July 9, 2018

By email: rule-comments@sec.gov

U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: Request for Comment on Auditor Independence with Respect to Certain Loans or Debtor-Creditor Relationships (Rel. Nos. 33-10491; 34-83157; IC-33091; IA-4904; File No. S7-10-18)

Dear Office of the Secretary:

Ernst & Young LLP (EY) is pleased to provide comments to the Securities and Exchange Commission (SEC or Commission) on its proposal to amend the auditor independence rules with respect to certain loans or debtor-creditor relationships (Proposed Amendments or Release).

We appreciate the efforts of the Commission and its staff to update and improve the effectiveness of the auditor independence rules. We support the Proposed Amendments –specifically, the focus on beneficial ownership, the “significant influence” test, the “known through reasonable inquiry” standard, and the amendment to the definition of “audit client.” Each of those Proposed Amendments further investor protection by appropriately directing the focus of the independence rules to those situations where auditor independence may be impaired, while reducing unnecessary evaluation of situations that do not pose a reasonable risk to independence.

The importance of auditor independence

Independence in fact, and in appearance, is central to who we are and to EY’s ability to properly discharge its role as an auditor. The independence of auditors from management and companies being audited underpins confidence in financial reporting. Independence facilitates objectivity and the use of impartial judgment in conducting audits. The Commission’s independence rules help ensure auditor independence by identifying certain relationships between the auditor and the entity being audited that impair an auditor’s independence in fact or appearance.

In recognition of the importance of auditor independence to confidence in the capital markets, the Commission’s independence rules have existed for decades. In recognition of the changing nature of the environment in which auditors operate, the Commission also has updated those rules from time to time. For example, significant strengthening of the independence rules accompanied the passage of the Sarbanes-Oxley Act of 2002.
The Commission is now considering updating certain aspects of its independence rules to ensure the rules are operating as intended. Because the application of some of the rules in the current business environment produces certain unintended consequences, we believe this effort is in the best interests of investors. For example, issuers and audit firms spend significant resources to comply with Rule 2-01(c)(1)(ii)(A) of Regulation S-X (the Loan Provision). The underlying principle of the Loan Provision remains sound, as it is intended to prevent certain lending relationships that would cause a reasonable investor with knowledge of all relevant facts and circumstances to question an auditor’s independence. However, the requirements of the Loan Provision have resulted in a significant amount of time and effort spent addressing situations that do not threaten independence. The Commission’s Release addresses many of those situations.

Beyond the Loan Provision, we believe there are additional situations in which the independence rules do not operate as intended in light of changes in market conditions and the business environment. Accordingly, we appreciate the SEC’s request for comment on other potential changes to the Commission’s independence rules to help ensure that the independence rules continue to function as intended, which is vital to investors and the capital markets.

Responses to the Proposed Amendments

Below we provide comments on the Proposed Amendments and suggestions regarding other possible changes to the auditor independence rules. In the Appendix we respond to the Commission’s specific questions regarding the Proposed Amendments and other potential changes to the Loan Provision. In some cases, the Appendix provides additional content on our broader comments. We are available to meet with the Commission and its staff to further clarify our comments and recommendations.

As noted above, EY supports the Commission’s Proposed Amendments and believes they would support auditor independence, provide clarity to market participants and address current market conditions. As requested in the Release, we provide the following comments on areas that may require additional clarity or in response to specific questions asked in the Release.

Summary of EY comments

- We support the elimination of consideration of the interests of shareholders that are exclusively record owners (but not beneficial owners) from the evaluation required by the Loan Provision.

- We support the Commission’s proposal to amend the Loan Provision to replace the 10 percent bright-line shareholder ownership test with a significant influence test. To help promote consistent application of a revised rule, we suggest that the Commission consider providing additional guidance on the application of the significant influence standard in the fund context.
We support the use of a reasonable inquiry standard for identifying shareholders with significant influence. We also recommend that the Commission provide clarification around expectations of what would constitute a reasonable inquiry.

We agree that excluding affiliated funds from the audit client definition for a fund under audit would address some of the compliance challenges with the Loan Provision without implicating an auditor’s objectivity and impartiality. We believe the rationale for the exclusion is sound, but it applies with equal force to other entities in a fund complex, as well as to non-fund situations; and should not be limited just to a fund under audit. We recommend that the Commission modify the exclusion to require an evaluation of significant influence only for those shareholders that are either investors in the entity under audit or shareholders of an entity that controls the entity under audit.

The Commission should consider expanding the specific types of loans that will be excluded from the Loan Provision to include: secured loans obtained under normal lending procedures, terms and requirements; student loans; and partner capital loans arranged through the firm’s normal lending arrangements.

We recommend the Commission consider including a grandfathering provision that is similar to Rule 2-01(c)(1)(ii)(A)(4) for all loans with non-affiliate shareholders that exert significant influence over the audit client.

We believe, with respect to the Loan Provision, that the definition of “covered person” in Rule 2-01(f)(11) should be amended to exclude the fourth prong of the definition, which includes any other partner, principal, or shareholder from an “office” of the accounting firm in which the lead audit engagement partner primarily practices in connection with the audit.

The following provides more specifics related to certain of the above observations.

**The focus on beneficial ownership**

EY supports the elimination of a requirement to consider the interests of shareholders that are exclusively record owners (but not beneficial owners) from the evaluation of the Loan Provision. We agree that tailoring the Loan Provision to focus on only “beneficial ownership” of the audit client’s equity securities would more effectively identify shareholders “having a special and influential role with the issuer” and, therefore, better capture those debtor-creditor relationships that may impair an auditor’s independence. There is no independence threat created by lending relationships with entities that hold securities solely as record owners. The risk of these record owners having either the ability or an incentive to use their record ownership position to influence the audit is extremely remote, and loans with such record holders do not create a self-interest threat to an auditor’s independence.
We believe the Commission also should consider replacing or defining the term “beneficial owner.” One option is to remove the phrase “beneficial owner” and instead refer to shareholders that exert significant influence over the audit client. This would focus the analysis on the significant influence test and eliminate use of an undefined term that requires further interpretation. If the phrase is retained, we recommend that the Commission define the term. Currently, the term “beneficial owner” may not be consistently applied as it could refer to someone with an economic interest, or it could refer to a shareholder’s voting or dispositive power as noted in Rule 13d-3 under the Securities and Exchange Act of 1934.

