January 5, 2012

To the International Accounting Standards Board;

The Japanese Bankers Association

Comments on the Exposure Draft *"Investment Entities"*

The Japanese Bankers Association is an organization that represents the banking industry in Japan; its members comprise banks and bank holding companies operating in Japan. The Association submits the following comments on *"Investment Entities"*.

We hope that the comments below will assist the Board in its further deliberation.

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?

(Response outline)

We agree.

(Reasons)

・ Entities commonly thought of as investment entities invest in ownership interest of an investee for the purpose of earning capital appreciation and investment income over a certain period of time rather than operating the investee as a part of group business. The users of financial statements prepared by investment entities will presumably make decisions on investment in an investment entity more on the basis of the investee's fair value than the status of its assets and liabilities. The presentation of the investment entity's financial position and operating results should reflect its investment purposes and substance, and measurement of them at fair value through profit or loss will be more useful in decision-making regarding investment entities than consolidation of them.

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?

(Response outline)

We do not agree with the "nature of the investment activity" and "pooling of funds" criteria.

(Reasons)

[Nature of the investment activity]

- The "nature of the investment activity" criterion requires that the **<u>only substantive activities</u>** of the entity be investment activities and that the entity hold "**<u>multiple investments.</u>**" This is only one feature that indicates the purposes of investment, and we do not believe it appropriate to make this a requirement just because investment entities commonly take this form. This criterion would limit the scope of applicable entities, and there could potentially be entities that invest for the purpose of earning capital appreciation and investment income for which measurement of fair value would be more useful, but that under this criterion would be required to consolidate investees. This would fail to appropriately reflect the entity's economic substance in the financial statements.
- To provide the most useful information to financial statement users, it should be sufficient for investment activities to be the "<u>primary business</u>," and even when the investment entity holds a "<u>single investment</u>" it should be measured at fair value. We think that substituting "primary business" for "only substantive activities" and "investment(s)" for "multiple investments" would appropriately account for the substance of investment entities and would also eliminate the Board's concerns with respect to BC 12.

[Pooling of funds]

- The existence of multiple, unrelated investors is certainly a typical feature of investment entities, but we do not believe that it should be a prerequisite.
- Many corporate groups, as part of their business, have venture capital organizations as subsidiaries, and the purpose of these entities is to earn capital appreciation and investment income. Measurement of the fair values of investees is crucial to the decision-making of corporate groups. It is also useful. If having only a single investor means that the entity fails to meet the criteria for being an investment entity, it would constitute a restriction on the business activities of corporate groups. In addition, the consolidation of investees would potentially fail to appropriately reflect the economic substance of the corporate group in the financial statements.
- There may be cases in which an external investor has a significant ownership interest, but the parent company owns substantially all of the investment entity. Such a parent company would still be able to use the investment entity provisions to achieve off balance sheet accounting for such investments so the Board's concerns with respect to BC 16 would not be fully addressed.
- Rather than setting "pooling of funds" as a criterion for consideration as an investment entity, we believe that establishing the following three criteria regarding the individual

investments of the investment entity would better address the Board's concerns regarding BC 16 and the potential for parent companies to abuse investment entity provisions.

1. <u>There are substantially no transactions between the corporate group owning an investment entity and the investee except for investments and loans executed as operating transactions.</u>

   (Reason for proposing criterion)

   Non-investment operating transactions between a parent company that is not an investment entity and an investee that is controlled by a subsidiary investment entity would ordinarily be offset on consolidated financial statements as internal transactions. However, the use of the investment entity provisions to measure investees at fair value would fail to offset these operating transactions and potentially fail to accurately reflect the substance of the corporate group due to, for example, overstating sales. We believe that these concerns can be eliminated by determining whether individual investments satisfy the proposed criterion.

2. <u>The investee is not deemed to merely have been assigned the business of the corporate group that owns the investment entity, or to be performing it on the behalf of the corporate group.</u>

   (Reason for proposing criterion)

   When a parent company that is not an investment entity performs its business through an investee, consolidating the controlled investee would present the most useful information to investors. Setting the proposed criterion would eliminate measurement of the investee at fair value because the investment entity provisions would not be applicable in these circumstances.

3. <u>Synergy effects or linkage between the corporate group that owns the investment entity and the investee is not expected.</u>

   (Reason for proposing criterion)

   Non-investment synergy effects and linkage between the group business of a parent company that is not an investment entity and the business of an investee indicate that the investment is not a pure investment, and consolidation of the investee would therefore provide the most useful information to investors. Setting the proposed criterion would eliminate measurement of the investee at fair value because the investment entity provisions would not be applicable in these circumstances.

- However, if this criterion ("pooling of funds") is not deleted, we would like a clear statement as to whether "<u>unrelated</u>" in the phrase "the entity has investors that are unrelated to the parent, and collectively hold a significant ownership interest in the entity" indicates that investors are not "related parties" as defined in IAS24. We would also encourage the Board to consider providing guidelines as to the degree of influence that constitutes "<u>significant ownership interest</u>."

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?

(Response outline)

We agree.

