

9 December 2011

Mr Hans Hoogervorst  
Chairman  
International Accounting Standards Board  
30 Cannon Street  
London  
United Kingdom, EC4M 6XH

Email: [commentletters@ifrs.org](mailto:commentletters@ifrs.org)

Dear Mr Hoogervorst,

### **Exposure Draft ED/2011/4 Investment Entities**

The Guardians of the New Zealand Superannuation is pleased to respond to the International Accounting Standards Board's (the Board's) Exposure Draft on Investment Entities (referred to as the exposure draft).

We strongly support the Board's proposal that investment entities measure all investments at fair value. It is our view that fair value measurement provides the most relevant and useful information to users of an investment entity's financial statements.

We do have concerns however that the criteria as written would unintentionally preclude certain Government Investment Funds (such as ourselves) from the consolidation exception. In order to best describe our concerns, we first provide some necessary background information about our organisation.

#### *Background*

The Guardians of New Zealand Superannuation (Guardians) and the New Zealand Superannuation Fund (Fund) were established by an Act of Parliament to reduce the tax burden on future New Zealand taxpayers of the cost of New Zealand Superannuation (a universal entitlement available to all New Zealanders over the age of 65).

The NZ Superannuation and Retirement Income Act 2001 (the Act) established:

- the Fund, as a pool of assets consolidated into the Government's balance sheet
- the Guardians, as a Crown agency charged with managing the Fund

Together, the Fund and Guardians exist to 'smooth' the tax burden between generations of New Zealanders arising from the higher future cost of New Zealand Superannuation. The tax smoothing occurs through the Government making contributions to the Fund. At a future date - currently from 2031 - the Government begins to withdraw money from the Fund to help to meet the cost, at that time, of New Zealand Superannuation.

The Guardians are expected to manage the Fund according to a legislated mandate. The mandate requires us to manage the Fund in a commercial, prudent fashion comprising:

- best-practice portfolio management
- maximising return without undue risk
- avoiding prejudice to New Zealand's reputation as a responsible member of the world community.

The Fund invests in assets such as equities, fixed income instruments, real assets, private equity funds and derivatives. All assets are managed to maximise returns through capital appreciation, investment income or both.

## *Investment Entities*

We are concerned that from a legal form perspective, the criteria as written would unintentionally exclude Government Investment Funds (sometimes known as Sovereign Wealth Funds) such as ourselves whose business model is that of an investment entity, that is, a legislated investment-only mandate with a view of maximising returns through capital appreciation, investment income or both. The Fund meets most of the criteria in the exposure draft to be considered an investment entity. However, as there is only one investor (the New Zealand government) and the Fund does not issue shares or units of ownership, the Fund fails to meet all of the criteria.

We believe that an entity with a single investor, (related or unrelated to the fund manager) should be eligible to qualify as an investment entity if it meets the other criteria, especially if it is a Government Investment Fund enacted by legislation. While government investment funds may only have one investor, they are accountable to the general public. As investments are held for capital appreciation and/or investment income, fair value information provides more relevant information for these users.

Appendix 2 sets out suggested alternative wording for the criteria to incorporate sovereign wealth funds.

### *Consolidation by the parent entity*

While we understand the concerns about structuring opportunities as outlined in the basis for conclusions, we also consider that where a group contains genuine investment entities, that carrying forward the specialised accounting from the investment entities is appropriate and may present more fairly the activities of the group as a whole. This is consistent with the “through the eyes of management” view of reporting which presents the different activities of the group the way each of them is managed.

This is particularly the case for governments which have set aside separate funds through legislation where the funds are managed on a fair value basis. Consolidation of the investees of investment entities in the government’s financial statements is less relevant to users who are more interested in the value and composition of the fund and its capacity to provide the promised future benefits.

We therefore prefer the FASB’s view that the fair value measurement of the investment entity’s investees should be “rolled up” into the group financial statements.

In order for such a roll up into the group financial statements to be appropriate, and to prevent structuring opportunities, certain of the criteria for the investment entity must also hold true at the group level i.e. the investment entity and its investees are held for capital appreciation and/or investment income and no other purpose by the group (other than to fund other activities from the investment income and capital appreciation). The investments must also be managed and their performance evaluated on a fair value basis (and not some other basis) from a group perspective.

Appendix 2 sets out suggested alternative wording for the criteria to enable roll up into the group financial statements.

### *Investments in Associates and Joint Ventures*

If the criteria for an entity to be considered an investment entity are not changed, the Fund is particularly concerned with the proposed changes to IAS 28: Investments In Associates and Joint Ventures. The Fund currently takes advantage of the exemption for venture capital organisations, mutual funds, unit trusts and similar entities including investment-linked insurance funds, by measuring such investments at fair value through profit or loss.

We consider that fair value measurement for associates and joint ventures provides more relevant information for users, because while the Fund may have more influence than with its other investments (such as those accounted for under IAS 39), these investments are still managed on a fair value basis with performance assessment and decisions made on whether investments are retained or sold based on fair value information. Information about the fair values of these





investments is therefore also more relevant information for users. Consequently, we agree with the alternative amendment to retain the voluntary measurement exemption for venture capital organisations, mutual funds, unit trusts and similar entities including investment-linked insurance funds if the investment entity criteria are not extended to capture Government Investment Funds enacted by legislation.