The “significant influence” test

We support the Commission’s proposal to amend the Loan Provision to replace the 10 percent bright-line shareholder ownership test with a significant influence test. We agree with the views expressed in the Release that a significant influence test would better capture those debtor-creditor relationships that may impair an auditor’s independence. Further, the concept of significant influence is well-defined in accounting standards and is used in other parts of the independence rules, and as a result auditors and many of their clients are familiar with the standard. We suggest that the Commission consider providing additional guidance on the application of the significant influence standard in the fund context as FASB Accounting Standard Codification (ASC) 323, Investments – Equity Method and Joint Ventures, does not provide significant guidance on how to apply the principles of the standard to a typical investment fund’s operating and governance structure and funds do not have as much experience applying the standard. Additional clarification from the Commission as to how to assess significant influence in common fund situations (e.g., mutual funds, ETFs, REITs, private equity funds, hedge funds, closed-end funds) would promote consistent application of the Proposed Amendments, particularly when the application of the significant influence principles to investment funds is more subjective.

With respect to determining significant influence for funds, we agree that the assessment should focus on a shareholder’s ability to influence the fund’s investment policies and day-to-day portfolio management processes. However, the proposal provides examples of a right to remove an adviser and participating on an advisory committee as indicators of significant influence. These rights would not generally give a shareholder the right to significantly influence the investment decisions of the fund. We recommend that the Commission consider drawing a distinction between rights that provide a shareholder with an ability to actively participate in fund investment decisions (for example approval or veto rights over a new fund investment) which would indicate significant influence, in contrast to rights that allow a shareholder to address inappropriate behavior on the part of the investment adviser (for example a right to remove an adviser for cause or the right to approve material changes to the fund governance documents) which would not indicate significant influence. In addition, we believe the Commission should also clarify that the 20% rebuttable presumption in ASC 323 would not be applicable in a fund context. In many scenarios a beneficial owner of a fund...
may own greater than 20% of the equity of the fund, but based on the limited legal rights of fund owners under the fund’s governance provisions, will not have either the right or the ability to exert significant influence over the fund as defined in ASC 323.

The “known through reasonable inquiry” standard

We agree with the Commission’s proposal to apply a reasonable inquiry standard to the identification of shareholders with significant influence. To ensure consistency in application of this standard, we recommend that the Commission provide clarification of what would constitute a reasonable inquiry and provide examples of how to address situations where “beneficial ownership” information may not be readily available.

The amendment to the definition of “audit client”

We agree that excluding affiliated funds from the audit client definition for a fund under audit would address some of the undue compliance challenges with the current rule and do so without compromising an auditor’s objectivity and impartiality or causing harm to investors. Shareholders in these affiliates have neither the ability nor the incentive to attempt to influence the audit.

To better meet the objective outlined in the Proposed Amendments of applying the Loan Provision to those shareholders that have a special and influential role with the audit client, the Commission should further amend the Loan Provision, with respect to shareholders that are not affiliates, so that the rule only includes in its scope shareholders that can exercise significant influence over the entity under audit.

To effectuate the above, we recommend that the Commission modify the proposed exclusion to:

- apply to all audit clients, not just fund audit clients; and
- limit the evaluation of significant influence to those shareholders that are either investors in the entity under audit or shareholders of an entity that controls the entity under audit.\(^1\)

While funds have clearly been the most impacted by the current rule, non-fund issuers face all of the same challenges associated with the Loan Provision as funds. Moreover, we believe that an informed investor would not view shareholders of affiliates that have no ability to influence the entity under audit as “having a special and influential role with the issuer” as a result of owning shares of an affiliate. Accordingly, a lending relationship with such shareholder would not compromise the auditor’s objectivity and impartiality and continuing to require evaluation of shareholders in most

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\(^1\) Investment advisors of funds under audit would generally have control by contract and shareholders of the investment advisor would be included in the evaluation of significant influence.
affiliates will continue to cause auditors and audit clients to expend substantial time and expense to comply with the rule.

In addition, we suggest the Commission clarify that the assessment of all the facts and circumstances in determining significant influence be made at the level of the entity for which financial statements are being audited and not at each individual downstream affiliate. While an investor in a downstream affiliate of an entity may exercise significant influence as it relates to the individual affiliate, that investor may not have significant influence over the entity being audited taken as a whole.

We acknowledge that shareholders of an investment adviser to a fund, or a controlling parent of an entity under audit, may be deemed to have significant influence over the entity under audit. While providing for an exclusion that specifically keeps such affiliates within the scope of the rule would be appropriate, an evaluation of such shareholders would still be required if the rule was modified to simply refer to owners that have significant influence over the entity under audit, which would eliminate the need for a separate exclusion. If the approach described in the preceding discussion is not adopted, we recommend that the Commission clarify that for purposes of applying the Loan Provision, downstream investees of commonly controlled funds are also excluded.

The following examples illustrate, after implementation of the Proposed Amendments, where the Loan Provision would continue to identify independence violations that would not appear to affect the auditor’s objectivity and impartiality absent the adoption of our recommendations:

- The custodian, administrator, and transfer agent of a registered fund (all within the definition of “Investment Company Complex,” and thus, within the definition of “affiliate” of a registered fund audit client) are service providers of a registered fund, and the shareholders in those entities do not have significant influence over the fund. Therefore, there is no reason to continue to have to track shareholders in such entities.

- The exclusion of fund affiliates would not apply to a broker-dealer in the same investment company complex. The broker dealer and its auditor would be required to continue to evaluate each affiliated fund to identify any lending relationships with shareholders that have significant influence over the fund. Any such shareholder would not have any ability to influence the broker-dealer.

- A registrant that is controlled by a private equity fund, and its auditor, would be required to continue to evaluate all other controlled portfolio companies in any other fund managed by the same investment adviser (as well as each of the funds themselves) to identify any lending relationships with shareholders that have significant influence over these entities under common control with the entity under audit. Any such shareholder would not have the ability to significantly influence the entity under audit or the auditor, just as the SEC has suggested in proposing the exclusion of fund affiliates of fund audit clients.
The rule as amended would continue to capture shareholders that exercise significant influence over an immaterial non-wholly owned entity that is controlled by a registrant, although the shareholder in the downstream affiliate has no ability to exert significant influence over the audit client as a whole.

