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Mr. Hans Hoogervorst
Chairman
International Accounting Standards Board
30 Canon Street, London, EC4m 6XH
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MACQUARIE

CC:
Mr. Kevin Stevenson
Chairman
Australian Accounting Standards Board
PO Box 204
Collins Street West
Melbourne, VIC, 8007

By Electronic Submission at: www.iasb.org

23 December 2011

Dear Mr Hoogervorst,

IASB Exposure Draft *Investment Entities*

We are responding to the IASB Exposure Draft *Investment Entities.*

Our responses to the questions included within the exposure draft are provided in the attached Appendix.

Overall, we agree that there is a class of entities for which the fair value of their investments may provide more decision-useful information. However, we recommend that an entity's management should have an irrevocable choice of measuring their investments at fair value through profit or loss which would be consistently applied to all investments regardless of the size of the holdings and the degree of influence (e.g. financial assets, associates, joint ventures and subsidiaries).

We consider the Board's approach to identifying an investment entity to be rule-based and therefore lacks an underlying principle. Consequently, it suffers from excluding certain entities that we suggest should be included (e.g. life insurance companies). We recommend using the general description of entities currently provided in IAS 28 paragraph 1 "investments ... held by venture capital organisations, mutual funds, unit trusts and similar entities including investment-linked insurance funds" and incorporating our earlier suggestion of an irrevocable choice to form the approach.

As for the parent of an investment entity that is itself not an investment entity, we recommend that the parent entity's management should also have an irrevocable choice of measuring their investments (e.g. financial assets, associates, joint ventures and subsidiaries) at fair value through profit or loss. We suggest that the IASB's reasons for investment entities to not consolidate subsidiaries are also valid for parents of investment entities.

If you have any questions in relation to this submission, please do not hesitate to contact myself (+61 2 8232 8670) or Frank Palmer (+61 2 8232 5193)

Yours sincerely

Stuart Dyson
Group Financial Controller
Macquarie Group

About Macquarie Group

Macquarie Group (Macquarie) is a global provider of banking, financial, advisory, investment and funds management services.

Macquarie's main business focus is making returns by providing a diversified range of services to clients. Macquarie acts on behalf of institutional, corporate and retail clients and counterparties around the world.

Macquarie Group Limited is listed in Australia (ASX:MQG; ADR:MQBKY) and is regulated by APRA, the Australian banking regulator, as the owner of Macquarie Bank Limited, an authorised deposit taker. Macquarie also owns a bank in the UK, Macquarie Bank International Limited, which is regulated by the FSA. Macquarie's activities are also subject to scrutiny by other regulatory agencies around the world.

Macquarie's approach to risk management is long-standing. Strong risk management practices are embedded in business unit management with central oversight of credit, market, funding, compliance and operational risk. These, together with a strong, committed team are key drivers of Macquarie's success.

Founded in 1969, Macquarie employs more than 15,000 people in over 28 countries. At 30 September 2011, Macquarie had assets under management of $A327 billion.

APPENDIX

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?

Yes, we agree with the underlying theme that there is a class of entities for which the fair value of their investments may be more relevant in providing decision-useful information. We consider this view to be valid for all investments held by an investment entity, regardless of the size of the holdings or the degree of influence over the investee (e.g. financial assets, associates, joint ventures and subsidiaries).

We disagree that all entities in the class should be required to measure their direct investments at fair value (or in other words, not consolidate subsidiaries), because users of financial statements often express differing views about whether fair value is more useful. All investments ultimately have the purpose of, perhaps minor in some cases, capital appreciation, investment income or both. We agree fair value can provide more relevant information to many investors; however, investors taking a longer-term view of investments may be concerned with other information such as stable cash flows or earnings.

Although the nexus between control and consolidation of controlled entities has been fundamental under IFRS, we support financial reporting moving with changes in the environment and needs of users. The current consolidated financial results do not always give the financial information that investors seek from a company intending to hold an underlying investment for a short period of time. Some users have had to independently gather and interpret other market information to fill this void. Additionally, we maintain that consolidated results can obscure information and reduce comparability with others that may invest in the same direct investment but do not control the entity.

Consequently, we recommend that the entity's management should have an irrevocable choice of measuring their investments in controlled entities at fair value through profit or loss or consolidating them. This choice should be made consistently for all investments held by an investment entity (i.e. financial assets, associates, joint ventures, subsidiaries).

The choice should be made based on the facts, circumstances and relevance to the users of the financial statements under IAS 8 paragraph 10 and should be changed only when it meets the conditions of IAS 8 paragraph 10.

