



Institutional Limited Partners Association's
Response to the Financial Accounting Standards Board's
Proposed Accounting Standards Update
Fair Value Measurements and Disclosures (Topic 820)

September 7, 2010

Mr. Russell Golden
Technical Director
Financial Accounting Standards Board
401 Merritt 7
Norwalk, CT 06856-5116

File Reference No. 1830-100

Dear Mr. Golden:

Re: ILPA Response to Financial Accounting Standards Board (FASB) Proposed Accounting Standards Update, “Fair Value Measurements and Disclosures (Topic 820)”

Thank you for the opportunity to respond to FASB concerning the proposed Accounting Standards Update (ASU), “Fair Value Measurements and Disclosures (Topic 820)”. The Institutional Limited Partners Association (ILPA) is a global organization of over 235 member institutional investors in private equity that have approximately \$1 trillion of private equity assets under management. The mandate of the ILPA is to support its members on issues relating to education and research and to communicate matters that may affect business processes.

Our members would find a common global approach useful when estimating fair value. However, we are concerned that the language of the proposed ASU may create uncertainty amongst stakeholders in the private equity industry and we request that the Board consider the clarifications and suggestions in our letter below. Given the constituency of our membership, we have limited our responses to only those questions that we think may directly or indirectly impact institutional investors who invest in private equity.

Responses to Specific Questions

Question 1: This Exposure Draft represents the Board’s commitment toward developing common fair value measurement guidance with the IASB. Do you think the proposed amendments:

a. Would improve the understandability of the fair value measurement guidance in U.S. GAAP? If not, why not?

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We believe that the proposed amendments could significantly change fair value measurements from those estimated under current guidance. We further believe that the proposed measurement uncertainty disclosure requirements are not implementable and will not provide additional information toward better decision making.

b. Would result in any unintended consequences on the application of the proposed amendments? If so, please describe those consequences.

Application of the proposed amendments could result in a significant downward estimate of the fair value of private equity investments in private companies and in private debt. As a result, Net Asset Values (NAV), which are commonly used by LPs to estimate the fair value of their private equity limited partnership interests, would decrease. The magnitude of the change in fair value estimates of private investments, would directly impact the fair value of interests reported by pension funds, endowments, not for profits and other investors in private equity, potentially exacerbating an already tenuous funded status.

Question 2: The Board has decided to specify that the concepts of highest and best use and valuation premise are only to be applied when measuring the fair value of nonfinancial assets. Are there situations in which those concepts could be applied to financial assets or to liabilities? If so, please describe those situations.

We do not believe that application of highest and best use and valuation premise to illiquid financial assets like private equity should be removed.

Private equity managers invest primarily in private debt and equity securities. A venture capital fund may invest in the shares of underlying companies in multiple series of fund raising; for example series A, series B, series C etc. Investments in private companies and private rounds of financing are generally monetized either by selling the entire ownership interest to a strategic investor or by taking the company public and converting shares to common stock. A venture capital fund would rarely, if ever, sell their series B shares and keep series C shares. Therefore, the concept of highest and best use is applicable to the combined interest in all of the series owned by the VC fund.

Some private equity managers invest in both the debt and equity of the same private company. When a private equity manager controls the investee company, amounts classified as equity or debt are best valued as a group because debt is generally required to be repaid when the equity is sold. A market participant investing in a private company generally estimates the overall enterprise value on a debt free basis. Most private equity deals are structured such that debt must be repaid (refinanced) upon a change in control. Fair value is therefore best estimated by looking at the entire claim on the capital structure owned by the investor.

Removing the highest and best use and valuation premise from consideration for private equity assets could cause assets to be valued on a basis different than that used by the market participant who is theoretically buying the assets. Therefore, the proposed change would undermine the basic fair value premise of relying on market participant assumptions.

Question 5: The Board has decided to clarify the meaning of a blockage factor and to prohibit the use of a blockage factor when fair value is measured using a quoted price for an asset or a liability (or similar assets or liabilities). Do you think that proposal is appropriate? If not, why not?

We have concerns about the Board's proposal to prohibit the use of blockage factors for level 3 inputs. Unlike actively traded securities for level 1 inputs, the illiquid nature of private equity relies more on this type of transaction in the absence of an active market pricing mechanism.

Market participants transacting in private equity investments (debt and equity) commonly buy and sell interests in blocks, or groups. Therefore, the prohibition of valuing a block of securities, especially securities valued using level 3 inputs, again undermines the basic concept of valuing investments from a market participant perspective. We suggest that the Board consider modifying the proposed guidance so that "blockage" from a market participant perspective is appropriately allowed and utilized.

Question 6: The Board has decided to specify that other premiums and discounts (for example, a control premium or a non-controlling interest discount) should be taken into account in fair value measurements categorized within Level 2 and Level 3 of the fair value hierarchy when market participants would take into account those premiums or discounts when pricing an asset or a liability consistent with the unit of account for that asset or liability.

a. Do you think that proposal is appropriate? If not, why not?