Suggestions for other changes to the Commission’s auditor independence rules

We appreciate the SEC’s request for comment on other changes to the SEC’s independence rules beyond the Loan Provision, as doing so will help inform the Commission on areas of its rules that may not be functioning as intended. We believe the general principles underlying the Commission’s auditor independence rule are sound and well-suited to protect investor interests. Nevertheless, to further the objective of those principles, we believe there are certain areas of the rules that should be modified in response to how businesses and markets have evolved and given the experiences to date in the application of the independence rules since they were adopted. We describe certain of those areas below.

As part of its review, we encourage the Commission to consider the independence standards adopted by other established standard setters, such as the International Ethics Standards Board for Accountants (IESBA) and the American Institute of Certified Public Accountants (AICPA). Increased harmonization with these recognized standards will promote capital formation without weakening appropriate investor protections, especially with respect to initial public offerings (IPOs).

Affiliate of the audit client through “common control”

The Commission’s independence rules apply not only to the entity under audit but also to its affiliates, which are defined to include all entities that are under “common control with the audit client.” An entity under common control is an affiliate and subject to the independence rules irrespective of the relationships with the entity being audited or consideration of the materiality of the entities to the controlling entity. Indeed, the Commission’s Release acknowledges the “practical challenge” posed by the “broad definition of the term ‘audit client’ giving rise to results that are out of step with the purpose of the rule,” and specifically references the inclusion of entities under common control.

Application of the independence rules to entities that are “affiliates” of the audit client has been among the most challenging areas of independence compliance. These challenges can be particularly acute in the context of private equity, sovereign wealth and similar organizations where there can be

2 See Rule 2-01(f)(4)(i) of Regulations S-X.
3 See pages 12 and 13 of the Commission’s Loan Rule Release.
hundreds of entities under common control, generally without overlapping operations, systems, or management. The inclusion of such common control entities in the audit client definition, irrespective of the lack of direct connection between the entities and the immateriality of such entities, results in those entities being subject to the independence rules even though services to or relationships with such entities do not pose independence concerns with respect to the entity under audit. It also increases the monitoring burden on the part of companies, audit committees and auditors; limits an audit committee’s options with respect to making an auditor change; and gives rise to independence rule violations that do not present a threat to the auditor’s objectivity or impartiality in the conduct of an audit. In light of the extensive number of portfolio companies controlled by private equity firms in today’s economy, and the pace of changes with those portfolios, the level of disruption in time or cost focusing on such immaterial common control affiliates that have no bearing on the auditor’s objectivity and impartiality can be significant and ultimately hinder capital formation without a commensurate benefit to investor protection.

We encourage the Commission to reexamine the affiliate definition with respect to entities under common control in light of these considerations. In connection with this assessment, we also encourage the Commission to consider reviewing the application of the term “control” as used in the first prong of the affiliate definition. In light of the number of entities potentially encompassed within the broad definition of the term “audit client,” together with the complex business structures that exist today, there are numerous practical challenges for companies, audit committees and auditors that arise in applying the concept of control under a legal framework. This often gives rise to results that are out of step with the purpose of the rule, particularly with respect to determining affiliates under common control. As noted in the Release, an accounting standard is already the basis used for the significant influence prongs of the affiliate definition in the SEC’s independence rules. We believe the Commission should consider in its assessment the merits of using an accounting standard for applying the control prong of the affiliate definition. This would enhance consistency and provide the

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4 For example, if a private equity firm seeks to acquire a controlling interest in an immaterial target entity, all non-audit services and relationships prohibited by the Commission’s independence rules that are provided by the target’s audit firm, as well as prohibited non-audit services and relationships provided to/with the target by other audit firms, must be terminated before the acquisition if the audit firms are subject to the Commission’s independence rules elsewhere within the private equity complex. Challenges also arise when a private equity firm seeks to take a portfolio company public given that the portfolio company is required to use an audit firm that is independent under the Commission’s rules retrospectively going back two to three years throughout the broader private equity complex, including at each affiliate under common control.

5 Challenges include the ability of companies and auditors to obtain nonpublic information necessary to make a control assessment under a legal framework.

6 See Rule 2-01(f)(4)(ii) and (iii) and the 2000 Adopting Release where it refers to Accounting Principles Board Opinion No. 18, “The Equity Method of Accounting for Investments in Common Stock” (Mar. 1971), which was codified at ASC 323.
benefit of familiarity as it is well-recognized and understood by preparers, users and auditors of financial statements.

**Transition provision for IPOs**

The SEC’s independence rules currently provide for a limited transition or accommodation with respect to an IPO by a company that qualifies as a foreign private issuer (FPI). This provision permits an accounting firm, solely for purposes of an FPI’s initial registration statement, to be independent under the Commission’s rules for only the most recent audited fiscal year, provided that the accounting firm is independent under local home country standards for all periods presented. This same accommodation is not available to domestic U.S. based companies accessing the public markets for the first time. Domestic companies are required to engage an accounting firm that has been independent under the Commission’s independence rules for all periods presented (typically a two or three-year period prior to the initial filing of the registration statement). In facilitating efficient capital formation for U.S. based companies, we encourage the Commission to consider extending this practical accommodation to domestic IPO situations or consider alternative IPO transition provisions.

**Business relationship rule**

Under the Commission’s independence rules, an accountant is not independent if, at any point during the audit and professional engagement period, the accounting firm or any covered person in the firm has any direct or material indirect business relationship with an audit client, or with persons associated with the audit client in a decision-making capacity, such as an audit client's officers, directors, or substantial stockholders. The relationships described above do not include a relationship in which the accounting firm or covered person in the accounting firm provides professional services to an audit client or is a consumer in the ordinary course of business.

Changes to the global economy and advances in technology have transformed the way companies and accounting firms operate. The manner in which businesses are delivering services through digital platforms and other technologies creates challenges in applying the business relationship rule that were not applicable when the rule was last amended. In the current business environment, service delivery increasingly relies on various software tools and technologies in the normal course of business that allow for broader distribution of solutions to meet market needs (such as cloud hosting services, mobile applications, online survey tools, web-based data-rooms, analytics tools, or software development tools).

Additional challenges also exist in applying the current business relationship rule given the Commission’s expansive definition of the term “affiliates of the audit client”, and the fact that the terms used in the rule such as “decision-making capacity,” “substantial stockholder,” and “indirect business relationship” are not defined in Regulation S-X. Under the current business relationships rule, independence issues can arise in certain situations despite the fact that there is no reasonable
threat to objectivity and impartiality in the conduct of an audit. This is often the case when the proposed business relationship is not with the entity under audit or one of its downstream or upstream affiliates, but with an entity under common control, a substantial stockholder, or an entity within the substantial stockholder’s broader complex. Some of these relationships are with certain shareholders at distant entities or of such insignificance that they pose no discernable risk to an auditor’s objectivity and impartiality in fact or in appearance, but they can still be covered by the current application of the Commission’s business relationship rule. As with the Loan Provision, this can unduly disrupt the provision of audit services or delay capital formation and transactions without a commensurate benefit to investor protection.

