only if the entity is still considered to manage on a fair value basis.
 - b. The FASB staff recommends that the application guidance state, consistent with the FASB ED, that an exit strategy is required for investments that an investment company's business purpose includes realizing capital appreciation, but that an exit strategy is not required for investments that an investment company's business purpose is to invest only for returns from investment income. The FASB also recommends that application guidance should clarify that the examples provided in

paragraph 49 of IASB Agenda Paper 8A/FASB Memo No. 46A could be viewed as investment companies holding investments for returns only from investment income.

19. The IASB staff also recommends the following regarding the application guidance for exit strategy:
- a. The application guidance should allow an entity to assess exit strategy at a portfolio level.
 - b. The application guidance should not include a discussion of the timing of exit strategy.
 - c. The application guidance should state that feeder funds should assess the exit strategy of the master funds' investments in a master-feeder structure.

Fair value management (paragraphs 91-107 of Agenda paper 8A)

20. The FASB staff recommends that the additional guidance related to the fair value management concept that was included in the FASB's Basis for Conclusions should be included in implementation guidance rather than in the Basis for Conclusions. That guidance would require an entity to consider the following to determine whether the entity is managing on a fair value basis:
- a. How it transacts with its investors
 - b. How asset-based fees are calculated and whether these fees are based on the fair value of the entity's net assets.
21. The IASB staff has the following recommendations regarding the application guidance accompanying the fair value management concept:
- a. The additional language in the FASB's Basis for Conclusions should not be included in the IASB's investment entities guidance.
 - b. The application guidance should state that there is no requirement for an investment entity to measure its financial liabilities at fair value and an investment entity is not required to manage its financial liabilities on a fair value basis to satisfy the fair value management concept.

Reporting entity (paragraphs 108-111 of Agenda paper 8A)

22. The staff recommends retaining the notion that an investment entity is not required to be a separate legal entity in application guidance.

'In conjunction with' guidance (paragraphs 112-116 of Agenda paper 8A)

23. The staff recommends that language be added in the application guidance to clarify that the 'in conjunction with' guidance applies even if investment funds are not set up at the same time.
24. The staff also recommends that application guidance be clarified to allow single investor or single investment funds to be set up alongside a main fund for various business reasons other than legal, regulatory or tax reasons provided they meet the other investment entity criteria.

Question 4 – Alternatives 2 and 3

- a) Do the Boards agree with the staff recommendations regarding the nature of investment activities application guidance described in paragraph 17?
- b) Do the Boards agree with the IASB staff recommendation or the FASB staff recommendations regarding the exit strategy requirements in the application guidance described in paragraph 18?
- c) Does the IASB agree with the staff recommendations regarding additional clarifications to the exit strategy application guidance described in paragraph 19?
- d) Do the Boards agree with the IASB staff recommendations or the FASB staff recommendation regarding the fair value management application guidance described in paragraphs 20 and 21?
- e) Do the Boards agree with the staff recommendation regarding the reporting entity application guidance described in paragraph 22?
- f) Do the Boards agree with the staff recommendations regarding the in conjunction with application guidance described in paragraphs 23 and 24?

Alternative 1 only: Requiring all six criteria to be met (ED approach)

25. The following is a summary of the staff recommendations if the Boards decide to retain the criteria approach proposed in the EDs. The background and staff analysis underlying those recommendations are contained in IASB Agenda Paper 8A/FASB Memo No. 46A.
26. For each of the criteria proposed in the EDs, below is a summary of the staff-recommended changes to the individual criterion itself, along with the accompanying application guidance.
27. One question for the Boards follows this summary of staff recommendations.

Nature of the investment activity (paragraphs 9-40 of Agenda paper 8A)*Criterion*

28. Some staff members recommend that the requirement to hold multiple investments be retained. Other staff members recommend removing that requirement.

Application guidance

29. The staff has the following recommendations in regards to the application guidance accompanying the nature of investment activities criterion:
 - a. The application guidance should not include a definition of *substantive*
 - b. The application guidance should clearly state that an investment entity would be allowed to provide investment-related services to third parties only if those services are not substantive. (IASB only)
 - c. The application guidance should clearly state that day-to-day management of investees should not disqualify an entity from investment entity status. (IASB only)
 - d. The application guidance should state that transactions between controlled investees would not be prohibited.

