Dynamic Investment Solutions

29 November 2011

The Chairman
Australian Accounting Standards Board
PO Box 204
Collins Street West VIC 8007

Dear Mr Stevenson

Comments on ED220 Investment Entities

Thank you for the opportunity to comment on Exposure Draft 220.

QIC has reviewed the exposure draft and provides the attached feedback on the matters for comment.

QIC is a Queensland government-owned corporation and one of the largest institutional investment managers in Australia, with more than 92 institutional clients and $58.7 billion (at 30 September 2011) in funds under management.

Yours sincerely

CMBlake.

Claire Blake
Chief Financial Officer

Level 5 Central Plaza Two 66 Eagle Street
GPO Box 2242 Brisbane Qld 4001 Australia
T +61 7 3360 3800 F +61 7 3360 3979

Responses on matters for comment

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. For investment entities, measurement and disclosure of investments at fair value is far more reflective of the substance of the arrangement.

The investment management industry in Australia is large and growing. In recent years, a more significant expansion into private capital assets has occurred and this has included offshore investment. This brings many tax, regulatory, liquidity and other challenges. These are commonly dealt with through investment entity structuring.

It is quite common for investment entities to vary their holdings in underlying investments based on investor cash flows, investment strategy and market movements. Where the underlying investment is in a controlled entity, this can result in multiple consolidation ownership percentages within a short space of time. This makes consolidation very unwieldy and inefficient and achieves no benefit for the readers of the financial statements or the investors in the entity. The requirement to undertake consolidations adds to the cost imposed on investors, with no material benefit.

The primary users of the financial statements of an investment entity are the investors in that entity. In general, the investors receive far more timely information regarding the value of their investment than that provided by the financial statements of the entity. Measuring and reporting at fair value in the financial statements would more closely align these two sources of information and reduce confusion for investors.

Investors typically do not view investment entities as a consolidated group, but rather on a 'look through' basis as a portfolio of investments held at fair value. Entities inserted into the structure to protect the interests of those investors do not change the underlying substance of the arrangement. Removing the requirement to consolidate these entities produces better and clearer financial reports that more appropriately reflect the true nature of the activities being undertaken.

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?

The criteria are generally acceptable. However, some changes are proposed.

Paragraph (a) refers to the entity 'investing in multiple' investments. It is suggested that the word 'multiple' should be removed. A holding in a very large asset in the private capital markets, such as real estate or infrastructure assets, is often the only investment asset within an entity. This is generally for tax, liquidity, legal liability or investor reasons. This is purely a function of the nature of those assets and should not preclude the entity from being classified as an investment entity.

Alternatively, paragraph B5 could be amended to include a further point that states 'It is not appropriate for the entity to hold more than one asset for tax, liquidity, legal liability or other reasons'.

Paragraph (d) refers to the pooling of funds from the entity's investors. Paragraph B16 further discusses an entity with a single investor. It should be possible for an entity to be classified as investment entity, even with only a single investor, provided that single investor is an investment entity. Paragraph B16 provides for this, but only where the single investor entity is formed in conjunction with the investment entity.

However, single investor entities may be created within an investment structure for legal, regulatory, tax or other reasons at any point in time and not necessarily in conjunction with the creation of the investment entity. This commonly occurs throughout the life of an investment entity structure when new assets are acquired, particularly in the private capital markets. Commonly, the pooling of investor funds occurs at a higher point in the overall investment structure.

It is suggested that the wording of B16 be modified to state that a single investor entity is acceptable, provided that the entity meets all of the other criteria for an investment entity, that the single investor is itself an investment entity and that there is pooling of investor funds at a higher point in the structure.

In relation to paragraphs B9 to B10, caution needs to be exercised in the requirement for an exit strategy. For many investors, such as superannuation funds, the investment horizon is very long term. Particularly for illiquid assets, such as real estate and infrastructure assets, it may not be appropriate or necessary to have a documented exit strategy. This would particularly be the case where an asset has only recently been acquired and is intended to be held for long term capital appreciation. It would be inappropriate to require an exit strategy to be in place in every case.

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 activities or (b) the investment activities of entities other than the reporting entity? Why or why not?