We encourage the Commission to reexamine the business relationship rule in light of the above considerations to help ensure the rule continues to protect investor interests and support capital formation in the current business environment. In addition, the Commission should consider providing clarity on key terms such as those mentioned above that are used within the business relationship rule, as well as reconsidering the rule with respect to business relationships with substantial stockholders in a decision-making capacity. In this regard, we believe the Commission should consider using a significant influence test, as outlined in the Release, instead of a decision-making test, which is not defined. For the same reasons highlighted in the Release with respect to the Loan Provision, we believe using a significant influence test in the business relationship rule provides appropriate investor protections and will promote more consistency in applying the rule.

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We are available to meet with the Commission and its staff to clarify our comments and recommendations.

If you have any questions, please contact Richard J. Huesken at [redacted].

Yours sincerely,

Ernst & Young LLP

Attachment: Appendix – EY’s responses to requests for comment
Appendix – EY’s responses to requests for comment

Requests for comment regarding Proposed Amendments

1. Focus the Analysis Solely on Beneficial Ownership

- Should the Loan Provision be analyzed by reference to beneficial owners rather than record owners? Why or why not?

EY supports the elimination of a requirement to consider the interests of shareholders that are exclusively record owners (but not beneficial owners) from the evaluation of the Loan Provision. We agree that tailoring the Loan Provision to focus on only “beneficial ownership” of the audit client’s equity securities would more effectively identify shareholders “having a special and influential role with the issuer” and, therefore, better capture those debtor-creditor relationships that may impair an auditor’s independence. There is no independence threat created by lending relationships with entities that hold securities solely as record owners. The risk of these record owners having either the ability or an incentive to use their record ownership position to influence the audit is extremely remote, and loans with such record holders do not create a self-interest threat to an auditor’s independence.

We believe the Commission also should consider replacing or defining the term “beneficial owner.” One option is to remove the phrase “beneficial owner” and instead refer to shareholders that exert significant influence over the audit client. This would focus the analysis on the significant influence test and eliminate use of an undefined term that requires further interpretation. If the phrase is retained, we recommend that the Commission define the term. Currently, the term “beneficial owner” may not be consistently applied as it could refer to someone with an economic interest, or it could refer to a shareholder’s voting or dispositive power as noted in Rule 13d-3 under the Securities and Exchange Act of 1934.

- Would eliminating the requirement to analyze record owners under the Loan Provision ease compliance challenges described above under Section 1.B.? Is there any further guidance the Commission should provide, or should the Commission consider alternatives?

We believe that eliminating the requirement to analyze record owners under the Loan Provision would substantially ease the current compliance challenges. It also would reduce the resources and time being spent to evaluate relationships with these parties that do not create a self-interest threat that could result in the auditor lacking objectivity and impartiality. These are costs that are ultimately borne by shareholders.
• Would eliminating the requirement to analyze record owners under the Loan Provision raise other concerns about the independence of auditors? If so, what concerns would it raise and why?

We do not believe that eliminating the requirement to analyze record owners under the Loan Provision would raise other concerns about the independence of auditors.

• If the Commission merely amended the Loan Provision to provide for evaluation of the beneficial owner, rather than record owner, would other proposed amendments be necessary or appropriate? Why or why not?

As further discussed herein, we believe that other proposed amendments, particularly those addressing shareholders of affiliates of an audit client, would be necessary and appropriate to achieve the Commission’s goals.

2. Significant Influence Test

• Should we amend the Loan Provision to replace the 10 percent bright-line test with a “significant influence” test? Why or why not?

We support the Commission’s proposal to amend the Loan Provision to replace the 10 percent bright-line shareholder ownership test with a significant influence test. We agree with the views expressed in the Release that a significant influence test would better capture those debtor-creditor relationships that may impair an auditor’s independence. Further, the concept of significant influence is well-defined in accounting standards and is used in other parts of the independence rules, and as a result auditors and many of their clients are familiar with the standard. There is a significant benefit to compliance when using a commonly understood and applied term.

We suggest that the Commission consider providing additional guidance on the application of the significant influence standard in the fund context as FASB Accounting Standard Codification (ASC) 323, Investments – Equity Method and Joint Ventures, does not provide significant guidance on how to apply the principles of the standard to a typical investment fund’s operating and governance structure and funds do not have as much experience applying the standard. Additional clarification from the Commission as to how to assess significant influence in common fund situations (e.g., mutual funds, ETFs, REITs, private equity funds, hedge funds, closed-end funds) would promote consistent application of the Proposed Amendments, particularly when the application of the significant influence principles to investment funds is more subjective.

With respect to determining significant influence for funds, we agree that the assessment should focus on a shareholder’s ability to influence the fund’s investment policies and day-to-day portfolio management processes. However, the proposal provides examples of a right to remove an adviser
and participating on an advisory committee as indicators of significant influence. These rights would not generally give a shareholder the right to significantly influence the investment decisions of the fund.

- **Would the proposed reference to ASC’s 323’s provisions for “significant influence” effectively identify those lending relationships that may compromise auditor independence?**

We believe that the proposed reference to ASC 323’s provisions for “significant influence” effectively identify those lending relationships that may compromise auditor independence. With respect to determining significant influence for funds, we agree that the assessment should focus on a shareholder’s ability to influence the fund’s investment policies and day-to-day portfolio management processes. However, the proposal provides examples of a right to remove an adviser and participating on an advisory committee as indicators of significant influence. These rights would not generally give a shareholder the right to significantly influence the investment decisions of the fund. We recommend that the Commission consider drawing a distinction between rights that provide a shareholder with an ability to actively participate in fund investment decisions (for example approval or veto rights over a new fund investment) which would indicate significant influence, in contrast to rights that allow a shareholder to address inappropriate behavior on the part of the investment adviser (for example a right to remove an adviser for cause or the right to approve material changes to the fund governance documents) which would not indicate significant influence. In addition, we believe the Commission should also clarify that the 20% rebuttable presumption in ASC 323 would not be applicable in a fund context. In many scenarios a beneficial owner of a fund may own greater than 20% of the equity of the fund, but based on the limited legal rights of fund owners under the fund’s governance provisions, will not have either the right or the ability to exert significant influence over the fund as defined in ASC 323.