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 consider the Board's approach to identifying entities required to use fair value to be rule-based and therefore lacks an underlying principle. Consequently, it suffers from excluding certain entities that we suggest should be included (e.g. life insurance companies as discussed below in respect to paragraph 2c) and will require further interpretation rather than judgment in applying a principle. We recommend using the general description of entities currently provided in IAS 28 paragraph 1 "investments ... held by venture capital organisations, mutual funds, unit trusts and similar entities including investment-linked insurance funds" and incorporating our suggestions in Question 1 above to form the approach.

If the Board instead progresses with its proposals, we make the following suggestions with regards to the criteria for determining an investment entity (paragraph 2):

- Paragraph 2a is unclear. Is it necessary to understand the underlying IFRS accounting for activities in a subsidiary, associate or joint venture in order to determine if investment income (dividends or interest) is being generated? For example, if the underlying business is a service concession that is accounted for under IFRIC 12, some are accounted for as financial assets and others as intangible assets. The financial asset model generates interest income and therefore could be seen as meeting the condition, whereas the intangible asset model could generate traffic revenues that would not meet the condition.

  Alternatively, if this look-through 'accounting' analysis is not required, because *the form* of the investment entity's direct investment (being equity issued by a subsidiary or associate) has the potential to generate 'legal' dividend income (regardless of the nature of the underlying accounting income generating the legal dividend), then it would seem the condition in paragraph 2a would always be met. We suggest inserting "accruing to the investor" after ", or both".

- Paragraph 2a requires multiple investments, and paragraph 2d requires an entity to have investors that are unrelated to the parent (if any). There are many fund structures with intermediary holding companies that then hold multiple individual investments. These structures are set up for a variety of reasons. We suggest that each of the intermediary holding companies, and the ultimate parent, should be investment entities. Unlike the types of arrangements explained in paragraph B16, the only investor in these structures is the immediate parent holding company.

- Paragraph 2c excludes entities that issue securities that are not units proportionate to the net assets. We recommend that some of these entities be included as investment entities for example, structured entities that issue CDOs, CLOs, and junior ranked notes (or entities that issue preference shares designed to obtain the variable returns). These securities bear the significant risk of the assets held.

  Another type of entity excluded by the condition of paragraph 2c is life insurance companies. If life companies are prohibited from fair valuing investments in controlled entities, then the accounting mismatch (and income statement volatility) created from having to use a current value for their liabilities will not portray the economic position that exists.

  We recommend extending the definition to include entities that issue participating securities as they bear similar risks to ownership interests.

- Paragraph 2d requires pooled investor funds. There are many funds with only one investor, established to tailor to their particular investment needs. These funds are managed similar to multi-investor funds and invest via a fund structure to utilise the experience of the manager. We recommend these one-investor funds be included as investment entities.

Investors generally want the investment manager to co-invest in the fund they manage in order to align the interests of the manager with that of the unrelated investors. We understand from paragraph B14 that an investment entity can have *some* investors related to the parent (so long as 'significant' ownership interests are held by unrelated investors). However, we are concerned that the second sentence of paragraph 2d could be interpreted differently, because the first part (investors to be unrelated to a parent (if any)) is joined to the second part (in aggregate hold a significant ownership interest) using a comma. This could mean that *all* investors are to be unrelated.

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 agree with the proposal to allow the inclusion of entities providing advisory services related to their own investment activities in the definition of an Investment Entity.

We agree with requiring consolidation of a controlled entity that provides these advisory services.

For example:

- where management of a fund is performed directly by the fund, as opposed to by a separate legal entity, the fund should be allowed to be an Investment Entity.
- where management of a fund is performed by a separate entity that is controlled by the fund (i.e. the investment entity), the management entity should be consolidated by the fund because it is an integral part of the fund.

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?

Yes. The number of investors in an entity should not impact whether an entity is an Investment Entity and thereby affect how it measures its investments. See our response to Question 2 above with respect to paragraph 2d in the Exposure Draft. We suggest the focus should be on an entity's investment activities (i.e. its facts and circumstances) and the relevance of fair value information to the users of the financial statements under IAS 8 paragraph 10.

(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.

Fund structures exist with intermediary holding companies each holding individual investments. These structures were set up for a variety of reasons. We suggest that these intermediary holding companies, along with their parent company, should be investment entities. Having the key criteria of an investment to be held for the purpose of capital appreciation and/or investment income (as opposed to operational returns or other benefits not available to other investors or non-investors) would protect against the Board's concern of a company being inserted into a larger corporate structure in order to achieve investment entity status (i.e. fair value measurement for its controlled investments).

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?

