

Launched in 1960, the European Banking Federation is the voice of the European banking sector from the European Union and European Free Trade Association countries. The EBF represents the interests of almost 5000 banks, large and small, wholesale and retail, local and cross-border financial institutions. Together, these banks account for over 80% of the total assets and deposits and some 80% of all bank loans in the EU only.

The EBF is committed to supporting EU policies to promote the single market in financial services in general and in banking activities in particular. It advocates free and fair competition in the EU and world markets and supports the banks' efforts to increase their efficiency and competitiveness.

Response of the European Banking Federation to the IASB Exposure Draft on Investment Entities

Key Points

- The EBF agrees with the proposal to establish an exception from the requirement in IFRS 10 to consolidate when the parent entity meets the definition of an investment entity as we agree that there are circumstances where the measurement of investments controlled by an investment entity at fair value results in information of greater decision-usefulness than consolidation.
- We however consider the proposal would certainly benefit from further elaboration as to the following concerns:
 - It is necessary to carefully limit the use of the investment entity exemption to those circumstances for which measurement at fair value is more decision-useful than consolidated financial information.
 - The concept of an exit strategy should be placed as part of the criteria for identifying an investment entity rather than being described in the application guidance as having an exit strategy is a key aspect in identifying an investment entity.
 - We do not agree with the decision not to allow a non-investment entity parent to retain the accounting of its investment entity subsidiaries.
 - Disclosures suggested in paragraph B19 can be interpreted as being a requirement check list. A shorter and more targeted list should instead be provided.
- Due to the potential impact of this ED on IFRS 10 and the fact that some of the entities which need to be re-assessed under the IFRS 10 principles and application guidance may meet the definition of investment entities, we believe that finalisation of this ED should be done by amending IFRS 10. We furthermore consider appropriate to delay the mandatory implementation date of IFRS 10 (and related amendments) until the Investment Entities project has been completed

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 though profit or loss? Why or why not?

The EBF agrees an investment entity should be required to measure investments in entities that it controls at fair value through profit or loss in accordance with IFRS 9 rather than consolidating such investments. We therefore agree with the proposal to establish an exception from the requirement in IFRS 10 to consolidate when the parent entity meets the definition of an investment entity. Measuring investments at fair value through profit and loss fits better with the business model and provides more decision-useful information than consolidating the underlying assets and liabilities.

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 important?

Whilst we accept consolidated financial statements of an investment entity may impede users' ability to assess an investment entity's financial position because of the emphasis on the position of the investee rather than the investment entity, we deem necessary to carefully limit the use of the investment entity exemption to those circumstances for which measurement at fair value is more decision-useful than consolidated financial information.

As to the proposed criteria for determining whether an entity qualifies as an investment entity we consider this a good approach but with clear need for improvement. We therefore urge the Staff to undertake further field-testing before the Boards takes a final decision as we have concerns of the usefulness of the criteria in its current shape to efficiently address our concern mentioned in the previous paragraph. We also believe the concept of an exit strategy should be placed as part of the criteria for identifying an investment entity (i.e. criteria described in paragraph 2 of the ED) rather than being described in the application guidance (paragraph B9 of the ED) as we believe that having an exit strategy is a key aspect in identifying an investment entity. We also urge clarification of the definition of 'investment' as when paragraph 2 of the ED refers to 'investment' it is not entirely clear whether this is meant to include just investments controlled by the investment entity. Moreover, paragraph B17 implies that this might include investment properties as well as investments controlled by the investment entity.

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 consider that if an investment entity provides investment services that relate to its own business then its investment entity classification should not be affected. This is consistent with the requirement that the entity's only substantive activities are investing in multiple investments for capital appreciation, investment income or both.

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.**

While we acknowledge there may not be conceptual reasons why an investment entity that has a single investor could not be an investment entity, we understand the Board's concern over the possibility of off balance sheet accounting and the difficulties that could exist to distinguish an investment entity and entities that are set up for other purposes. Moreover, as we consider that an entity having more than one investor ensures that the objectives of the investment entity are aligned with those of its investors rather than just those of its parent, we find appropriate to require that an investment entity has more than one 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?

The EBF considers an investment entity should apply fair value measurement to asset classes such as investment properties and financial assets subject that they are managed with the same objectives and on a fair value basis as well.

We furthermore suggest the ED should clearly indicate that entities using the option of measurement at cost as proposed by IAS 40 should not be prevented to continue using this accounting treatment for the reason that they may look like investment entities. Choosing the cost measurement of IAS 40 would exclude these entities from the scope of the ED as the criterion of fair value measurement is not met.

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? If not, why not and how would you propose to address the Board's concerns?

We do not agree with the Board decision not to allow a non-investment entity parent of an investment entity to apply the requirements proposed in this exposure draft when preparing consolidated financial statements. We strongly recommend the Board to review the decision taken as we consider the Board's concerns about possible abuses are overstated. Furthermore, there are conditions set in parts of the ED, i.e. paragraph 2: pooling of funds, sufficiently tightly to mitigate any potential accounting inconsistencies and possibilities for abuse.

Question 7

- a) **Do you agree that it is appropriate to use this additional 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 proposed instead?

We agree with the proposed disclosure objective that would require an investment entity to provide information to enable users of the financial statement to evaluate the nature and financial effect of the investment activities in which it engages. We however have concerns about the list of suggested disclosures included to explain the objective. Our concerns are on the basis that such lists of examples are often interpreted as being a requirement check list. Further, some disclosures i.e. B19 (b) and B19(c) refer to management ratios which we consider should be information of the management report rather than part of financial statements.

We instead would favour a shorter and more targeted list which places the onus on management to use its judgment over what disclosures should be provided.

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?

We believe that the transition provisions should be aligned with those of IFRS 10, i.e. retrospective application unless that is impracticable. Although we welcome the Board's decision to consider practicality, we fear that prospective application would seriously undermine comparability between current and comparative periods. We believe that the Board's concerns about undue use of hindsight in determining fair value are overstated given that to qualify for the use of the exemption the entity must manage its investments at fair value. It is therefore highly likely that qualifying investment entities will have collected fair value.

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?**

We do not agree with the proposal to amend IAS 28. Other entities than investment entities have as their main business model to invest in certain entities with the purpose of capital appreciation and/or investment income. Such investments are managed and evaluated on a fair value basis. Consolidation according to the equity method of these investments does not provide a more relevant financial reporting. Therefore, we believe that there is a continuing need for an exemption regarding venture capital organizations, mutual funds, unit trusts and similar entities in *IAS 28 Investments in associates and joint ventures* even under the proposed changed standard.

With regards to the proposed alternative presented in question 9b we tend to favour this alternative as it would lead to consistent information using the same measurement method for the same type of investments which implies a more comparable, relevant and transparent financial information. Nonetheless, before taking a final decision we would find very helpful having further elaboration on the alternative. This should include greater definition of the underlying principle and carrying out an impact assessment to understand better the practical implications of any amendments to IAS 28.

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