



December 12, 2007

Russell G. Golden,  
Director of Technical Application and Implementation Activities  
FASB, 401 Merritt 7  
P.O. Box 5116, Norwalk, CT 06856-5116

Re: File Reference: Proposed FSP SOP 07-1-a.

Dear Mr. Golden:

The Dealer Accounting Committee (“the Committee”) of the Securities Industry and Financial Markets Association (“SIFMA”)<sup>1</sup> appreciates the opportunity to comment on the above referenced proposed FASB Staff Position that would delay indefinitely the effective date of AICPA Statement of Position 07-1 (“SOP 07-1” or “the SOP”) *Clarification of the Scope of the Audit and Accounting Guide Investment Companies and Accounting by Parent Companies and Equity Method Investors for Investments in Investment Companies*.

The Committee has always been supportive of the broadest possible use of fair value accounting, which is key to financial reporting, internal control and risk management in the securities industry. However, as we indicated in our earlier memorandum to FASB on SOP 07-1 (a copy is attached) we believe that the net impact of SOP 07-1 would be “less fair value reporting in situations where the business is clearly better suited for a fair value model.”

As noted in the minutes of the November 6<sup>th</sup> Board meeting on this topic, a number of commentators have expressed deep concern about their ability to fully comply with the SOP. We believe that the SOP would create very significant implementation problems for the securities industry. Our earlier letter highlighted a number of major issues that would need to be addressed and remedied before our industry could fully implement the SOP. At the very minimum, the SOP should be delayed unless and until those problems are corrected.

Further, the Committee questions the need for the SOP, as we have not been able to identify the issue or sets of issues that led the AICPA to develop the SOP in the first instance. We believe that existing guidance should suffice to permit issuers and their auditors to exercise appropriate professional judgment regarding their investments in investment companies. Particularly in light of FASB Statement No. 159, we do not believe that there are pressing issues

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<sup>1</sup> The Securities Industry and Financial Markets Association brings together the shared interests of more than 650 securities firms, banks and asset managers. SIFMA’s mission is to promote policies and practices that work to expand and perfect markets, foster the development of new products and services and create efficiencies for member firms, while preserving and enhancing the public’s trust and confidence in the markets and the industry. SIFMA works to represent its members’ interests locally and globally. It has offices in New York, Washington D.C., and London and its associated firm, the Asia Securities Industry and Financial Markets Association, is based in Hong Kong.

that necessitate the eventual implementation of the SOP. Finally, SOP 07-1 seems to us a reversal of the attempt to make U.S. GAAP more principles-based rather than rules-based.

At the November 6<sup>th</sup> meeting, the Board unanimously agreed to indefinitely defer the SOP, which is a decision we strongly support. But in light of the serious problems associated with SOP 07-1 that out-weigh any benefits we can identify, we strongly urge the Board to consider simply terminating the SOP.

If you have any questions regarding our letter or wish to discuss these issues further, please feel free to contact me at 212-357-8437.

Sincerely,

A handwritten signature in dark ink, appearing to read "Matthew Schoeder". The signature is fluid and cursive, with the first name "Matthew" written in a larger, more prominent script than the last name "Schoeder".

Chairman  
Dealer Accounting Committee

**SOP 07-1, *Scope of the Audit and Accounting Guide Investment Companies and Accounting by Parent Companies and Equity Method Investors for Investments in Investment Companies* (the “SOP”)**

**Key Conclusions and Recommendations to FASB  
SIFMA Dealer Accounting Committee (“We” or the “Committee”)**

**Executive Summary**

The following memo sets forth key practice issues raised by Committee members in applying the provisions of the SOP. The comments are limited to issues related to retention of investment company accounting by a parent or equity method investor. We believe that, except in limited circumstances, stand-alone investment companies currently following the Guide will be able to continue applying the Guide upon initial application of the SOP.

While the continuation of stand-alone investment company accounting generally will continue to exist under the SOP, we are extremely concerned by the provisions in the SOP for retaining investment company accounting in consolidation. There are many operational issues for large multi-national financial services firms that need to be addressed in order to comply with the SOP’s retention criteria. Failure to comply with the criteria—which in many cases are based on rules and not principles—can result in the loss of investment company accounting in situations where the objective of the investment is for current income and/or capital appreciation, and not for strategic purposes.

Committee members are working diligently towards the goal of retaining investment company accounting in consolidation within the confines of the SOP or, alternatively, retaining fair value accounting via the fair value option on a look-through basis for eligible items to the extent possible. Because of the punitive “tainting” provisions discussed below, coupled with the fact that the fair value option is not available as a “cure all,” we believe adoption of the SOP will result in less fair value reporting in situations where the business is clearly better suited for a fair value model. The following are the key implementation issues that the Committee has identified and conclusions on the application of the provisions of the SOP.