Our comments in response to the particular questions raised are enclosed as Appendix 1 to this letter. Should you wish to discuss, or require any clarification, please contact Melanie Beestestone at [mbeestestone@nzsuperfund.co.nz](mailto:mbeestestone@nzsuperfund.co.nz) or by phone +64 9 300 6993.

Yours sincerely,



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## Appendix 1: Specific Questions for Comment

- 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, we agree that investment entities should not be required to consolidate controlled entities because measurement at fair value through profit or loss provides more meaningful information for investors in the investment entity than is otherwise available if the controlled investments are consolidated.

However, we think that measurement at fair value should be a choice and not a requirement. For example, an investment entity that is part of a wider group (that does not meet the investment entity criteria) may determine that the cost of preparing two reporting packs outweighs the benefits to investors.

- 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?**

While we acknowledge the IASB's need to limit the exemption, we are concerned with the criteria in paragraphs 2(c) and 2(d). Our comments in relation to 2(d) are covered in question 4 below.

In respect of the criteria in paragraph 2(c) we are not sure how the requirement for ownership to be represented by units of investments aligns with the reporting entity project. We note that the Exposure Draft ED 2010/2 Conceptual Framework for Financial Reporting: The Reporting Entity states that "*A portion of an entity could qualify as a reporting entity if the economic activities of that portion can be distinguished objectively from the rest of the entity and financial information about that portion of the entity has the potential to be useful in making decisions about providing resources to that portion of the entity.*" To the extent there are users that would find this information useful we believe that the exemption should be available for the portion of the entity's financial statements if the portion meets the other criteria as an investment entity (subject also to our comments in relation to Question 4 below). We acknowledge that a different outcome may be required by the larger entity (which may not meet the criteria as an investment entity).

- 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?**

Yes, if services relate to its own investment activities. In regards to services provided to other entities we believe the entity should still be eligible to qualify if the services provided are incidental to the investing activities. We agree that the core business purpose of an investment entity should be investing for capital appreciation and/or investment income so if this is no longer the purpose of the entity (as it is instead providing more than incidental investment services to third parties) then it should no longer meet the criteria.

- 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.**

We believe that an entity with a single investor, (related or unrelated to the fund manager) should be eligible to qualify as an investment entity if it meets the criteria (a) and (e), especially if it is a Government Investment Fund. While Government Investment Funds (including the New Zealand Superannuation Fund) may only have one "investor", they are accountable to the general public,





the ultimate “investors”. As investments are held for capital appreciation and/or investment income, fair value information provides more relevant information for these users.

The criteria should include (a), and (e). We do not consider that criteria (c) and (d) are necessary. For Government Investment Funds criteria (b) and (f) could be amended to refer to a “fund that is enacted by legislation where that fund makes a public commitment that the business purpose of the fund is investing to earn capital appreciation, investment income (such as dividends or interest) or both” and that “the fund will provide financial information about its investment activities publicly...”

- 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?**

We don't believe that it is necessary to specify that the fair value model in IAS 40 should be required for investment entities that hold investment properties. We note that measurement at fair value would provide information that is more consistent with an investment entity's business model and we expect that most investment entities would therefore make this accounting policy choice. As noted in question 1 we believe that measurement at fair value should be a choice and not a requirement.

- 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?**

We do not agree that the parent should be required to consolidate all of its controlled entities if it is not itself an investment entity. While we understand the concerns about structuring opportunities as outlined in the basis for conclusions, we also consider that where a group contains genuine investment entities, that carrying forward the specialised accounting from the investment entities is appropriate and may present more fairly the activities of the group as a whole. This is consistent with the “through the eyes of management” view of reporting which presents the different activities of the group the way each of them is managed.

This is particularly the case for governments which have set aside separate funds through legislation where the funds are managed on a fair value basis. Consolidation of the investees of investment entities in the government's financial statements is less relevant to users who are more interested in the value and composition of the fund and its capacity to provide the promised future benefits.

In addition, we consider that the requirement for consolidation leads to unnecessary costs to maintain two sets of accounting records.

We also note that the FASB's Exposure Draft Topic 946 Financial Services – Investment Companies states that  
*“BC34. The FASB agreed with the conclusions reached by the EITF that assuming the specialized industry accounting principles are appropriate at the subsidiary level those principles should be retained in consolidation. In addition, the FASB believes that this approach improves the visibility into the investments held by the subsidiary entity. Accordingly, the FASB decided that a noninvestment company parent of an investment company should retain the specialized industry accounting principles of its investment company subsidiaries when preparing consolidated financial statements.”*

We agree with the FASB's comment about improved visibility in the group financial statements of investments held for the purpose of capital appreciation, investment income or both. We therefore prefer the FASB's view that the fair value measurement of the investment entity's investees should be “rolled up” into the group financial statements.





We acknowledge the concerns expressed by the IASB in BC 12, BC 16 and BC20 in particular and the comment made that "*in most cases, investment entities would have investment entity parents*". As this requirement is therefore not expected to impact many entities we suggest that the parent should have an accounting policy choice.