(Reasons)

- With respect to (a), we think that an investment entity providing services related to its own investment activities naturally qualifies because it performs investment activities that is one of the criteria for an investment entity.
- With respect to (b), when an investment entity provides services related to the investment activities of other entities rather than its own investment activities, the objective is presumably not capital appreciation or investment income but compensation for the provision of services. An entity offering such services as part of its business should therefore not be treated as an investment entity. However, if the "nature of the investment activity" criterion is changed to "primary business" as proposed in our comments to Question 2, the entity should be treated as an investment entity as long as the services do not constitute "primary businesses."

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 Board in paragraph BC16.

(Response outline)

(a) We believe that such an entity should qualify. We therefore disagree with the exposure draft.

(b) For a discussion of the structures and examples that we think should satisfy the criterion and the way to cope with the Board's concern, see our response to Question 2.

(Reasons)

- The proposal in the exposure draft to measure the investees of an investment entity at fair value is because measurement of investees at fair value is suited to the objectives of the investors of investment entities and provides them with useful information. Given the intent of the proposal, whether there is a single investor or multiple investors is a separate discussion, and we do not believe it appropriate to conclude that an entity does not satisfy the criteria for being considered an investment entity merely because it has a single investor.

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?

(Response outline)

We agree.

(Reasons)

- IAS 40 provides a choice of fair value or acquisition cost when measuring investment properties. We agree with the proposal in the exposure draft only to allow fair value measurement for investment entities because measurement of investees at fair value provides useful information to investors.
- With respect to other measurement guidance, we do not see problems with application only to financial assets as stipulated in IFRS 9 and IAS 39 because an investment entity can be assumed in most cases to invest only in investment properties or financial assets (or both).

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?

(Response outline)

We do not agree.

(Reasons)

- It is useful to investors in a parent company that is not an investment entity to measure at fair value investees held via subsidiaries that are investment entities. Therefore, we believe that the accounting treatment of the subsidiary investment entity should be maintained on the consolidated financial statements of the parent company.
- In BC 6, the IASB concludes that the measurement of investments in entities controlled by an investment entity at fair value through profit or loss provides useful information. This proposal is inconsistent with that conclusion.
- The Board argues that "in most cases, investment entities do not have non-investment

entity parents," but that is not necessarily true. It is in fact common for Japanese financial institutions, as a part of their business, to have venture capital subsidiaries that invest for the purpose of earning capital appreciation and investment income. Even if these venture capital organizations satisfy the criteria for investment entities, their parent financial institutions do not. In such circumstances requiring the parent of an investment entity to apply to the investments of the investment entity different accounting treatment than the investment entity itself, even though the investments constitute the same economic substance, lacks consistency and would potentially impede rational decision-making by financial statement users.

- On the other hand, there is concern about the abuse of investment entity accounting treatment in the consolidated financial statements of parent companies that are not investment entities, and we believe these concerns should be addressed and eliminated by establishing exceptional provisions. For example, BC 20 notes the potential for a parent company to value its own equity at fair value by not consolidating an indirectly-owned investee when the parent company, which is not an investment entity, issues equity to an investee of a subsidiary that is an investment entity. This concern can be addressed by establishing exceptions disallowing investment entity accounting treatment in such situations (i.e. the issuance of equity to investees of subsidiaries that are investment entities by parent companies that are not investment entities).

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?

(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?

(Response outline)

(a) We agree with the disclosure objectives of providing information that enables valuation by the users of financial statements.

(b) We believe that disclosure should be limited to only what is necessary.

(Reasons)

- While we agree with the disclosure objectives proposed in the exposure draft, we do not think that all of the items in the proposed application guidelines are useful to investors. We think that the proposed guidelines should limit disclosure only to what is necessary. Given the idea that it is useful to measure specific investments at fair value, we think it would be preferable to identify the disclosure that is truly useful to and needed by investors and present it as disclosure specific to investment entities, rather than always require IFRS 12 disclosure,.

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?

(Response outline)

We agree.

(Reasons)

- Retrospective application would require measurement of past fair values, which raises questions of feasibility and arbitrariness, and also presents very large practical difficulties. We therefore agree with the proposal in the exposure draft.

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?
(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?

(Response outline)

(a) We do not agree.

(b) We agree.

(Reasons)

- We agree that fair value should be the only measurement approach because fair value measurement of investees provides financial statement users with more useful information about investment entities than equity method measurement.
- However, the proposal in (a) would require application of the equity method to venture capital organizations, mutual funds, unit trusts and similar entities ("VC, etc.") that do not constitute investment entities. In light of the purposes of VC, etc., we believe that measurement of them at fair value similarly to investment entities is more useful to investors, and we do not believe the option to measure them at fair value should be removed.
- With respect to IAS 28, there are still many arguments about the definition of significant influence, whether to apply the equity method to investments where there is significant influence, and whether use of the equity method constitutes a simplified approach to consolidation. The recently published IFRS 10 was not amended in a consistent manner, and we believe that the IASB will need to engage in a separate, comprehensive study of these questions going forward. In other words, we do not believe that the exposure draft

should amend IAS 28, but that any such amendments should be made within the framework of a comprehensive study of accounting treatment for associates. We therefore believe that the proposal should be as an exception to IFRS 10, and that the exceptions allowed in IAS 28 should be retained.