**Overview of Key Issues**

- Equity Method Investors’ eligibility for the fair value option
- Application of paragraph 30(b) on a prospective basis
- Defining “similar investments”
- Parent retention of investment company accounting when non-investment company subsidiaries hold “similar investments” that are not eligible for the fair value option (eg. real estate)
- Applying the “similar investment” rule to consolidated employee funds for which the parent has no economic interest
- Practical application of the “tainting” rule when a parent loses the ability to retain investment company accounting and the subsequent accounting after curing.

## **I. Retention of Investment Company Accounting by Equity Method Investors**

- **Equity Method Investors' Eligibility for the Fair Value Option**

We believe that the issues (more fully described below) related to application of the SOP by equity method investors can be resolved by electing fair value upon (a) adoption of SFAS 159 or (b) loss of the ability to retain investment company accounting for investments in investment companies reported at fair value (an election date under paragraph 9c).

However, this implementation strategy cannot be used by entities that x) early adopted SFAS 159, y) did not elect the fair value option for their equity method investments because the SOP had not been issued and z) do not report such investments at fair value and thus cannot make a paragraph 9(c) election. Many such entities have requested an amendment to SFAS 159 to allow for an additional election date upon adoption of the SOP.<sup>1</sup>

Moreover, some have questioned whether this strategy (electing fair value) can be applied to investments that are structured as partnership interests and where the reporting entity a) manages the fund and b) receives a disproportionate share of earnings as compensation for performance (i.e., a carried interest). They believe financial instruments with cash flows that combine an ownership interest with a significant service element are not eligible for the fair value option. Those supporting this view believe that paragraph 5(c) of SFAS 159, which requires that the fair value option be applied to an entire instrument, would not allow bifurcation of the service element from the ownership interest.

We believe that paragraph 5(c) of SFAS 159 did not contemplate an embedded service element and that cash flows arising from the service element are bifurcatable but not eligible for the fair value option. Conversely, we believe the “host” ownership interest is eligible for the fair value option and the service element should be separately accounted for under EITF Topic D-96 *Accounting for Management Fees Based on a Formula*. We believe this bifurcation approach towards the service element is consistent with existing practice. We believe this approach is conceptually sound because it will further the Board’s goal of having more financial instruments recorded at fair value, while setting aside that portion of the investment that does not represent a financial instrument.

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<sup>1</sup> See letter to FASB from The Clearing House Banks dated July 10, 2007

## **II. Retention of Investment Company Accounting by Parent Investors**

- **Application of Paragraph 30(b) on a Prospective Basis**

To retain investment company accounting, paragraph 30(b) of the SOP requires a parent “to follow established policies that effectively distinguish the nature and type of investments made by an investment company from the nature and type of investments made by other entities within the consolidated group.” We believe that paragraph 30(b) should be applied on a prospective basis. In other words, “similar” investments may be held in and out of an investment company subsidiary, after adoption of the SOP, if those investments were made prior to the adoption of the SOP and the parent company established policies and procedures to comply with the SOP for investments made after adoption.

Practically speaking, it is not possible to apply newly established policies to transactions that happened in the past. It would be unreasonable, in our view, to require a parent to exit from investments purchased prior to the initial application of the SOP that are held outside of an investment company and are similar to investments held in an investment company. It also would be unreasonable and operationally difficult, if not impossible, to move these investments inside an investment company because of their large number, global location and tax consequences. Further, as discussed below, there are certain investments that are not eligible for fair value, such as real estate.

Rather than force a sale or move these assets we believe it appropriate for these investments to be excluded from the similar assessment. We believe that prospective compliance with newly established policies is provided for in paragraph 57 of the SOP which requires that the provisions of the SOP do not need to be met upon initial application. Paragraph 57 states that not meeting the provisions prior to application would not cause a parent to lose the ability to retain investment company accounting in its consolidated financial statements. Additionally, paragraph A63 of the SOP notes that, for practical reasons, entities should be given the opportunity to modify existing arrangements, policies and activities prior to the initial application of the SOP and continue with their current accounting.

Finally, we believe Paragraph 30(b) applies only to consolidated investment companies held by a parent, and not to investment companies where an equity method investor has significant influence. Paragraph 30(b) prohibits a consolidated group from selectively making investments within an investment company subsidiary that are similar to investments held by non-investment company members of the consolidated group. Paragraph 30(b) is clearly not applicable to an equity method investor because it references a parent company and not an equity method investor. We agree with this guidance because an equity method investor cannot ensure that a “similar investment” will not be made within an investment company as it does not control the investment company. We ask that this be clarified since some practitioners may not have made the distinction between parent companies and equity method investors.

