August 20, 2004

Letter of Comment No: 2
File Reference: FSPFAS142C
Date Received:

Mr. Lawrence Smith
Director of Technical Application and Implementation Activities
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

RE: Proposed FASB Staff Position No. FAS 142-c, Application of FASB Statement No. 142, Goodwill and Other Intangible Assets, to Exchange Memberships.

Dear Mr. Smith:

Citigroup appreciates the opportunity to respond to the Proposed FASB Staff Position No. FAS 142-c, *Application of FASB Statement No. 142, Goodwill and Other Intangible Assets, to Exchange Memberships* (the Proposed FSP). We have the following comments and observations for your consideration.

We do not support the changes in accounting for exchange memberships as proposed in this FSP as we do not believe it represents an improvement in the financial reporting for these assets. Exchange memberships very clearly meet the definition of a financial asset, and although they have certain characteristics of intangible assets, we believe that they are not unlike many other financial assets in that regard. The Proposed FSP would replace existing accounting guidance that is well understood and consistently implemented across the industry with an entirely new model that creates different financial reporting for an exchange membership based solely on investor intent. We do not understand why the FASB staff is pursuing such a novel approach to the accounting for a financial asset with certain intangible characteristics, especially given the lack of current practice issues in this area.

We believe that exchange memberships are financial assets and, therefore, are outside the scope of FASB Statement No. 142, and that the most appropriate guidance is that required by paragraph 7.34 of the AICPA Audit and Accounting Guide, Brokers and Dealers of Securities. That guidance recognizes the substance of exchange memberships and requires that exchange memberships held for operating purposes be valued at cost or at a lesser amount if there is an other than temporary impairment in value.

Exchange Memberships are Financial Assets

Regardless of whether it is held for investment or for operating purposes, an exchange membership is an ownership interest in an exchange. Thus, it meets the definition of a financial asset in FASB Statements No. 107 and 140. In contrast, FASB Statement No. 142 defines

¹ Paragraph 364 of FASB Statement No. 140 and paragraph 3 of Statement 107 define a financial asset as "cash, evidence of an ownership interest in an entity, or a contract that conveys to a second entity a contractual right (a) to receive cash or another financial instrument from a first entity, or (b) to exchange other financial instruments on potentially favorable terms with the first entity" (emphasis added).

intangible assets as "assets (not including financial assets) that lack physical substance" (emphasis added). It is very clear that an asset, like an exchange membership, that meets the definition of a financial asset is precluded from being considered an intangible asset and is therefore outside of the scope of FASB Statement No. 142.

The fact that an exchange membership may be purchased to obtain an operating advantage does not alter its status as a financial asset, just as an investment in other equity securities made for competitive, strategic, or other operating purposes does not change the character of the equity securities to intangible assets from financial assets.

Similar to other equity ownership interests, exchange memberships are investments that represent a residual ownership of the assets of the exchange. For example, if the New York Stock Exchange were to dissolve itself, members would receive equal portions of the net proceeds from the liquidation of the Exchange. In contrast, intangible assets when liquidated do not distribute net proceeds.

Finally, many exchange memberships have a quoted bid-and-asked and last sale price,² are traded in an auction market, and are therefore very similar to marketable equity securities (financial assets) accounted for under FASB Statement No. 115.

Inappropriate Solution for an Asset with Mixed Attributes

We agree with the FASB staff that some exchange memberships have certain attributes of intangible assets. However, we believe that this situation is not unique to exchange memberships, and this is certainly not a new issue. There are many financial assets with significant "embedded" intangible assets that are not separately recognized – residential mortgage loans and credit card receivables are two common examples. Under certain circumstances, the embedded intangible assets in these financial assets are separately recognized as mortgage servicing rights, and purchased credit card relationships. However, the fact that embedded intangible assets may exist has not called into question the appropriate accounting or impairment methodology used for the financial asset itself.

In contrast, the Proposed FSP introduces an entirely new model for dealing with this issue, by searching for the "predominant objective for owning the exchange membership" to determine the basis of accounting for an exchange membership as either a wholly intangible asset or a wholly financial asset. We believe that the basis of accounting for an asset should be determined by the asset's characteristics and not by the investor's intent for owning the asset. The definitions chosen by the Board in FASB Statements No. 107, 140, and 142 are based solely on asset characteristics, not on investor intent. Given the strong precedent in the accounting for other sorts of financial assets with embedded intangibles, we fail to see the need to pursue the proposed approach of using intent-based criteria to focus only on certain characteristics of an instrument, while ignoring other important fundamental characteristics to recharacterize a financial asset as an intangible asset.

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² FASB Statement No. 115, paragraph 3a: The fair value of an equity security is readily determinable if sales prices or bid-and-asked quotations are currently available on a securities exchange registered with the Securities and Exchange Commission (SEC) or in the over-the-counter market, provided that those prices or quotations for the over-the-counter market are publicly reported by the National Association of Securities Dealers Automated Quotations systems or by the National Quotation Bureau

One of these fundamental characteristics is that, like other financial assets, the value of exchange memberships is somewhat volatile. An exchange membership's market value has been correlated to activity in the brokerage industry; as trading activity and stock prices rise and fall, seat prices rise and fall too³. In contrast, most intangible assets tend to have values that would not fluctuate widely up and down, but rather would follow longer-term trends. Said another way, one would not normally expect an intangible asset to lose significant value in one period, only to recover significantly shortly thereafter. Therefore, the impairment methodology in FASB Statement No. 142, which allows only for downward adjustment for falling asset values, but not upward adjustments for recoveries, is appropriate for most intangible assets. However, for a financial asset with values that may regularly fluctuate up and down, such an impairment methodology does not accurately reflect or fairly present the substance of the asset. The impairment test for financial instruments (for example, in FASB Statement No. 115) is more commonly an "other-than-temporary" impairment test to avoid these short-term fluctuations in value from being recognized in the income statement.

Proposed FSP Presents a False Alternative

Although the Proposed FSP appears to allow certain exchange memberships to be treated as financial assets based on intent, it goes on to state that this alternative may be used only if the exchange is operated to earn a profit. Most exchanges of which we are aware are established as not-for-profit or break-even organizations, and therefore memberships in those exchanges may not be accounted for as financial assets. Thus, from a practical perspective, the framework established by the Proposed FSP to identify the "predominant objective for owning the exchange membership" is largely irrelevant because in most situations, the FSP itself would preclude its application and would simply require the exchange membership to be classified as an intangible asset.

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We appreciate the opportunity to express our views on the proposal. If you have any questions regarding our comments, please do not hesitate to contact me at (212)-559-7721.

Sincerely,

Robert Traficanti

Vice President and Deputy Controller

Bob Draficanti

³ "Stock Exchange Seats as Capital Assets", Journal of Financial Economics, G. William Schwert, 1977