FSC FINANCIAL SERVICES COUNCIL

30 November 2011

The Chairman
Australian Accounting Standards Board
PO Box 204
Collins Street
WEST VICTORIA 8007

By email: standard@aasb.gov.au

Dear Sir

RESPONSE TO ED 220

The Financial Services Council (*FSC*) represents Australia's retail and wholesale funds management businesses, superannuation funds, life insurers and financial advisory networks. The FSC has 128 members who are responsible for investing $1.8 trillion on behalf of more than 11 million Australians. The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Stock Exchange and is the fourth largest pool of managed funds in the world. The FSC promotes best practice for the financial services industry by setting mandatory Standards for its members and providing Guidance Notes to assist in operational efficiency.

The FSC thanks the AASB for the opportunity to comment on the proposals in Exposure Draft ED 220 "Investment Entities".

The principle underpinning the requirement for an entity to show consolidated accounts under Australian Accounting Standards is that it provides users of the financial statements with more relevant information on the financial position and performance of the entity and will assist them in their ability to make informed decisions.

The FSC fully supports the specific exemption for investment entities from the consolidation requirements of AASB 10 *Consolidated Financial Statements* as consolidation of controlled entities by investment entities does not satisfy this purpose.

We agree that there is a class of entities, commonly thought of as investment entities, which should not consolidate controlled entities providing that they measure the controlled entities at fair value through profit or loss. Based on the information requirements of investors and the relevance of information to key decision makers, we believe that the fair value of investments in controlled entities is a more relevant basis of accounting than consolidation.

In our view, accounting standards must take into account the substance, over the form, of controlling interests held by investment entities. The strategy of an investment entity is to hold investments, either on a short or long term basis, and to maximise the return on investments for its unitholders through capital appreciation and/or interest and dividends.

The purpose of investment entities having a controlling interest in another entity is for speculative purposes to add value to its investors through increases in the fair value of the investment.

An investment entity typically does not participate in the decision making of the underlying entity nor does it aim to manage the assets and operations of that entity. As such, the consolidated information will not show investors the value of resources available to the investment entity as in substance it has no control over these assets.

The majority of instances where investment entities have a controlling interest in other entities are "fund of fund" structures established by investment managers and product providers for administrative convenience. Managers are able to more easily create blended "multi-manager" or "multi-asset class" funds by establishing a "parent" fund that invests into individual underlying funds that are managed by different managers that employ different investment styles or that provide exposure to different asset classes.

Investment entities have an established mandate outlining their strategy to increase wealth for investors and how that wealth will be distributed during the life of the investment entity. When assessing the success of this strategy and reporting the performance to investors, investment entities base their assessment on the fair value of the investments at each reporting date and not on other factors such as historical cost or amortised cost as these are not relevant criteria when making investment decisions. Internally, management will use the fair value of its investments to drive business decisions, modify investment strategy, perform internal evaluations on investments, and to measure the performance of the investment entity as a whole.

Commercially, the requirement for consolidation in investment entities leads to inefficiencies in financial reporting. As management do not report consolidated information internally, because it is the fair value of investments which drives business decisions and performance management, the reporting of consolidated information for statutory purposes is an additional reporting requirement which would not otherwise be produced.

The underlying entity may also be managed by an unrelated fund manager and as such obtaining detailed financial information for consolidation purposes may be challenging. As investors primarily base their decisions on the fair value of the investments in controlled entities and not on consolidated information, the process of consolidation for statutory reporting purposes provides little (if any) value to investors and as such is an inefficient use of management's time and resources.

Investment entities generally issue puttable unit capital, which allow investors to sell back their units to the investment entity at fair value. The net asset value for which investors are able to put these instruments back to the investment entity is based on the fair value of the investments held, including investments in controlled entities. As such, the fair value of the investment entity's assets, and not the consolidated positions, will be what is most relevant to the unitholders when making their investment decisions.

The purpose of investors contributing capital to the investment entity is to increase their wealth through capital appreciation and investment related income. Therefore, they will monitor the performance of their investment through the changes in value of their capital which is driven by the changes in fair values of the investment entity's assets.

On the basis that the fair value of controlled entities is of most relevance to both key internal decision makers and to external investors, and not the consolidated results and financial position of the investment entity and the entities it controlled throughout the year, the FSC supports the proposed exemption for investment entities from consolidating their controlled entities under AASB 10 *Consolidated Financial Statements.*

Should you have any queries, please do not hesitate to contact myself or Senior Policy Manager, Blake Briggs on 02 8235 2566.

Yours sincerely

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