- **Would amending the Loan Provision to replace the 10 percent bright-line test with a “significant influence” test, along with the other proposed amendments, address the compliance challenges that we identify above?**

Yes, amending the Loan Provision to replace the 10 percent bright-line test with a significant influence test, along with the other proposed amendments, particularly those addressing shareholders of affiliates of an audit client, would significantly reduce compliance challenges. Shareholders in funds could be evaluated based on fund documents and governance structure, eliminating the need to evaluate individual shareholders that constantly change.

- **Application of “significant influence” for financial reporting purposes and evaluation of auditor independence may not necessarily be congruent. Accordingly, does ASC 323 –**
Investments – Equity Method and Joint Ventures, provide an appropriate framework for analyzing “significant influence” in the context of the Loan Provision? Why or why not?

We believe that the framework in ASC 323 is appropriate for analyzing whether a shareholder has significant influence over an audit client in a typical corporate environment. As previously stated, we suggest that the Commission consider providing additional guidance on application of the framework to funds and other audit clients organized as limited partnerships, or similar structures.

• Are there challenges associated with implementing the “significant influence” test that we should consider? Will accounting firms’ and audit clients’ relative experience with application of the “significant influence” test, given its use in other contexts, mitigate any such challenges? To what extent do audit clients lack experience with application of the significant influence test, and what costs would such audit clients bear in learning to apply the test? Will funds, which may have relatively less experience than operating companies with the significant influence test, face any particular challenges in applying the test?

There is a significant benefit to using a commonly-understood term such as significant influence, which is used in accounting standards and other parts of the independence standards. Accountants and audit clients already routinely apply the standard for determining significant influence, including when identifying affiliates of audit clients. Fund audit clients will not be as familiar with interpreting whether fund shareholders have significant influence, and FASB ASC 323 does not provide significant guidance on how to apply the principles of the standard to a typical investment fund’s operating and governance structure. Accordingly, without additional guidance from the SEC, the determination of whether an investor exercises significant influence over an investment fund may lead to inconsistent application in practice.

• Is the proposed “significant influence” test sufficiently clear? Are there specific circumstances for which we should provide additional guidance? For example, we discuss above the application of the significant influence test in the fund context. Is the guidance sufficiently clear? Would the application of the significant influence test as applied to funds be effective in addressing the compliance challenges generated by the current Loan Provision while also identifying debtor-creditor relationships that may bear on an auditor’s independence with respect to a fund client? Why or why not? Is there further guidance that we should provide or other approaches that we should consider?

In the fund audit context, the theory in the proposal that significant influence requires an ability to influence the fund’s investment policies and day-to-day portfolio management processes is an appropriate approach to evaluating whether a fund shareholder has significant influence. However, the proposal provides examples of a right to remove an adviser and participating on an advisory committee as indicators of significant influence. These rights would not generally give a shareholder
the right to significantly influence the investment decisions of the fund. We recommend that the Commission consider drawing a distinction between rights that provide a shareholder with an ability to actively participate in fund investment decisions (for example approval or veto rights over a new fund investment) which would indicate significant influence, in contrast to rights that allow a shareholder to address inappropriate behavior on the part of the investment adviser (for example a right to remove an adviser for cause or the right to approve material changes to the fund governance documents) which would not indicate significant influence.

- Should the “significant influence” test (or specific elements) be codified in our rules? Why or why not?

Since the SEC has made clear in its proposal that they intend significant influence to mean as defined in ASC 323, we suggest that this reference be included in the adopting release. The independence rules themselves should not codify the detailed considerations, even if those considerations currently align with ASC 323, so as to avoid confusion in the future if changes are subsequently made to ASC 323.

- Authorized participants (“APs”) for ETFs deposit or receive basket assets in exchange for creation units of the fund. We believe that the deposit or receipt of basket assets by an AP that is also a lender to the auditor alone would not constitute significant influence over an ETF audit client. Should we provide additional guidance about the proposed “significant influence” test with respect to APs? Similarly, should we provide additional guidance about the proposed “significant influence” test with respect to a market maker that is also a lender to the auditor and that engages an AP on an agency basis to create or redeem creation units of the ETF on its behalf?

We do not believe that the deposit or receipt of basket assets by an AP and market maker that is also a lender to the auditor would constitute significant influence over an ETF audit client.

- ASC 323 includes a rebuttable presumption of 20 percent. For purposes of the Loan Provision and the proposed significant influence test, should the rebuttable presumption be lower or higher than 20 percent? Would a lower threshold (e.g., 10 percent) be more likely to capture relevant independence-impairing relationships, or to result in additional false positives that the proposed rule seeks to avoid? Would setting our threshold differently than ASC 323 diminish the benefits that we seek to achieve by using an existing standard—e.g., by requiring the reperformance of certain analyses at a greater degree of sensitivity? How much more complex would it be to apply a threshold other than 20 percent? Are there further relevant facts about a lower or higher threshold that we should consider?
We believe that there is a significant benefit to using a commonly understood standard for assessing significant influence that accountants and audit clients are well-versed in applying. This is the same standard commonly used to identify affiliates of the audit client. We believe that using a consistent framework, including the 20 percent presumptive threshold for identifying those investors with a “special and influential role”, achieves the objectives of safeguarding auditor independence and promotes consistency in the application of the rule. A lower threshold, such as 10 percent, would not be more likely to capture relevant independence-impairing relationships, and may result in false positives that the proposed rule seeks to avoid.

The Commission should also clarify that the 20% rebuttable presumption in ASC 323 would not be applicable in a fund context. In many scenarios a beneficial owner of a fund may own greater than 20% of the equity of the fund, but based on the limited legal rights of fund owners under the fund’s governance provisions, will not have either the right or the ability to exert significant influence over the fund as defined in ASC 323.

- Would the proposed amendment raise any new concerns regarding auditor independence (e.g., are there circumstances related to lending relationships in which an auditor’s independence should be considered impaired that would not be identified under the proposed “significant influence” test)? Conversely, would the proposed “significant influence” test result in an auditor’s independence being considered impaired in circumstances under which the auditor should otherwise be considered independent?

