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December 10, 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: Exposure Draft on Consolidation of Variable Interest Entities – a modification of FASB Interpretation No. 46

Dear Larry:

The American Bankers Association (ABA) appreciates the opportunity to comment on the Exposure Draft issued by the Financial Accounting Standards Board (FASB), Consolidation of Variable Interest Entities – a modification of FASB Interpretation No. 46 (ED). The ABA brings together all categories of banking institutions to best represent the interests of the rapidly changing industry. Its membership – which includes community, regional, and money center banks and holding companies, as well as savings associations, trust companies and savings banks – makes ABA the largest banking trade association in the country.

We are concerned that there is a declining appreciation of the time, energy, and resources that corporations devote to adopting new accounting rules. Companies are experiencing a “circuit overload” on systems and corporate personnel responsible for implementing these changes. The adoption of new rules requires process changes and many systems changes, which take considerable time, budgeting, and advance preparation. As an example, the implementation of Financial Interpretation No. 46 (FIN 46) is creating undue hardships on preparers, parallel to difficulties that surrounded FASB Statement of the Financial Accounting Standards No. 133, Accounting for Derivatives. Banking institutions work diligently to comply with new rules, and we respectfully request the FASB to be cognizant of the implementation process and impact that new rules will have on preparers. This should not be interpreted to mean that changes should not be made to existing standards; instead, we encourage the FASB to work more closely with the industry earlier in the process to help ensure that problems are understood and resolved prior to issuance of new rules.

As mentioned in our previous comment letter to the FASB, many critical issues related to the implementation of FIN 46 remain unanswered. While we appreciate the willingness of the FASB to answer some of the questions regarding FIN 46, we believe the process to address implementation issues needs structure, organization,

and additional due process. We are concerned that the accounting profession is assuming a governing role in making critical decisions on implementation issues related to FIN 46 instead of the FASB, and due process is being ignored. In addition, it has been a challenge for companies to stay current on all relative guidance issued relating to FIN 46. For example, following the issuance of FIN 46 in May 2003, a number of FASB Staff Positions on FIN 46 when issued to provide additional interpretive guidance on FIN 46. The public comment deadline on these proposals was a maximum of 30 days, and each proposal had a different comment deadline. It is unrealistic to believe that companies can keep up with the number of newly issued proposals, devote time, staff and resources to interpret and analyze the impact of the proposals, and provide useful comments to the FASB. We are concerned that this process is contributing to a lack of due diligence on each proposal and that the FASB may not be receiving adequate useful information to develop guidance. To allow constituents the opportunity to fully consider all of the proposed changes together, we strongly encourage the FASB to reissue all guidance related to FIN 46 in one comprehensive document for public comment.

We strongly believe that the implementation of FIN 46 should be deferred until all complex issues can be addressed for U.S. companies. More time is needed to understand the issues, interpret and develop the correct guidance, and implement the rules. The Canadian Accounting Standards Board (AcSB) voted to defer the effective date of Accounting Guideline AcG-15, Consolidation of Variable Interest Entities (Canada's version of FIN 46) for one year. The AcSB decided that the significance of the issues brought to its attention, including concerns by regulators, warranted a one-year delay in the effective date. The AcSB is also forming a task force to work on the significant implementation issues under AcG-15. Historically, the FASB has worked closely with the AcSB on accounting standards, and we recommend that you follow their lead in acknowledging the need for additional time.

As we have previously discussed with Board and staff members, our specific concerns on the amendment to FIN 46 are as follows:

- 1.) Personal trusts
- 2.) Mutual funds
- 3.) Reevaluation events
- 4.) Troubled debt restructurings
- 5.) Expected losses and residual returns
- 6.) De facto agency
- 7.) Appendix B
- 8.) Effective date and transition

#### Personal trusts

We applaud the FASB in its recent decision to exclude from the consolidation rules under FIN 46 personal trusts, such as accounts of a bank's trust activity or customer accounts that involve fiduciary services. Banks act as trustees or custodians of personal trusts, and it is clear from the trustee relationship that the assets are owned by the trust itself, not the bank.<sup>1</sup> To require consolidation of trust assets to the balance sheet, even if the assets were separately labeled, would be misleading for

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<sup>1</sup> 12 USC 92a; 12 USC 1464; Sec. 179 of Scott on Trusts

users of financial statements because the assets would appear to be solely owned by the bank.