Express business purpose (paragraphs 41-59 of Agenda paper 8A)*Criterion*

30. The staff does not recommend any changes to be made to the express business purpose criterion.

Application guidance: Exit strategy

31. There is a split staff recommendation regarding the exit strategy requirements in the application guidance accompanying the business purpose criterion
- a. The IASB staff recommends that the application guidance should require an investment entity to have an exit strategy for substantially all of the investments in its portfolio. The IASB staff thinks that the application guidance should indicate that an investment entity should not hold a significant amount of its portfolio only for returns from investment income. The application guidance should also contain a statement that allows an investment entity to hold debt investments without an exit strategy only if those instruments do not form a significant part of the investment entity's investment portfolio and only if the entity is still considered to manage on a fair value basis.
 - b. The FASB staff recommends that the application guidance state, consistent with the FASB ED, that an exit strategy is required for investments that an investment company's business purpose includes realizing capital appreciation, but that an exit strategy is not required for investments that an investment company's business purpose is to invest only for returns from investment income. The FASB also recommends that application guidance should clarify that the examples provided in paragraph 49 of IASB Agenda Paper 8A/FASB Memo No. 46A could be viewed as investment companies holding investments for returns only from investment income.
32. The IASB staff also recommend the following regarding the application guidance for exit strategy:

- a. The application guidance should allow an entity to assess exit strategy at a portfolio level.
- b. The application guidance should not include a discussion of the timing of exit strategy.
- c. The application guidance should state that feeder funds should assess the exit strategy of the master funds' investments in a master-feeder structure.

Unit ownership (paragraphs 60-73 of Agenda paper 8A)

Criterion

33. The staff recommends the following changes be made to the unit ownership criterion:
 - a. *Unit ownership* should be changed to *ownership interest*.
 - b. The criterion should not include any references to required 'forms' of ownership interest (such as equity or partnership interests).
 - c. The criterion should state that 'a specifically identifiable portion' of net assets are attributed to ownership interests rather than the specifically identifiable concept being included in application guidance. That would replace *proportionate share* for the IASB and would add *specifically identifiable* for the FASB.

Pooling of funds (paragraphs 74-90 of Agenda paper 8A)

Criterion

34. The staff recommends the following changes be made to the pooling of funds criterion:
 - a. The requirement to have multiple investors should be removed.
 - b. The requirement to have unrelated investors should be removed.

Fair value management (paragraphs 91-107 of Agenda paper 8A)*Criterion*

35. The staff does not recommend any changes be made to the fair value management criterion.

Application guidance

36. The FASB staff recommend that the additional guidance related to the fair value management criterion that was included in the FASB's Basis for Conclusions should be included in implementation guidance rather than in the Basis for Conclusions. That guidance would require an entity to consider the following to determine whether the entity meets the fair value management criterion:
- a. How it transacts with its investors
 - b. How asset-based fees are calculated and whether these fees are based on the fair value of the entity's net assets.
37. The IASB staff has the following recommendations regarding the application guidance accompanying the fair value management criterion:
- c. The additional language in the FASB's Basis for Conclusions should not be included in the IASB's investment entities guidance.
 - d. The application guidance should state that there is no requirement for an investment entity to measure its financial liabilities at fair value and an investment entity is not required to manage its financial liabilities on a fair value basis to satisfy the fair value management concept.

Reporting entity (paragraphs 108-111 of Agenda paper 8A)*Criterion*

38. The staff recommends removing the reporting entity criterion.

Application guidance

39. The staff recommends retaining the notion that an investment entity is not required to be a separate legal entity in application guidance.

'In conjunction with' guidance (paragraphs 112-116 of Agenda paper 8A)*Application guidance*

40. The staff recommends that language be added in the application guidance to clarify that the 'in conjunction with' guidance applies even if investment funds are not set up at the same time.
41. The staff also recommends that application guidance be clarified to allow single investor or single investment funds to be set up alongside a main fund for various business reasons other than legal, regulatory or tax reasons provided they meet the other investment entity criteria.

Question 5 – Alternative 1 only

- a) Do the Boards think that an investment entity should be required to hold multiple investments?
- b) Do the Boards agree with the staff recommendations regarding the nature of investment activities application guidance described in paragraph 29?
- c) Do the Boards agree with the staff recommendation that no changes should be made to the express business purpose criterion?
- d) Do the Boards agree with the IASB staff recommendation or the FASB staff recommendation regarding the exit strategy requirements described in paragraph 31?
- e) Does the IASB agree with the staff recommendations regarding additional application guidance for the exit strategy requirements described in paragraph 32?
- f) Do the Boards agree with the staff recommendations regarding the unit ownership criterion described in paragraph 33?

- g) Do the Boards agree with the staff recommendations regarding the pooling of funds criterion described in paragraph 34?
- h) Do the Boards agree with the staff recommendation that no changes should be made to the fair value management criterion?
- i) Do the Boards agree with the IASB staff recommendations or the FASB staff recommendations regarding the fair value management application guidance described in paragraphs 36-37?
- j) Do the Boards agree with the staff recommendations regarding the 'reporting entity' criterion and application guidance described in paragraphs 38 and 39?
- k) Do the Boards agree with the staff recommendations regarding the 'in conjunction with' application guidance described in paragraphs 40 and 41?