We agree that the concept of valuing all features of an investment, including control or non-control, from a market participant perspective is appropriate. We are concerned, however, that the language of the proposal does not accomplish the goal of taking all features of an asset into account in estimating fair value because of confusion on determining the appropriate unit of account. The proposed ASU would eliminate situations in which shares can be grouped together because of the elimination of highest and best use, valuation premise and blockage factors. Therefore, while the proposed ASU allows control factors to be considered, there may never be a situation in which it would be applicable because the unit of account would never be deemed to be the controlling block of shares.

b. When the unit of account for a particular asset or liability is not clearly specified in another Topic, how would you apply that proposed guidance in practice? Please describe the circumstances (that is, the asset or liability and the relevant Topic) for which the unit of account is not clear.

For Private Equity investments, the unit of account would be designated by Topic 946, Investment Company Accounting. However, as Topic 946 is silent on the unit of account, we fear that many would interpret the unit of account to be a single share. Therefore, value associated with control would never exist under the proposed ASU. Our concern could be alleviated by allowing current highest and best use and valuation premise for financial assets and allowing Level 3 inputs to be grouped as a block to the extent a market participant would purchase a block.

Question 7: The Board has decided to require a reporting entity to disclose a measurement uncertainty analysis that takes into account the effect of correlation between unobservable inputs for recurring fair value measurements categorized within Level 3 of the fair value hierarchy unless another Topic specifies that such a disclosure is not required for a particular asset or liability (for example, the Board has decided in its project on the accounting for financial instruments that a measurement uncertainty analysis disclosure would not be required for investments in unquoted equity instruments). Do you think that proposal is appropriate? If not, why not?

We do not believe the proposed reporting is appropriate for the following reasons:

1. The example included at Paragraph 820-10-55-80 of the proposed ASU indicates that limited partners would be required to provide measurement uncertainty disclosures in addition to the best estimate of fair value obtained by using NAV. When limited partners comply with the provisions of ASU 2009-12, and use NAV as their estimate of the fair value of an interest in a private equity fund, the limited partner generally has no additional information upon which to calculate other fair value estimates. Compliance with the proposed change would not be possible because additional information is generally not available.
2. Even if measurement uncertainty information were available, we do not believe the measurement uncertainty disclosures for interests in private equity funds would provide readers of the financial statements of limited partners (pension funds, endowments, fund-of-funds, etc.) with meaningful information. Limited partners invest in a multitude of funds, sometimes hundreds of funds. Upon aggregation the result is highly improbable and the resulting disclosure would be meaningless.
3. As noted in Question 7 above, general partners may be given an exemption under US GAAP from providing measurement uncertainty disclosures for investments in the equity of private companies. We agree with the exemption

for GPs as we do not believe that LPs find the measurement uncertainty disclosures helpful. However, the exemption means that LPs will not receive any information which would allow them to comply with the example in 820-10-55-80. While we concur with the Board's exemption for GPs, we believe that a similar exemption must logically be provided to LPs for interests in Funds as well.

4. Generally, LPs utilize GP best effort estimates of fair value which is included in NAV as their best estimate of fair value. Requiring additional disclosures would result in significant additional costs with no discernable benefit.

Question 8: Are there alternative disclosures to the proposed measurement uncertainty analysis that you believe might provide users of financial statements with information about the measurement uncertainty inherent in fair value measurements categorized within Level 3 of the fair value hierarchy that the Board should consider instead? If so, please provide a description of those disclosures and the reasons why you think that information would be more useful and more cost-beneficial.

To comply with ASU 2009-12, LPs must evaluate the policies and procedures used by GPs to estimate the fair value of underlying investments. As such, applicable information already exists and is used by LPs, both from the financial statements and outside the financial statements. We do not believe that additional disclosures, beyond those currently required would be cost-beneficial.

Question 11: The amendments in this proposed Update would apply to public and nonpublic entities (that is, private companies and not-for-profit organizations). Should any of the proposed amendments be different for nonpublic entities? If so, please identify those proposed amendments and describe how and why you think they should be different.

Although the majority of our members are non-public entities, we believe the unintended adverse impacts of the proposed changes will apply to both public and nonpublic entities. If, however, the Board decides to move forward with the proposed changes, we believe that the disclosure requirements should not be applicable to nonpublic entities.

Question 12: How much time do you think constituents would need to prepare for and implement the amendments in this proposed Update?

If the proposal were implemented without change, we estimate that significant time (a minimum of two to three years) would be required to prepare and implement the proposed Update because information required to prepare measurement uncertainty disclosures does not currently exist.

We appreciate the opportunity to respond to the Board's questions pertaining to the proposed Update. We are happy to discuss our comments with you should you require any clarification. Please feel free to contact us.

Sincerely,

Darrell Pinto
Director of Research
Institutional Limited Partner Association