Federal law states that trustees have the duty to avoid even the appearance of impropriety. Busby v. Worthen Bank & Trust 484 F.Supp. 647 (E.D. Ark 1979) Banks are regularly examined every 12-18 months by bank examiners of banking regulatory agencies (the Office of Thrift Supervision, the Federal Reserve Board, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency) for compliance with fiduciary responsibilities and rules associated with trust assets.

We encourage the FASB to retain the decision to exclude personal trusts from consolidation under FIN 46.

#### Mutual funds

We believe the FASB is heading in the right direction to exclude mutual funds from the consolidation rules under FIN 46, and believe that this scope exception should apply to all mutual funds. The ED states that mutual funds organized in trusts, that by design and law are not established for the benefit of the trustee, are excluded from the guidance in FIN 46. Some mutual funds are established in legal form as entities or trusts, such as partnerships. Alternatively, mutual funds may not be legal entities, but may be structured as accounts. We are concerned that the ED is not clear as to what types of mutual funds are excluded from the scope. Mutual funds (and the trustees in custody of the funds) were not believed to be included in the scope at the time the FASB developed and issued FIN 46. We encourage the FASB to clarify that the consolidation rules in FIN 46 do not apply to all types of mutual funds, including managed accounts and other similar arrangements.

#### Reevaluation events

FIN 46 requires that the determination of which entity is the primary decision maker (thus, the entity that would consolidate the off-balance sheet transaction) should be reevaluated only upon certain triggering events rather than at each consecutive reporting date. The ED provides examples to demonstrate when a triggering event has occurred; however, such events may not be known by the company, because the triggering event occurred at a different company. It would be operationally burdensome, if not impossible, to require each company involved in a transaction to notify a separate company that a transaction has occurred that may require reevaluation of consolidation for a third party. We recall that many of the examples included in the ED were deliberated at the time FIN 46 was being developed. At that time, the ABA, as well as many other constituents, commented to the FASB that it would not be operational to require companies to follow the activities of a third-party investor in the transaction (a separate company) and/or primary beneficiaries. We encourage the FASB to remove the examples from the ED and reconsider its previous guidance to require reevaluation when there has been a significant change in the entity's design and the company knows that the change could have a material impact on the company's original FIN 46 assessment.

### Troubled debt restructurings

The ED would require certain bank borrowers whose loans are restructured, and who qualify as voting interest entities, be analyzed under FIN 46 as variable interest entities. We believe this accounting would lead to inappropriate consolidations by banks of their borrowers.

The ED states that if an entity incurs operating losses or renegotiates debt caused by the incurred operating losses, the circumstances should not cause a change in the determination of whether an entity is a voting interest entity. The ED further requires that reconsideration of the determination of whether an entity is a voting interest entity should occur if the level of subordinated debt or other financial support is modified as a result of the debt restructuring. We believe that such a change in financial support should not require bank customers to be considered as variable interest entities for the bank. An increase in subordinated financial support as a result of extinguishing a loan obligation does not increase an entity's overall expected losses in the transaction and should not trigger a reconsideration of whether the entity is a voting interest entity. For example, in some circumstances a loan that is restructured may result in the lender receiving newly issued subordinated debt or equity from the borrower as consideration in payment to extinguish the loan obligation. This issuance of debt or equity may increase the total subordinated financial support for the lender; however, the restructuring does not increase the lender's exposure to expected losses. Thus, the borrowing entity is still a voting interest entity and should not be considered a variable interest entity.

