

January 19, 2005

Letter of Comment No: 13
File Reference: FSP46RB

Director, TA&I—FSP
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

Re: Proposed FASB Staff Position FSP FIN 46(R)-b, "Implicit Variable Interests Resulting From Related Party Relationships Under FIN 46(R)"

Dear Director:

We appreciate the opportunity to respond to the proposed staff position, FSP FIN 46(R)-b. It is in the spirit of improving the overall variable interests model, and enhancing the clarity of that guidance, that we provide the following comments to you.

While we agree that some clarifying guidance should be provided in the area of implicit arrangements that may be variable interests in a VIE, we do not believe that such guidance should be limited to related party arrangements. In particular, we believe that what Jane Poulin described as, "Activities around the entity" (in her remarks before the 2004 AICPA National Conference on SEC and PCAOB Developments) should be woven into the fabric of the FIN 46 model. Below, we propose wording that would bring this concept into the written guidance; we view our proposal as:

1. Clarifying the concepts in the draft FSP, to re-focus the guidance on arrangements that absorb variability; and
2. Expanding the scope, to incorporate arrangements with third parties.

Paragraph B10 of FIN 46(R) mentions that an implicit arrangement may be a variable interest. We believe that notion is appropriate. In fact, any arrangement in which an enterprise will absorb variability of a VIE may be a variable interest, whether that arrangement is directly with the VIE or is an arrangement with another entity involved with the VIE (e.g., a holder of an interest in the VIE).

However, an arrangement either is a variable interest because through it an enterprise absorbs variability, or is not a variable interest because the enterprise does not absorb variability. When an entity absorbs variability, it stands to receive or pay an amount that may vary based on the changes occurring at the VIE. As written, the draft FSP would 'promote' an arrangement to 'variable interest' status, even though that arrangement does not absorb variability (as in accordance with the draft FSP wording, the starting point is an arrangement not deemed a variable interest). To further the point, we note that the example provided in the FSP describes no implicit arrangement by which Manufacturing Company has guaranteed the value of the facility purely through the owner's investment in Leasing Company. There is no promise (stated or implied) to transfer value to the parent in the event of negative variability. In the absence of some promise on the part of Manufacturing Company, that entity is more likely to cause variability in Leasing Company (e.g., by defaulting, or deciding to renew, non-renew, or terminate the lease) than they are to absorb any variability. To clarify, we believe the guidance should indicate that certain

arrangements that on first appearance are not identified as variable interests, for example because the VIE may not be a counterparty to it, may nonetheless be variable interests under FIN 46(R). The term 'indirect' more aptly captures this situation than the term 'implicit.'

Further, we do not see any basis for limiting the guidance to arrangements within a related party group. As our view above describes, a variable interest may stem from a direct or an indirect arrangement with the VIE. One example of an indirect arrangement that absorbs variability of a VIE's net assets is a third party guarantee of an interest in a VIE, in which the beneficiary of the guarantee is not the VIE but rather the holder of the guaranteed interest. In that example, the guarantor has no direct arrangement with the VIE, yet through the guarantee absorbs some of the VIE's expected variability. In practice today, that indirect arrangement is excluded from the determination of the primary beneficiary.

We propose the following wording, to adopt the notion that an arrangement that indirectly absorbs variability of a VIE, may be a variable interest in that VIE:

A variable interest in a VIE may arise from an indirect arrangement with a VIE, in which one enterprise absorbs variability of the VIE through an arrangement with another party involved with the VIE. If the indirect arrangement is part of the design of the VIE, then it is a variable interest in the VIE.

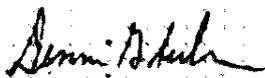
For this purpose, an indirect arrangement should be deemed to be a part of the design of the VIE if it:

- 1. Is entered into or arranged by those involved in the creation, design or redesign of the VIE, and it is entered into or anticipated contemporaneously with the creation, design or redesign of the VIE;*
OR
- 2. Is entered into after the design or redesign of the VIE, but it is entered into or arranged by one variable interest holder (Seller), and a new variable interest holder (Buyer) that is acquiring Seller's variable interest. (In this case, the indirect variable interest would be considered a part of the design of the VIE only by the Buyer, Seller, and if different from Seller, the enterprise that may absorb variability through the indirect arrangement.)*

Applying this proposed wording to the example of an indirect guarantee would identify the guarantee as a variable interest if it is part of the design of the VIE. The holder of the direct interest in the VIE is, by design, NOT absorbing the variability from the VIE that is subject to the guarantee – the guarantor is. Without our proposed change, guarantor's could 'elect' to consolidate a VIE by providing the guarantee to the VIE itself, or avoid consolidation by providing guarantees by separate arrangement to variable interest holders.

Our proposal allows for some arrangements that absorb variability indirectly to not be considered variable interests, to accommodate arrangements entered into by a variable interest holder as part of their own risk management process. A variable interest holder's decision to hedge some of the risks they absorb from a VIE would not be viewed as part of the design of the VIE, and therefore such indirect arrangements should not be viewed as variable interests that could affect the identification of the primary beneficiary.

Sincerely,



Dennis G. Sullivan