An entity should only be eligible to qualify as an investment entity if its substantive activities are investing for capital appreciation, investment income or both.

If an entity undertakes services, either in relation to its own investment activities or those of other entities, then it should not qualify as an investment entity unless those services are either

- immaterial in comparison to the investment activities that the entity undertakes
- ancillary to the investment activities that the entity undertakes (for example car parking income in relation to a shopping centre investment)

Provision of services of this nature, if forming a substantive part of the entity's activities, suggest that the entity is running a business beyond pure investment and should therefore fall within the consolidation regime where applicable.

Question 4: Should an entity with a single investor unrelated to the fund manager be eligible to qualify as an investment entity? Why or why not? 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.

An entity with a single investor (whether or not related to the fund manager) should be eligible to qualify as an investment entity. Paragraph B16 provides for this provided that single investor is an investment entity and where the single investor entity is formed in conjunction with the investment entity. However, single investor entities may be created within an investment structure for legal, regulatory, tax or other reasons at any point in time and not necessarily in conjunction with the creation of the investment entity. This commonly occurs throughout the life of an investment entity structure when new assets are acquired, particularly in the private capital markets. Commonly, the pooling of investor funds occurs at a higher point in the overall investment structure.

It is suggested that the wording of B16 be modified to state that a single investor entity is acceptable, provided that the entity meets all of the other criteria for an investment entity, that the single investor is itself an investment entity and that there is pooling of investor funds at a higher point in the structure.

The requirement that pooling of investor funds must occur at a higher point in the structure should also assist to address the concerns raised in paragraph BC16.

An example of a structure where this would occur is attached. Under this structure, it is suggested that no consolidation should occur. Although the 'higher level trust' holds 100% of each of the lower level trusts, this is likely to be for liquidity, regulatory, taxation or other purposes. The 'ultimate trust' would meet the definition of an investment entity as proposed under the exposure draft.

A fund with a single investor unrelated to the fund manager, such as a sovereign wealth fund, should qualify as an investment entity provided the commercial arrangements between the investor and the fund or on arms' length terms.

Question 5: Do you agree that investment entities that hold investment properties should be required to apply the fair value model in IAS40 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?

Agreed

If an entity wishes to meet the definition of an investment entity, then it is essential that it measures its investment properties at fair value.

Fair value of investments is a well established principle in the investment management industry. If an entity is not prepared to apply fair value measurement to investment properties, then it should not be permitted to meet the definition of an investment entity.

Australian investment entities that hold investment properties and have third party investors would typically already be applying fair value measurement to their investment properties, in line with a number of industry standards and guidelines including:

- Standard No. 9 Valuation of Scheme Assets and Liabilities issued by the Financial Services Council of Australia
- The Valuation and Property Standards issued by the Australian Property Institute
- International Valuation Standards issued by the International Valuation Standards Council
- Guidance issued by the Australian Prudential Regulation Authority

Valuation of other financial assets should continue to occur in line with existing accounting standards, including IFRS 9 and IAS 39.

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?

Agreed

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?

Agreed

Question 7(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?

No. Much of this information is generally already provided to investors by investment entities through a combination of product disclosure statements, information memorandum and regular reporting. Replication of all of this information in the financial statements is unnecessary.

The requirements contained within points (a) and (d) are reasonable.

However, with reference to points (b) and (c), calculation of expense ratios and investment returns are not currently covered by accounting standards and differing methodologies are applied. These calculations can be very complex. This means the disclosures are not necessarily comparable and does not assist users of the financial statements. It also means that auditors would be expected to audit these disclosures, which is not considered appropriate without further accounting or industry standard and formalised guidance being in place.

It is recommended that points (b) and (c) be removed from the application guidance. In their place, it would be appropriate for the financial statements to refer readers to the relevant document that contains that information (for example the product disclosure statement of the investment entity or regular investee reports).

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?

Agreed

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?

Agreed

Question 9(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?

Agreed – while an entity may not meet the definition of an 'investment entity' under the exposure draft, it is common for entities to undertake investment activity. This would more commonly manifest through associates and joint ventures, rather than controlled entities. On that basis, it is reasonable to continue to provide a voluntary measurement exemption to those entities in relation to associates and joint ventures.