We do not believe that the Proposed Amendments raise any new concerns regarding auditor independence. The significant influence test proposed by the Commission will no longer rely on bright lines that have proven to be inconsistent with the objectives of the independence rules while providing for the application of appropriate principles for identifying shareholders that are relevant to investor protection under the Loan Provision. As stated in the Proposed Amendments, the general standard under Rule 2-01(b) will continue to apply to auditors and require auditors and audit clients to assess whether a reasonable investor with knowledge of all relevant facts and circumstances would conclude that the accountant is not capable of exercising objective and impartial judgment on all issues encompassed within the accountants engagement.

- Should we consider alternatives to this test? If so, what tests should we consider, and what would be the anticipated costs and benefits? For example, should the modifier “significant” be removed, such that the test hinges on whether a lender shareholder has influence over an audit client? Why or why not? What is the difference between “influence” and “significant influence” in the auditor independent context and how does that difference inform the test?

We believe a test based on the significant influence framework in ASC 323 is the most appropriate test to achieve the objectives of the Commission. We do not believe that the modifier “significant”
should be removed, as the well-established significant influence framework in ASC 323 best supports the stated objectives of the Loan Provision as summarized in the Proposed Amendments. If the term “significant” was removed or substituted, a currently undefined framework will need to be developed with sufficient supporting guidance to achieve the desired consistency in application, with no apparent improvement in investor protections. Further, by removing the modifier “significant” and basing the test only on influence, many more shareholders would likely have to be evaluated, unnecessarily increasing costs to audit clients and their investors.

- Should the nature of the services provided by the investment adviser be part of the significant influence test as proposed? Why or why not?

The services provided by the investment adviser should be considered as those services would be relevant in an assessment of significant influence over a fund’s investment decisions and day to day portfolio management processes.

3. Known Through Reasonable Inquiry

- Should the Loan Provision include a “known through reasonable inquiry” standard? Why or why not? What alternatives should we consider?

While we agree that the rules should recognize that there will be many situations where it may not be possible to identify the “beneficial owners” of shares held by record owners, we recommend that the Commission provide clarification of what would constitute a reasonable inquiry and provide examples of how to address situations where “beneficial ownership” information may not be available.

- Would the proposed “known through reasonable inquiry” standard with respect to identifying beneficial owners help to address compliance challenges associated with the Loan Provision?

In practice, inquiries of record owners are conducted in an attempt to identify “beneficial owners.” It is certainly helpful for the Commission to acknowledge that “beneficial ownership” information will not always be available. We believe that if the audit client and auditor are not aware of a “beneficial owner,” then it is unlikely that such “beneficial owner” would exercise significant influence over the audit client or pose any significant threat to the auditor’s objectivity and impartiality.

- Are there specific circumstances for which we should provide additional guidance about the proposed “known through reasonable inquiry” standard?

We believe it would be helpful for the Commission to provide examples of common situations where a client/auditor would be able, and conversely unable, to obtain the relevant information from a
record owner. For example, would the Commission expect the client/auditor to be able to obtain beneficial ownership information from: the ADR Depositary holding company shares on behalf of the ADR holders; a broker dealer holding shares of a mutual fund on behalf of its clients; or a bank holding shares of a fund in an omnibus account on behalf of its customers?

- **Does the “known through reasonable inquiry” standard raise any new concerns regarding auditor independence (e.g., are there circumstances related to lending relationships in which an auditor’s independence should be considered impaired that would not be identified under the proposed amendment and the use of “known through reasonable inquiry” standard)?**

We believe that there are no new concerns regarding auditor independence if the Commission provides sufficient clarification of the application of the “known through reasonable inquiry” standard. For example, subsequent to conducting a “reasonable inquiry,” the possibility exists that there could be unidentified shareholders with significant influence over the audit client. If the existence of those shareholders was not made known through reasonable inquiry or otherwise, it is unlikely that they would have the ability to influence the audit and it follows that the auditor’s independence would not be impaired. The Commission should consider whether application guidance should encompass this concept.

- **Alternatively, should we amend the Loan Provision to apply the significant influence test to “known beneficial owners” of an audit client’s equity securities, without also including a reasonable inquiry standard, consistent with the way beneficial owners are treated elsewhere in Regulation S-X (that is, when assessing compliance with the Loan Provision, the determination would encompass assessing whether the known beneficial owners have significant influence over the audit client)?**

We believe that this alternative would yield substantially the same result as reasonable inquiry.

- **Proposed Amendment to Exclude from “Audit Client” Other Funds that Would Be Considered an “Affiliate of the Audit Client.” Should affiliates of an audit client be excluded from the definition of “audit client” as it relates to the Loan Provision? Why or why not?**

We agree that excluding affiliated funds from the audit client definition for a fund under audit would address some of the undue compliance challenges with the current rule and do so without compromising an auditor’s objectivity and impartiality or causing harm to investors. Shareholders in these affiliates have neither the ability nor the incentive to attempt to influence the audit.

To better meet the objective outlined in the Proposed Amendments of applying the Loan Provision to those shareholders that have a special and influential role with the audit client, the Commission
should further amend the Loan Provision, with respect to shareholders that are not affiliates, so that the rule only includes in its scope shareholders that can exercise significant influence over the entity under audit.

To effectuate the above, we recommend that the Commission modify the proposed exclusion to:

- apply to all audit clients, not just fund audit clients; and
- limit the evaluation of significant influence to those shareholders that are either investors in the entity under audit or shareholders of an entity that controls the entity under audit.7

While funds have clearly been the most impacted by the current rule, non-fund issuers face all of the same challenges associated with the Loan Provision as funds. Moreover, we believe that an informed investor would not view shareholders of affiliates that have no ability to influence the entity under audit as “having a special and influential role with the issuer” as a result of owning shares of an affiliate. Accordingly, a lending relationship with such shareholder would not compromise the auditor’s objectivity and impartiality and continuing to require evaluation of shareholders in most affiliates will continue to cause auditors and audit clients to expend substantial time and expense to comply with the rule.

In addition, we suggest the Commission clarify that the assessment of all the facts and circumstances in determining significant influence be made at the level of the entity for which financial statements are being audited and not at each individual downstream affiliate. While an investor in a downstream affiliate of an entity may exercise significant influence as it relates to the individual affiliate, that investor may not have significant influence over the entity being audited taken as a whole.

We acknowledge that shareholders of an investment adviser to a fund, or a controlling parent of an entity under audit, may be deemed to have significant influence over the entity under audit. While providing for an exclusion that specifically keeps such affiliates within the scope of the rule would be appropriate, an evaluation of such shareholders would still be required if the rule was modified to simply refer to owners that have significant influence over the entity under audit, which would eliminate the need for a separate exclusion. If the approach described in the preceding discussion is not adopted, we recommend that the Commission clarify that for purposes of applying the Loan Provision, downstream investees of commonly controlled funds are also excluded.

