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Financial Accounting Standards Board  
401 Merritt 7  
Norwalk, Connecticut 06856-5116

Letter of Comment No: 6  
File Reference: FSP46RB

**File reference No FSP46RB**  
Send by email to [director@fasb.org](mailto:director@fasb.org)

Dear Sir:

RBC Financial Group ("RBC") would like to thank you for the opportunity to provide our comments on the draft abstract for FSP FIN 46(R)-b, *Implicit Variable Interests Resulting from Related Party Relationships under FASB Interpretation No. 46 (revised December 2003), Consolidation of Variable Interest Entities* ("FSP46RB").

We understand the intent of the FSP is to ensure aggregation of variable interests held by related parties of an enterprise even when the enterprise does not have a variable interest in the VIE provided the enterprise has some form of interest or other involvement with the VIE. This is a useful and necessary clarification of paragraph 16 of FIN 46 (Revised). Without this clarification, reporting enterprises could interpret the paragraph as requiring the enterprise to have a variable interest in the VIE as a precondition to aggregating variable interests held by related parties.

The second sentence in footnote 3 of FSP46RB reads as follows:

*Regardless of whether a related party relationship exists, the determination as to whether an implicit variable interest exists should always be based on whether, in substance, the reporting enterprise will absorb the variability of a VIE.*

It appears that this sentence extends the requirement to identify an implicit variable interest to the following situation: A reporting enterprise would have to consider whether contracts with other unrelated parties involved with a VIE result in an implicit variable interest of the reporting enterprise even though there is no direct contractual link between the reporting enterprise and the VIE being assessed.

We request you to delete this second sentence of footnote 3 for the following reasons, illustrated by means of an example:

Consider an example where a bank enters into a derivative with an investment fund (F1). The derivative requires the bank to pay the return on another fund (F2) to F1. In return, F1 pays the bank the total return on its portfolio of assets. Through this arrangement, the investors in F1 gain exposure to F2 whereas the bank takes exposure to the assets of F1. In order to satisfy its obligation under the derivative, the bank invests in F2 by buying units of F2. Under FIN 46R, if the funds were determined to be VIEs, a comparison of the variability of the assets of F1 (which are the exposure of the bank) and the variability of F2 (which is the exposure of the investors in F1) would determine whether the bank or a majority investor in F1 is the primary beneficiary of F1. The bank would assess its investment in F2 and determine if that exposed it to a majority of F2's variability in which case the bank would consolidate F2.

However, if we apply the second sentence of footnote 3 to this situation, then regardless of whether the bank and F1 are considered related parties, F1 could be seen as having an implicit variable interest in F2, as a result of the derivative between F1 and the bank. As such, the bank would no longer consider itself to have a variable interest in F2 even though contractually, it is the bank that has an interest in F2. Instead the bank would assume that F1 was consolidating F2 as a result of the implicit variable interest.

The consequence of applying the second sentence of footnote 3 creates the following problems in practice:

1. F1 may not be aware of the bank's investment in F2. They may only see their derivative with the bank and conclude that they don't have a variable interest in F2. Thus, it is possible that no one consolidates F2 in the end. The bank thinks F1 is the primary beneficiary due to F1's implicit variable interest whereas F1 only considers its derivative with the bank and does not see an implicit variable interest in F2.
2. Even if F1 was aware that the bank was hedging the derivative with F1 by directly investing in F2 and concludes F1 has an implicit variable interest in F2, F1 would still not be able to obtain information necessary for consolidation from F2 as it has no contractual relationship with F2. This is different if the bank was a related party of F1 in which case F1 would be able to get information necessary for consolidation by exercising influence over the bank. Thus, the concept of implicit variable interest works in practice where related parties are being considered. However, it is difficult, if not impossible, to apply it where the parties are not related.

Theoretically as well, the second sentence of footnote 3 is not consistent with the existing provisions of FIN 46R. Variable interests are defined in FIN 46R as *contractual, ownership, or other pecuniary interests in an entity that change with changes in the fair value of the entity's net assets exclusive of variable interests*. This

definition requires a contractual, ownership or other pecuniary link to a VIE as a precondition to having a variable interest in a VIE. Thus, the second sentence of footnote 3 of FSP46RB is inconsistent with this definition because it forces one to consider implicit variable interests even where there is no contractual link to the VIE. It assumes that all parties with direct or indirect interests in a VIE's activities are equally informed of each other's interests in the VIE and their underlying intent. Such knowledge regarding the design of the VIE and the intent of the various parties may not be universally applicable.

For the aforementioned reasons, we highly recommend that the second sentence from footnote 3 be deleted.

Please feel free to contact the undersigned should you have any questions or would like further information in relation to our comments.

Yours truly,

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