- **Defining “Similar Investments” When Applying Paragraph 30(b) of the SOP**

We believe that the prohibition against holding similar investments in a non-investment company subsidiary that are not accounted for at fair value applies only to *non-strategic* investments. Entities will need to clearly define their interpretation of “similar” and what they consider to be “strategic” to their business. Possible definitions of “similar” include:

- Same or similar line of business or industry as parent company (e.g., using SIC codes);
- Investments with the same overall investment objectives and restrictions;
- For non-financial assets such as real estate, (i) consider each property to be unique and not similar to any other, or (ii) consider properties in different locations not to be similar, or (iii) consider properties with different uses not to be similar (e.g., commercial office blocks are not similar to hotels).

However, we believe it would not be appropriate to conclude an investment is strategic (or similar) solely because it “operates in the same industry as the investor”. For example, if Large Bank A owns 10,000 shares of Large Bank B in its trading portfolio, it should not be considered a strategic investment simply based on operating in the same industry, if other evidence shows the investment was made for current income, capital appreciation or both.

Illustration 8 in the SOP (paragraphs B-64 through B-74) provides that an entity can be an investment company and the parent can retain investment company accounting even if it is owned by only one investor. Accordingly, a possible solution to the complications of tracking “similar” investments held outside of investment companies that are consolidated by a parent would be for the parent to require all non-strategic principal investments to be held through one or more wholly-owned investment companies. This would clearly identify, at inception, those investments which are strategic (and therefore held outside the wholly-owned investment company) and those which are for current income, capital appreciation or both (and therefore held by the wholly-owned investment company). Member firms are evaluating the feasibility of this approach.

- **Parent Retention of Investment Company Accounting When Non-Investment Company Subsidiaries Hold “Similar Investments” That Are Not Eligible for the Fair Value Option (Eg. Real Estate)**

We considered whether a strategy of automatically electing the fair value option for all investments held outside an investment company that would not otherwise be accounted for at fair value would resolve the “similar investment” issue. The strategy is effective and provides relief for financial instruments. However, the fair value option strategy provides no relief for direct investments in non-financial assets, such as real estate, because such investments are currently outside the scope of SFAS 159. One approach to resolving this issue would be to amend SFAS 159 and include real estate investment properties within its scope.

However, this approach is not practical because of time constraints as the SOP must be adopted on January 1, 2008 for calendar-year entities. A more practical approach would be to defer the provisions of the SOP related to investment real estate until FAS 159 can be amended. IAS 40, paragraph 5, provides a good definition of real estate investment properties that may be useful for this purpose.

- **Applying the “Similar Investment” Rule to Consolidate Employee Funds for Which the Parent Has No Economic Interest**

Many financial services companies and all Committee members offer their employees the opportunity to invest in employer-sponsored investment companies; that is, funds of which the employer is the general partner.

Employee participation is voluntary and their capital is at-risk. The employer’s general partnership interest in employee funds is typically a trivial amount based generally on the need to satisfy tax criteria.

Because the terms and conditions imposed upon employees are usually different from those imposed on outside investors (e.g., waived fees for employees over a defined service period), it is common to set up a separate legal entity as a member of a “fund family” to facilitate employee investment. Thus, an offering of an investment opportunity that is externally perceived as a single investment company actually involves several different legal entities; for example, an On-Shore Fund, an Off-Shore Fund, an Institutional Fund, and an Employee Fund. In situations where investors in a fund have the participating rights envisioned by EITF Issue 04-5, the employer-sponsor, as GP, does not consolidate the fund.

However, member firms believe that providing such rights to employee-investors in an employee fund is not substantive, as it is unlikely employee-investors would actually vote to remove their employer as GP of a fund. Accordingly, member firms have concluded that their employee funds must be consolidated. Because (a) their GP interest is trivial and (b) it is common for member firms to forego imposing fees on their employee-investors, member firms generally have no economic exposure to their employee funds.

Typically, an employee fund is the smallest entity in the “fund family.” If the employee-investors were to invest in one of the third-party funds rather than a separate employee fund, in most if not all instances, member firms would not consolidate the resulting entity, as the interests ascribed to the firm would not rise to the level of a controlling interest.