The following examples illustrate, after implementation of the Proposed Amendments, where the Loan Provision would continue to identify independence violations that would not appear to affect the auditor’s objectivity and impartiality absent the adoption of our recommendations:

7 Investment advisors of funds under audit would generally have control by contract and shareholders of the investment advisor would be included in the evaluation of significant influence.
• The custodian, administrator, and transfer agent of a registered fund (all within the definition of “Investment Company Complex”, and thus, within the definition of “affiliate” of a registered fund audit client) are service providers of a registered fund, and the shareholders in those entities do not have significant influence over the fund. Therefore, there is no reason to continue to have to track shareholders in such entities.

• The exclusion of fund affiliates would not apply to a broker-dealer in the same investment company complex. The broker dealer and its auditor would be required to continue to evaluate each affiliated fund to identify any lending relationships with shareholders that have significant influence over the fund. Any such shareholder would not have any ability to influence the broker-dealer.

• A registrant that is controlled by a private equity fund, and its auditor, would be required to continue to evaluate all other controlled portfolio companies in any other fund managed by the same investment adviser (as well as each of the funds themselves) to identify any lending relationships with shareholders that have significant influence over these entities under common control with the entity under audit. Any such shareholder would not have the ability to significantly influence the entity under audit or the auditor, just as the SEC has suggested in proposing the exclusion of fund affiliates of fund audit clients.

• The rule as amended would continue to capture shareholders that exercise significant influence over an immaterial non-wholly owned entity that is controlled by a registrant, although the shareholder in the downstream affiliate has no ability to exert significant influence over the audit client as a whole.

• Would the proposed amendment to exclude from the term “audit client” for a fund under audit any other fund that otherwise would be considered an “affiliate of the audit client” address compliance challenges associated with the Loan Provision while still effectively identifying lending relationships that may impair auditor independence?

The proposed amendment would assist in achieving the objectives of the Loan Provision as outlined in the Release with respect to affiliated funds of the fund under audit. However, as stated previously, it does not address similar issues for other affiliated entities in a fund complex and for affiliates of audit clients that are not funds, and these entities face the same challenges associated with the Loan Provision. Shareholders in these affiliates have neither the ability nor incentive to attempt to influence the auditor and do not create an auditor self-interest threat, and should therefore be excluded from the Loan Provision.


- Would the proposed amendment appropriately exclude funds of an “investment company complex” (other than the fund under audit) that are currently within the Loan Provision’s ambit?

Yes, the proposed amendment would appropriately exclude affiliated funds of an “investment company complex” (ICC). It is appropriate to exclude affiliated funds in an investment company complex as shareholders in one fund typically do not possess the ability to influence the policies or management of another fund in the same fund complex. In addition, the auditors have little transparency into the shareholders of the other funds in an ICC.

- Alternatively, are there other changes we should consider to the Loan Provision to appropriately exclude certain affiliated funds?

Please see all noted responses above.

Requests for comment regarding other possible amendments

A. Materiality

The proposed amendments to the Loan Provision do not consider whether the lender’s investment in the equity securities of the audit client is material to the lender or to the audit client. We believe that adding a materiality qualifier to the proposed significant influence test is unnecessary to achieve our goal of effectively and appropriately identifying lending relationships that could pose threats to auditor independence. Nevertheless, we request comment on whether there should be a materiality qualifier as part of the Loan Provision.

- For example, should we include a provision for assessing materiality in the Loan Provision such that an auditor’s independence would only be impaired as a result of certain relationships where the lender to the auditing firm has beneficial ownership in the audit client’s equity securities and that investment is material to the lender or to the audit client (and the lender has the ability to exercise significant influence over the audit client)? Would that approach more effectively identify lending relationships that are likely to threaten the auditor’s objectivity and impartiality? Would focusing on the perspective of the lender, the audit client, or both be the most effective barometer of independence?

If the Commission adopts the recommendation that all affiliates of an entity under audit (other than those that control the entity under audit) be excluded (rather than only the affiliated funds outlined in the proposal), we believe that it is not necessary to add a materiality qualifier to evaluate the lender’s investment in the audit client’s securities. The inclusion of a materiality qualifier in this manner would be redundant because the lender in the situation where the entity is material to the investor/lender would be deemed an affiliate of the audit client under Rule 2-01(f)(4)(iii) of
Regulation S-X (ascribing affiliate status where an entity has significant influence over an audit client and that investment is material to the entity), and thus the loan would be prohibited as a loan between the auditor and the audit client. However, if affiliates (other than those that control the entity under audit) of an entity under audit remain within the confines of the Loan Provision, a materiality qualifier for the lender’s investment in the affiliate would be appropriate. A lending relationship with a shareholder with an immaterial investment in an affiliate of the audit client is unlikely to impact an auditor’s objectivity and impartiality.

We also believe that it would be appropriate to add a materiality qualifier to the Loan Provision if the intent of the qualifier is to classify lending relationships as prohibited only if they are material to the lender or the accountant. It would not appear that a lender would have the ability to influence the accountant nor create a self-interest threat as a result of an immaterial lending relationship.

If we were to add a materiality qualifier to the Loan Provision as described above, which qualitative and quantitative factors should be considered in making the materiality assessment? Would such a materiality assessment add unnecessary complexity to the significant influence analysis? Would a materiality qualifier tend to exclude most lending relationships from the Loan Provision? What guidance, if any, should the Commission provide?

If the Commission pursued a materiality qualifier on the lending relationship itself, we believe that it would be appropriate to consider, in addition to the quantitative measure, whether the loan was entered into under normal lending procedures, terms, and requirements available to similar borrowers.

B. Accounting Firms’ “Covered Persons” and Immediate Family Members

The Loan Provision is implicated with respect to loans both to and from an accounting firm, and also any “covered person” in the firm or any of his or her immediate family members. Some of the consultations the Commission staff have had with audit firms, funds, and operating companies involved lending relationships to or from covered persons or their immediate family members.

Should we amend the definition of “covered person” for purposes of the Loan Provision or elsewhere in the auditor independence rules, and if so, how should the definition of “covered person” be amended?

