



Letter of Comment No: 99
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December 1, 2003

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: Comments on Proposed Interpretation, *Consolidation of Variable Interest Entities, a modification of FASB Interpretation No. 46.*

Dear Mr. Smith:

Wachovia Corporation is pleased to comment on the Proposed Interpretation, *Consolidation of Variable Interest Entities, a modification of FASB Interpretation No. 46* (the Proposed Interpretation). We welcome the Board's efforts to address implementation issues of FASB Interpretation No. 46, *Consolidation of Variable Interest Entities* (FIN 46). Since the issuance of FIN 46 early in 2003, we and other financial statement preparers have worked diligently to understand and apply its guidelines to new and existing structures. In doing so, we have had to follow a moving target of interpretations and guidance developed by ourselves and our peers, the accounting firms, and even the Board and the FASB staff. As we write this today, there are seven FASB Staff Positions issued in final form, three proposed FASB Staff Positions pending finalization, and the Proposed Interpretation modifying FIN 46, all before FIN 46 is even a year old. Additionally, the Board has deferred the effective date of applying FIN 46 to entities existing prior to February 1, 2003, to provide some relief from the confusion and inconsistent interpretations.

The deferral itself is an example of the ever-changing aspect of this project – deferral was discussed at two different Board meetings during the third quarter and rejected by the Board each time. After the end of the third quarter and after Wachovia had completed its internal processes to “close the books” for the third quarter, the Board changed its course and decided to defer the effective date from July 1 to December 31. At that point, we had

already implemented FIN 46 and consolidated the commercial paper conduits that we administer. We elected to move forward and report our results including the consolidation while some of our peers elected to defer implementation and any resulting consolidation. This has led to inconsistent application of the new standard.

Another example of the confusion and inconsistent application of FIN 46 is the trusts that issue "trust preferred securities." These trusts are owned by the sponsoring organization that issues subordinated debt to the trust. The trusts purchase this debt with proceeds from the issuance of preferred securities to the public. The nature of the various agreements between the sponsoring organizations and the trusts has traditionally resulted in the sponsoring organizations making disclosures along the lines of "obligations of the Parent Company constitute a full and unconditional guarantee by the Parent Company of the Trusts' obligations with respect to the trust preferred securities." In an accounting standard where consolidation is evaluated based on risks and benefits, it would seem apparent that the sponsoring organization making such disclosures would consolidate those trusts. However, because of the actual rules in FIN 46, this is not necessarily the case in some people's view. As noted in a recent American Banker article, different accounting firms appear to have different conclusions. The inconsistent reporting among companies is certainly not what the Board intended when it issued FIN 46.

We do support the Board in its efforts to address implementation issues that have arisen. However, we are concerned that the provisions of the Proposed Interpretation do not achieve the Board's intent and that it will not be a conclusive step in the overall FIN 46 implementation process. There are many unanswered questions. In fact, a Staff member noted in a recent Board meeting that the Staff did not necessarily know how to define a variable interest, how to calculate expected losses and expected residual returns, nor how to allocate those losses and returns to variable interest holders. These are the basic building blocks in the FIN 46 model – if neither the Board nor the Staff is able to answer these questions, what are financial statement preparers and auditors to do?

We believe that any modification to FIN 46 should reflect all of the Board and the FASB Staff's intended clarifications and guidance, including previously issued guidance. The continued issuance of FASB Staff Positions to address implementation issues on an ad-hoc basis is not helpful in applying FIN 46 to new or existing structures. We strongly encourage the Board to complete all of its deliberations on implementation issues – including addressing the basic questions noted in the previous paragraphs – prior to issuing a final Interpretation that modifies FIN 46. We also suggest the Board incorporate into the final Interpretation all of the previously issued FSPs. Finally, we request that the Board include in the final Interpretation its informal guidance that consolidation of a lessor trust by a lessee does not impact leveraged lease accounting by the equity investor in the lessor trust.

In addition to these overall observations, we have the following comments on specific items in the Proposed Interpretation.

Variable Interest Entities – Paragraph 5

We are unclear what the Board's goal is in the modification to paragraph 5a to note that subordinated financial support provided "by any parties, including equity holders." We assume 'subordinated', in this context, means subordinate to the equity, but would like the Board to clarify the context. We are concerned that this could have broad implications in its application. For example, is an equity holder who provides personal loan guarantees a type of subordinated support anticipated by this paragraph? Similarly, is a liquidity agreement or other similar guarantee provided by an equity holder that is senior to the equity, but subordinate to debt, the type of support being addressed?