In order for such a roll up into the group financial statements to be appropriate, and to prevent structuring opportunities, certain of the criteria for the investment entity must also hold true at the group level i.e. the investees of the investment entity are held for capital appreciation and/or investment income and no other purpose by the group (other than to fund other activities from the investment income and capital appreciation). The investments must also be managed and their performance evaluated on a fair value basis (and not some other basis) from a group perspective. This should address the concerns in BC 12 and BC 16.

In addition, to address the concern in BC 20, there could be a prohibition on rolling up if investees of the investment entity own the parent's shares or other equity instruments or there could be a requirement for additional disclosure.

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?**

We agree that the disclosure objective with application guidance is a reasonable approach.

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 agree with the prospective application of the proposals and the proposed transition requirements.

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 that IAS 28 should be amended and prefer the alternative approach outlined in 9(b). We consider that fair value measurement for associates and joint ventures provides more relevant information for users of the Fund's financial statements, because while the Fund may have more influence than with its other investments (such as those accounted for under IAS 39), these investments are still managed on a fair value basis with performance assessment and decisions made on whether investments are retained or sold based on fair value information.

If the criteria are not changed as above (questions 2 and 4), the Fund, as a Government Investment Fund, would be required to revert to equity accounting for its associates and joint venture entities which we believe does not provide useful information for our users and is not how our business is managed. Therefore we request that the current exemption is retained.





**Appendix 2 Suggested Criteria for Government Investment Funds (sometimes known as Sovereign Wealth Funds) to qualify as Investment Entities and for Roll up to the Group Financial Statements**

<p><b>Exposure Draft criteria for an Investment Entity</b></p>	<p><b>Government Investment Fund</b></p>	<p><b>Exposure Draft criteria amended to incorporate Government Investment Funds</b></p>	<p><b>Group additional criteria for carry forward of investment entity accounting</b></p>
<p><b>(a) Nature of the investment activity</b> The entity's only substantive activities are investing in multiple investments for capital appreciation, investment income (such as dividends or interest) or both</p>	<p>Criteria met.</p>	<p>No change proposed.</p>	<p>N/A</p>
<p><b>(b) Business Purpose</b> The entity makes an explicit commitment to a group of investors that the entity's purpose is investing to earn capital appreciation, investment income (such as dividends or interest), or both</p>	<p>The fund is enacted by legislation and the fund makes an explicit public commitment that the fund's purpose is investing to earn capital appreciation, investment income (such as dividends or interest) or both.</p>	<p><b>(b) Business Purpose</b> The entity makes an explicit commitment to a group of investors, or to the public where it is a Government Investment Fund enacted by legislation, that the entity's purpose is investing to earn capital appreciation, investment income (such as dividends or interest), or both.</p>	<p>The group makes an explicit commitment to its investors that it holds the investment entity and its investees for capital appreciation, investment income (such as dividends or interest) or both and not for another business purpose</p>
<p><b>(c) Unit ownership</b> Ownership in the entity is represented by units of investments, such as shares or partnership interests, to which proportionate shares of net assets are attributed</p>	<p>The fund is for the benefit of the public.</p>	<p><b>(c) Unit ownership</b> Ownership in the entity is represented by units of investments, such as shares or partnership interests, to which proportionate shares of net assets are attributed, or the entity is a Government Investment Fund enacted by legislation.</p>	<p>N/A</p>
<p><b>(d) Pooling of funds</b> The funds of the entity's investors are pooled so that investors can benefit from professional investment management. The entity has investors that are unrelated to the parent (if any), and collectively hold a significant ownership interest in the entity</p>	<p>Investments are pooled for the benefit of the public.</p>	<p><b>(d) Pooling of funds</b> The funds of the entity's investors are pooled so that investors can benefit from professional investment management. The entity has investors that are unrelated to the parent (if any), and collectively hold a significant ownership interest in the entity, or the entity is a Government Investment Fund enacted by legislation.</p>	<p>N/A</p>



<p><b>Exposure Draft criteria for an Investment Entity</b></p>	<p><b>Government Investment Fund</b></p>	<p><b>Exposure Draft criteria amended to incorporate Government Investment Funds</b></p>	<p><b>Group additional criteria for carry forward of Investment entity accounting</b></p>
<p><b>(e) Fair value management</b> Substantially all of the investments of the entity are managed and their performance is evaluated, on a fair value basis.</p>	<p>Criteria met.</p>	<p>No change proposed.</p>	<p>Substantially all of the investments of the investment entity subsidiary are managed and their performance is evaluated, on a fair value basis (and not some other basis) at a group level.</p>
<p><b>(f) Reporting</b> The entity provides financial information about its investment activities to its investors. The entity can be, but does not need to be, a legal entity.</p>	<p>The fund makes financial information about its investment activities publicly available.</p>	<p><b>(f) Reporting</b> The entity provides financial information about its investment activities to its investors, or to the public if it is a Government Investment Fund. The entity can be, but does not need to be, a legal entity.</p>	<p>N/A</p>