We believe, with respect to the Loan Provision, that the definition of “covered person” in Rule 2-01(f)(11) should be amended to exclude the fourth prong of the definition, which includes any other partner, principal, or shareholder from an “office” of the accounting firm in which the lead audit engagement partner primarily practices in connection with the audit. Our proposal to eliminate the fourth prong of covered person is based on the evolution of virtual staffing models, which now result in staffing individuals on client engagements, based on technical skillset, who generally work from...
virtual workspaces at home, abroad or in “hotel space” provided by the firm. Therefore, we believe that it is unlikely that partners or principals unassociated with the audit engagement, and who are not in the chain of command above the lead audit engagement partner, would have interaction with the audit engagement team on substantive matters or exert influence over the audit engagement team by virtue of physical proximity to, or frequent contact with the audit engagement team.

- In particular, taking into account the proposed “significant influence” test, should we, for example, remove or revise the part of the current definition that includes any partner, principal, or shareholder from an “office” of the accounting firm in which the lead audit engagement partner primarily practices in connection with the audit? Should all of these persons practicing out of an office from which an audit is conducted be included? Should immediate family members be removed from the definition? Why or why not?

We believe that lending relationships with this fourth prong of covered persons do not pose a risk to the objectivity and impartiality of the audit engagement team as it is unlikely that a lender would attempt to exert influence over these covered persons in order for them to attempt to influence the audit engagement team members with whom they are not involved. Further, entering into a lending relationship with these professionals does not create a self-interest threat, in fact or appearance.

We do not recommend that immediate family members be excluded from the definition. Immediate family members have such regular and close contact with a covered person that it is appropriate, for independence purposes, to attribute to the covered person any financial and employment relationships that immediate family member has with the audit client. Immediate family members include a person’s spouse, spousal equivalent and dependents. We believe that the Commission, for the purposes of the Loan Provision, should consider modifying the definition of immediate family member to include only dependents residing in the same household as the covered person. We do not believe that financial dependence on a covered person necessarily equates to regular and close contact with a person when the persons are not living in the same household.

- In addition, the Loan Provision provides that it does not apply to certain loans made by a financial institution under its normal lending procedures, terms, and requirements, such as automobile loans and leases collateralized by the automobile. Should we consider expanding or otherwise modifying the specific types of loans that will not implicate the Loan Provision, given that the Loan Provision applies to covered persons of the accounting firm and their immediate family members? For example, should the Loan Provision address student loans or partner capital account loans? If so, how should it address them? For example, should it exclude them altogether or exclude them under certain conditions? If so, under what conditions?
The Commission should consider expanding the specific types of loans that will be excluded from the Loan Provision to include: any secured loan obtained under normal lending procedures, terms and requirements (for example: cell phone installment plans, retail installment loans, solar panels, second homes, boats, motorcycles, RVs, etc.); student loans; and partner capital loans arranged through the firm’s normal lending arrangements. We believe that such loans under normal terms and conditions to a covered person would not create a competing self-interest between the auditor and its audit client or those shareholders of the audit client who have a “special and influential role” with the audit client. In addition, we recommend the Commission consider including a grandfather provision in Rule 2-01(c)(1)(ii)(A)(4) for all loans with non-affiliate shareholders that exert significant influence over the audit client, as the independence threat primarily exists when the loan is initially entered into (for example: student loans obtained prior to becoming a covered person). Allowing such previously-existing loans to run to maturity, assuming they are kept current, would not pose any significant threat to independence.

C. Evaluation of Compliance

Rule 2-01(c)(1) of Regulation S-X provides that an accountant is not independent if the accountant has an independence-impairing relationship specified in the rule at any point during the audit and professional engagement period. Some existing disclosure requirements require information about beneficial owners as of a specified date.

- Should the rule provide that auditor independence may be assessed in reliance on such disclosures? Should we make any changes related to the frequency with which, the date as of which, or circumstances under which, an auditor must assess compliance with the Loan Provision or other provisions of Rule 2-01 of Regulation S-X? More specifically, should we permit the Loan Provision or other financial relationships to be assessed at specific dates during the audit and professional engagement period, or the beginnings or ends of specific periods, or under specified circumstances? If so, what would be appropriate dates, periods, or circumstances?

Since it is the Staff’s view that independence is the shared responsibility of the auditor and the audit client, the rule should indicate that the audit client and the auditor may rely on such ownership information disclosed in SEC filings as an example of evidence obtained or known through reasonable inquiry. Accordingly, we also believe that information contained in Proxy Statements and Schedules 13D and 13G provide reliable information about the existence of beneficial owners to be evaluated under the Loan Rule. Under the securities laws, beneficial ownership information is periodically updated and disclosed as changes in ownership occur and as required filings are made with the Commission. We believe that, given the impact of the Proposed Amendments, it is not necessary to specify dates, periods or circumstances under which compliance should be assessed. We believe that if the auditor determines that significant influence over the fund’s management processes
could not exist\textsuperscript{8}, the auditor would reevaluate its determination only in response to a material change in the fund’s governance structure and governing documents. For non-fund audit clients, the evaluation would be triggered by new publicly available information about beneficial owners, or other information which may implicate the ability of a beneficial owner to exert significant influence, of which the audit client or auditor becomes aware.

- **Would this approach be sufficient for evaluating compliance with the Loan Provision? Why or why not?**

Yes, we agree that an assessment for a fund can be done based on the fund governance structure and fund documents, thus eliminating the need to continually evaluate changes in shareholders.

**D. Secondary Market Purchases of Debt**

The existing Loan Provision encompasses lending arrangements that may change depending upon secondary market purchases of syndicated or other debt. For example, audit firms may issue private placement notes for financing purposes, which could then be sold on the secondary market to new purchasers thereby creating new lending relationships between the audit firm and these new secondary market purchasers.

- **Should such secondary market relationships be taken into account or excluded from the Loan Provision? Do secondary market relationships raise concerns about auditor independence?**

We do not believe that secondary market relationships should be excluded from the Loan Provision. We do not believe that the fact that the loan was established through a secondary market purchase impacts the evaluation of whether the auditor’s self-interest competes with the auditor’s obligation to serve only shareholders’ interests. However, as recommended previously, we believe that the Commission should including a grandfather provision in Rule 2-01(c)(1)(ii)(A)(4) to all loans with shareholders that exert significant influence over the audit client.

\textsuperscript{8} For funds, the auditor’s initial determination would be based on an evaluation of a fund’s governance structure and governing documents, the manner in which its share are held or distributed, and any contractual arrangements, among any other relevant factors.