We encourage the FASB to consider changes in debt, subordinated debt, or equity as events that do not result in a change in the determination that bank borrowers are voting interest entities.

### Expected losses and residual returns

All returns to variable interest holders should be considered when evaluating expected losses and expected residual returns from an entity under FIN 46. The ED does not permit short-term returns to be included when assessing which company has the majority of expected losses and expected residual returns of an entity and should consolidate the entity. Short-term returns could impact the returns of the entity and thus, impact the determination of which entity is the primary beneficiary. To not include short-term gains could force the wrong company to consolidate an entity.

We encourage the FASB to include all returns to variable interest holders in the evaluation of expected losses and expected residual returns.

### De facto agency

We agree with the FASB that qualitative factors should be considered as heavily as quantitative calculations when determining whether the equity investment at risk is sufficient. A qualitative assessment of the activities of other parties associated with a variable interest entity is an important component when considering which company, if any, should consolidate the variable interest entity. The ED requires that companies use judgment to select the best method to evaluate the probability that

the company will absorb a majority of an entity's expected losses and/or expected residual returns.

We are concerned, however, that the ED notes that the FASB may consider specifying a technique at a later date. If the FASB decides to change this guidance after a final rule is issued, significant cost, training, and time would have been wasted to implement this ED. We encourage the FASB to consider delaying the issuance of this ED as a final rule until the Board can evaluate whether a single method should be required or if companies should use their best judgment.

#### Appendix B

We do not support the removal of paragraphs B1 – B10 in FIN 46 until the FASB can provide replacement guidance. Many companies and accounting firms find it challenging to interpret the descriptions of variable interests to identify which structures qualify as variable interest entities. No specific guidance exists that defines a variable interest entity. Paragraphs B1 – B10 provide the only guidance to assist preparers in identifying variable interest entities. We believe those paragraphs are fundamental and necessary for a proper understanding of the consolidation of variable interest entities. To remove these paragraphs without providing replacement guidance, particularly at this stage in the process when FIN 46 is effective within a few weeks, would further exacerbate the confusion and complications in applying FIN 46.

#### Effective Date and Transition

More time is needed to address many implementation issues related to FIN 46, FASB Staff Positions relating to FIN 46, and this amendment to FIN 46 prior to the effective date (the first reporting period ending after December 15, 2003). We agree with the members of the FASB who have expressed concern about the struggles that companies and accounting firms are facing in the implementation of FIN 46 and subsequent related rules. We strongly encourage the FASB to extend the effective date of FIN 46 until the critical issues can be adequately addressed and the guidance can be issued in a comprehensive format.

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In conclusion, we are concerned that the process for issuing new rules relating to the consolidation of variable interest entities continues to be burdensome on standard setters, the accounting industry, and preparers. More time is needed to obtain a basic understanding and common agreement on what the new rules should require. The lack of common understanding could impair the credibility of the rulemakers, the rules, and the resulting financial statements. Personal trusts, trusts or accounts under bank trust activity, including personal accounts and managed accounts, and mutual funds in the form of trusts or partnerships that provide services that consist of fiduciary services should be excluded from the consolidation rules under FIN 46. Further, activities of a third-party investor should not be permitted to trigger a reevaluation event under FIN 46. We also believe that a change in the debt, subordinated debt, or equity of a bank borrower should not require that the borrower be analyzed for possible consolidation by the bank. We believe that all returns to variable interests should be included in the evaluation of expected losses

and expected residual returns, and that a qualitative assessment of activities of other parties associated with an entity is an important component in determining which party has control over an entity. We do not support the removal of paragraphs B1-B10 until replacement guidance can be provided by the FASB. Last, we encourage the FASB to delay the effective date of FIN 46 until the critical issues related to FIN 46 can be addressed.

Thank you for your consideration. If you would like to discuss this letter in more detail, please do not hesitate to contact Gwen Ritter (202-663-4986) or me (202-663-5318).

Sincerely,

Donna Fisher