The discussion of qualitative considerations in paragraph 5a appears to introduce a higher level of judgment into the determination of whether an entity is a voting interest entity. We are not clear as to why this approach is introduced at the end of paragraph 5a, when just prior, the statement is made that an analysis of expected losses is the "benchmark" for assessing equity. We also note that the proposed revision to paragraph 5a notes "qualitative consideration *may* also be important," while the proposed new paragraph 9A notes that "qualitative assessments *shall* be carefully considered..." Additionally, a similar judgmental approach does not appear acceptable for a calculation of expected losses under paragraph 8. We suggest the Board be consistent in its guidance within the Proposed Interpretation and also believe that the judgment should first be applied in both paragraph 5a and paragraph 8 analyses.

Expected Losses and Expected Residual Returns – Paragraphs 2(c) and 8

There has been significant confusion caused by the guidance in paragraphs 2 and 8 and Appendix A of FIN 46. We note the Board's proposed changes to paragraph 8, removing the references to net income or loss and changes in the fair value of assets and inserting a reference to long-term return. Appendix A, however, is a cash flow analysis based on Concepts Statement No. 7, *Using Cash Flow Information and Present Value in Accounting Measurements*. Neither of these are consistent with the definition of a variable interest in paragraph 2(c), which states that a variable interest is an interest whose value changes with changes in a VIE's "net asset value." We encourage the Board to provide a clear understanding of the analysis to use in determining the expected variability of an entity and, additionally, to what interests that variability should be allocated. Please see our comments herein regarding the proposed amendments to Appendix A and Appendix B.

We are not certain that the Board's proposed revisions to paragraph 8 will address this confusion. Already, different parties are trying to determine what "long-term" and "return" mean in the context of analyzing various entities and structures. Among other issues is whether a plan to sell an asset from an entity in the short-term should be considered in assessing the variability of the entity or should the analysis assume the

entity holds the asset until its maturity. Additionally, how should the analysis be handled for variable interests that have different terms? Which variable interest should determine the “long-term” horizon for assessing variability and how can a variable interest with a shorter term than that be analyzed?

Additionally, the example used in Appendix A of FIN 46, even as modified in Proposed FSP 46-d, continues use of a situation that is too simplified to apply in actual transactions. The example determines paragraph 8 fees based on the variances in cash flows; however, most of the structures we see have paragraph 8 fees that do not vary based on cash flows, but on other factors such as total assets, debt, net income, etc. These different structures lead to a complicated process of trying to determine variability from different sources (changing asset balances and changing cash flows) and trying to apply them equally across a structure. Finally, the example itself does not seem complete, as none of the estimated cash flow scenarios results in the instrument returning its total cash flows (the highest level of estimated cash flows on \$1 billion investment is only \$900 million); this discrepancy seems to imply that either a variable interest is missing or a variable interest has a \$100 million loss embedded in it. We encourage the Board to provide additional examples that reflect the realistic and complex transactions that are widely seen in the marketplace.

Consolidation Based on Variable Interests – Appendix A and Appendix B

We note the Board’s proposed removal of Appendix B in its entirety and the edit to paragraph A5 in Appendix A. We also note that the Board’s intention for issuing the Proposed Interpretation is to address implementation issues. Without any guidance regarding the identification of variable interests, the implementation issues will only continue – in fact, we believe that they will probably increase. Thus, we feel that the Board is not achieving the stated intent of the Proposed Interpretation. Similar to our comments above, we believe the Board should provide all guidance, and as much as possible, at the same time.

Related Parties – Paragraph 16

We suggest the Board clarify the meaning of “manage the economic risks or realize the economic rewards” in the Proposed Interpretation. We note the Board’s proposed revision to paragraph 16d and do believe it will reduce the number of situations in which two parties are considered related parties under FIN 46. However, we believe clarification of the proposed revision, or examples relating to it, would be helpful as we are not certain how to apply the guidance in today’s complex financial market. For instance, if a party is able to manage their economic risk through derivatives, such as a total return swap, does that imply that the two parties would not be considered related parties? The issue is that a party holding an interest in an entity is always able to manage economic risks or realize the economic rewards of an instrument through the use of derivatives, either contemporaneous with the closing of a transaction or at some point

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during the term of the transaction, regardless of any transfer restrictions imbedded in the interest itself. We believe this strategy is prudent and acceptable and should not present any potential related party issues.

We would be pleased to address any questions you may have regarding the comments in this letter or to discuss our position in more detail at your convenience. I can be reached at 704-383-6101 or by email at david.julian@wachovia.com.

Sincerely,

David M. Julian
Senior Vice President
Corporate Controller