

**MEMO# 27328**

June 21, 2013

## **Possible SEC Staff Statement On Application Of S-X 3-09 And 4-08(g)**

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TO: ACCOUNTING POLICY SUBCOMMITTEE No. 3-13 RE: POSSIBLE SEC STAFF STATEMENT  
ON APPLICATION OF S-X 3-09 AND 4-08(G)

SEC staff in the Division of Investment Management is considering issuing a policy statement applying rules 3-09 and 4-08(g) of Regulation S-X to investment companies and business development companies. The policy statement is intended to ensure investors have access to financial information relating to majority-owned and controlled subsidiaries that are not consolidated. SEC staff has asked the Institute for industry reaction to the policy statement and its application to investment companies prior to its issuance. Please give me any comments on the application of these rules to investment companies by June 26 ([smith@ici.org](mailto:smith@ici.org) or 202/326-5851).

Rule 3-09 of Regulation S-X requires registrants to file separate financial statements for majority-owned subsidiaries not consolidated that meet certain significance tests based on assets or income. These significance tests are contained in rule 1-02(w) of Regulation S-X and consider the registrant's investments in the subsidiary and the registrant's equity in the income of the subsidiary. Per rule 3-09(a), when performing the significance tests, 20 percent should be substituted for 10 percent. Importantly, as part of the policy statement, SEC staff would indicate that a registrant could satisfy the requirement to file separate financial statements for any subsidiary that is a public company by including in the registrant's shareholder report a statement indicating where the subsidiary's financial statements may be obtained (e.g., the fund sponsor's website address). Feeder funds, however, would still be required to include the master fund's financial statements in the feeder fund's shareholder report. Also, a fund of funds that invests substantially all of its assets (e.g., greater than 75 percent) in one investee fund would still be required to consider including the investee fund's financial statements in its shareholder report.

Rule 4-08(g) of Regulation S-X requires the registrant to include in the notes to its financial statements summarized financial information for controlled subsidiaries not consolidated that satisfy the significance tests in rule 1-02(w). "Control" for this purpose is 25 percent of the voting securities as specified in 6-02(a) of Regulation S-X and Section 2(a)(9) of the Investment Company Act. The summarized financial information to be provided is specified in rule 1-02(bb) of Regulation S-X and includes generally information on the subsidiary's

assets, liabilities, and results of operations. When applying the significance tests in 1-02(w) the registrant would use 10 percent (and not 20 percent as noted above). When applying the significance tests, each subsidiary should be considered individually, as described in 4-08(g)(1)(ii)(A) and on an aggregated basis as described in 4-08(g)(1)(ii)(B). As part of the policy statement, SEC staff would indicate that a registrant could satisfy the requirement to provide summarized financial information for any controlled subsidiary not consolidated that is a public company by including in the registrant's shareholder report a statement indicating where the subsidiary's financial statements may be obtained (e.g., the fund sponsor's website address).

The policy statement is primarily aimed at BDCs, which may have majority-owned or controlled subsidiaries that are not consolidated. Application of these rules would ensure investors in BDCs have financial information relating to the subsidiary. SEC staff is of the view that application of these rules to open and closed-end funds would have no significant effect on their financial reporting as these funds either: a) do not have majority-owned or controlled subsidiaries that are not consolidated, or b) if they do and the subsidiary is a public entity, then the open/closed-end fund could comply with the required disclosures by providing a reference to where the subsidiary's financial statements may be obtained.

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