Consistent with our response to Question 1, we recommend that the management of an investment entity holding investment properties be given an irrevocable choice of applying the fair value model in IAS 40. This choice should be made consistently for all investments held by an investment entity (e.g. financial assets, associates, joint ventures and subsidiaries). The choice should be made based on the facts, circumstances and relevance to the users of the financial statements under IAS 8 paragraph 10 and should be changed only when it meets the conditions of IAS 8 paragraph 10.

We recommend that the measurement guidance need not apply only to financial assets – it could apply to all investments held for capital appreciation and/or investment income.

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 Board's concerns?

No, we do not agree. We consider the Board's proposal for non-investment entity parents to consolidate all of their subsidiaries to be inconsistent with the proposal for them to carry investments in associates held by an investment entity subsidiary at fair value. We suggest that the choice of measurement attribute should be determined consistently for these investments. Further, the requirement to consolidate all controlled entities could result in accounting mismatches, from measuring the underlying net assets on a different basis to liabilities of the parent that are performance linked to the investment in the controlled entity, which do not exist economically.

We consider the IASB's reasons for investment entities to not consolidate subsidiaries (i.e. providing more decision-useful information) to also be valid for the parent of an investment entity. Consequently, consistent with our response to Question 1, we recommend that a parent's management should have an irrevocable choice of measuring their investments in investment entities (e.g. controlled investment entities, associates and joint ventures that are investment entities) at fair value through profit or loss, or consolidating controlled entities (and applying the equity method to associates and joint ventures). This choice should be made consistently for all investments held by a parent.

We disagree that parents of investment entities are typically investment entities. We are currently assessing the impact of IFRS 10. We expect interpretations of the principal vs. agency guidance, and the substantiveness of rights to remove asset managers, to evolve. We envisage circumstances where a parent of an investment entity may not be an investment entity itself.

We note the US FASB supports retaining fair value accounting applied by an investment company when rolling this up to its non-investment entity parent's financial statements. If the IASB does not agree with our recommendation (giving management of the parent an irrevocable choice), then we recommend following the US FASB approach in order to achieve the goal of globally comparable financial statements.

We suggest that the IASB's concern (BC20) regarding the potential overstatement of a non-investment entity parent's capital base via the issuance of equity to an investee of its investment entity subsidiary can be addressed through disclosure of the equity held by an investment entity that is carried at fair value.

Question 7

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

We agree with the disclosure objective in paragraph 9, as opposed to specific disclosures.

(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 consider the example disclosure of the ratio of expenses and net investment income to net assets in paragraph B19(b) to not be useful to investors, because the nature of expenses incurred by funds can vary significantly depending on the activities of each fund. Certain funds only incur management fees; whereas others incur various expenses including audit fees, transaction costs, etc.

In addition, we consider the wording in paragraph 10(c) ambiguous, as the realms of "other support" and understanding "intentions" could vary. We suggest this information may be speculative and could confuse users before a legal commitment comes into existence.

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?

IFRS 9 and IFRS 10 require retrospective application, which could change the population of entities controlled by another entity. We are concerned that differences in the transition requirements with investment entities could cause difficulty in understanding comparative information. We recommend a retrospective approach.

Question 9

(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?

No, refer to our response to Question 1. We recommend that an entity's management should have an irrevocable choice of measuring their investments at fair value through profit or loss, consistently applied to all investments held by an investment entity (i.e. financial assets, associates, joint ventures and subsidiaries).

(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 trusts and similar entities, including investment-linked insurance funds? Why or why not?

We consider this alternative to continue to create rules as opposed to relying on a principle. However, since the outcome is closer to our recommendation in Question 1 (but limited to investments in associates only), we would reluctantly agree. We continue to recommend that all investments held by an investment entity (i.e. financial assets, associates, joint ventures and subsidiaries) be subject to the same choice as discussed in Question 1. Refer also to our comments on US GAAP in Question 6.

Other comments:

We anticipate the following practical difficulties if a standard were finalised based on this exposure draft:

- Where an entity previously qualified and used the current scope exclusion in IAS28 paragraph 1, but fails the definition of an Investment Entity in this Exposure Draft, there could be difficulty obtaining the historical information necessary to restate the carrying value using the equity method of accounting. A transition provision could be created to allow fair value at the date of transition to be deemed the carrying value.

- The IASB should consider the treatment when an entity, subsequent to implementation of the new requirements, meets or fails the investment entity definition (e.g. one that is not initially an investment entity, but later meets the definition; and one that is an investment entity, but later fails the definition). We suggest that a) upon failing the definition but maintaining control, one could view the fair value of the investment as the 'consideration given' and apply IAS27/IFRS10 (i.e. giving rise to goodwill or a discount); and b) upon meeting the definition, one could apply the loss of control guidance under IFRS10, and treat any difference between the carrying value of consolidated net assets and the fair value of the investment as a gain/loss.