As a result of consolidation, the employer-sponsor will be required to address the “similar” criterion discussed above, despite having no *economic* interest in the employee fund. As part of this effort, firms will need to track and evaluate the accounting for assets held outside the employee fund that may be “similar” to those held by the employee fund, even though the results of the employee fund will have no impact on the firm’s consolidated net income.

Additionally, if the parent lost its ability to retain investment company accounting for employee funds, the parent would need to perform a consolidation analysis of the underlying portfolio companies held by the employee funds. That analysis would consider investments in the portfolio company held by other non-consolidated funds of which the firm is the general partner and that are recognized at fair value under the fair value option or by retaining investment company accounting. Consolidation of a portfolio company creates complex tracking issues.

We believe that the prohibition of holding investments in a consolidated investment company that are similar to investments held by non-investment company subsidiaries should not apply to consolidated employee funds for which substantially all of the economics are not held by the consolidated group. We believe the principle of paragraph 30(b) is not violated by adopting policies for similar investments and excluding from those policies consolidated employee funds for which substantially all the economics are not held by the consolidated group. In other words, the “similar” guidelines in paragraph 30(b) should only apply when the parent company could substantively benefit from the investment company subsidiary’s “similar” investments.

- **Practical Application of the “Tainting” Rule when a Parent Loses the Ability to Retain Investment Company Accounting and the Subsequent Accounting After Curing**

*Tainting – Punitive and hard to implement*

Pursuant to paragraph 31 of the SOP, the failure of a parent to meet the requirements of paragraph 30 for one of its consolidated subsidiaries would taint the investment company status of all other investment companies within the consolidated group. We believe the biggest areas of risk that can lead to tainting are 1) having similar investments outside of an investment company that are not at fair value, either because the fair value option was not elected or the investment was not eligible for fair value accounting under current GAAP and 2) concluding that a relationship with an investee is a strategic relationship. The tainting rules do not allow for any margin of error and do not allow the parent to isolate the problem, if any, to a specific fund. As the issues relating to retention are very significant and difficult to track, it is inevitable that firms with global fund operations invested in many different asset classes will likely run afoul of the strict tainting rules even without violating the spirit of the SOP.

*Change in Status – Operational issues*

If investment company accounting ceases to be available because of noncompliance with the provisions of the SOP, the parent company or equity method investor should report the change in status prospectively. Operational issues will arise when trying to determine how to allocate that fair value to any investee that is now required to be consolidated due to the loss of investment company accounting (i.e., controlling financial interests).



### *Curing a loss of ability to retain investment company accounting in consolidation*

Pursuant to paragraph 49 of the SOP, the ability to retain investment company accounting in consolidation should be reevaluated each reporting period and may result in changes in status. Assuming that the circumstance which caused the investment company not to comply with paragraph 30 can be remedied, we believe that paragraph 49 would require investment company accounting to be immediately resumed upon curing. However, certain violations cannot be remedied other than through passage of time (e.g. violating factors that would lead a parent to believe it is investing for strategic purposes). We recommend that any tainting issue be isolated to the investment company involved. The actions that impact one investment company can be unrelated to other investment companies and it is an extreme result to have one tainted investment result in tainting the entire consolidated population

### **Conclusion**

In summary, the Committee supports fair value reporting and would like to be able to continue accounting for principal investments at fair value. Adoption of the SOP will pose significant challenges for member firms to continue accounting for investments in consolidated investment companies at fair value. Additionally, to avoid diversity in practice when applying the SOP, we believe interpretive guidance should be issued as soon as possible which addresses the practice issues identified above. While we believe all the matters we have raised are important, the following is a summary of our most significant conclusions and recommendations to FASB:

- Bifurcate any significant service element and account for under Topic D-96. Elect fair value for the remaining “host” ownership interest.
- Develop policies for similar investments held in consolidated investment companies to be applied on a prospective basis (investments entered into after adoption of the SOP). The “similar investment” criteria should apply only to non-strategic investments.
- FASB should amend the SOP such that a tainted investment company does not automatically taint every other investment company. Problems should be isolated to the affected investment company, with appropriate disclosure of the reasons that caused the investment company to become tainted.
- Use of a wholly-owned investment company to hold principal investments.
- Use of the fair value option to its fullest extent. FASB should amend SFAS 159 to allow for a new election date upon adoption of the SOP and to defer the provisions of the SOP related to investment real estate until SFAS 159 is amended accordingly.

Questions or comments about this memorandum can be directed to Matt Schroeder, Goldman Sachs & Co. & Committee Chair (212-357-8437), Kyle Brandon (212-618-0580) or Gerard J. Quinn (212-618-0507) the SIFMA staff advisers to the Committee.