



Letter of Comment No: 71
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Ms. Lawrence W. Smith
Director - Technical Application and Implementation Activities
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, Connecticut 06856-5116

Subject: Comments Regarding the Exposure Draft of the Proposed Interpretation for Consolidation of Variable Interest Entities, a modification of FASB Interpretation No. 46; File Reference No. 1082-300

Dear Mr. Smith:

I am writing on behalf of the Equipment Leasing Association ("ELA") to provide comments to the Financial Accounting Standards Board ("Board") regarding the Exposure Draft ("ED") of the Proposed Interpretation of Consolidation of Variable Interest Entities, a modification of FASB Interpretation No. 46. We welcome the opportunity to provide both information and commentary in response to the Board's request on its ED on accounting for variable interest entities ("VIEs"). A central part of the mission of the ELA and its Financial Accounting Committee is to provide educational information to the public as well as standards setters like the Board relative to data and analyses on leasing industry products, practices, and trends

Organized in 1961, the ELA is a non-profit association that represents companies involved in the dynamic equipment leasing and finance industry to the business community, government, and media. ELA's diverse membership consists of independent leasing companies, banks, captives, financial services corporations, broker/packagegers and investment banks; as well as service providers like accountants, consultants, equipment managers, executive recruiters, insurance companies, lawyers, publishers, and software providers. ELA promotes the leasing industry as a major source of funds for capital investment in the U.S. and other countries. Headquartered in Arlington, Virginia, ELA is a national organization with more than 800 member companies and a staff of 25 professionals. In 2003, equipment leasing is estimated to be a \$208 billion industry.

Effective Date

We are concerned about the proposed effective date. For the reasons listed below, we recommend that the Board seriously consider resetting the effective date to the second reporting period ending after December 15, 2003. We believe that the Exposure Draft's proposed effective date will likely provide insufficient lead time for the Board to complete its due process and for the preparer and audit communities to achieve consistency in interpretation. First, we believe that the Board will likely receive the bulk of its comment letters on December 1. Accordingly, it appears that the Board would not be in a position to deliberate on the points raised in the comment letters until its December 10 meeting. Second, it appears that the Board would need to issue the guidance at or near year-end to make immediate implementation technically feasible. The inelasticity of the proposed time line may serve to compromise due process and/or the implementation process. Third, we believe that the numerous entities affected by FIN 46, the extensive data gathering requirements, the high sensitivity of the computational results to a range of reasonable assumptions, and the need for considerable professional judgment in applying the guidance will likely overwhelm the available technical resources. As such, the envisioned cost-benefit economics may not be achieved.

Overview

We understand that the Board intends to achieve more consistent application of consolidation policies to variable interest entities in order for enterprises to consolidate entities in which they have a controlling financial interest. The technical corrections and implementation guidance is intended to improve the comparability between enterprises evaluating entities for consolidation and to assist enterprises that have delayed adoption of FIN 46. . The proposed modification also intends to add certain limited-scope exceptions that appear warranted based on practice issues encountered in the initial application of FIN 46.

The ELA provides comment on a number of technical items in the ED below. However, the ELA believes that it is imperative that the Board provide adequate time and deliberation for review and reconsideration of the proposed Interpretation and for implementation of a new interpretation. We agree that comparability of financial reporting has been compromised due to inconsistencies in application. From our perspective, the haste with which FIN 46 was issued in January 2003 and limited transition time was counterproductive to creating clarity. Subsequently, a number of FASB Staff Positions (FSPs) were issued to provide both staff-directed and Board-deliberated implementation guidance. The volume of inquiries and the ultimate deferral of adoption are indicative of shortfalls in the Interpretation. We seek to avoid similar confusion over implementation of a new Interpretation by giving adequate time to the thoughtful consideration of comments and redeliberation, if necessary, along with adequate transition time. This process can help to reduce increased cost of transition.

As in the past, we support consolidation based on control and the use of risks and rewards analysis where ownership of a majority of the voting interest does not provide an appropriate basis for determining whether an entity has a controlling financial interest in another entity. However, we have concerns about the application of this principle in practice.

In the sections below, we comment or address particular concerns that we have about the proposed Interpretation including the use of implementation guidance, descriptions of variable interests, qualitative analysis, de facto agency relationships and reconsideration of an entity's status.

Use of Examples

The examples provided in Appendix B of FIN 46 were invaluable to developing an understanding of application of FIN 46. These paragraphs served to clarify different types of variable interests and their significance. As a result, the paragraphs helped enterprises to determine where resources were best applied in analyzing various variable interests. Insight into the Board's thinking was a step towards minimizing analysis and cost of implementation where appropriate.

We agree that the sections deleted in the proposed Interpretation often lacked clarity. However, for the reasons stated above, we believe it critical that the replacements to paragraphs B1-B10 be completed and incorporated into the new Interpretation. While we understand that these examples are not the subject of Board discussion, we wish to provide suggestions on certain paragraphs to assist your efforts.

B8. The second sentence of the paragraph regarding a variable rate liability has created confusion where the paragraph is otherwise clear on liabilities. A variable rate liability tied to an interest rate index is functionally similar to a fixed liability in that it is a primary obligation of the entity and a lender is expected to receive a fixed margin over its cost of funds. A lender does not stand to lose or gain if it has properly evaluated the adequacy of an entity's capital to support its activities or assets. Additionally, our position is that a variable interest is not significant when it consists of a senior unconditional liability of an entity directly rated investment grade or its assets generate revenue from investment grade obligors.

B10. The description of long-term leases should be restated to clarify that lease terms do not contain elements of variable interests that would serve to shift expected losses and expected returns to the lessee. Such interests would include residual guarantees, but also fixed purchase options and other forms of limits on a lessee's exposure to losses and opportunity for residual returns. However, we believe that there should be a standard of significance for such variable interests since almost every interest would carry an element of expected loss or expected residual return. Such standard of significance can best be expressed as one in which the feature from which a variable interest arises is "in the money" economically. For example, many leases contain fixed purchase options. For tax purposes though, the fixed purchase price must be considered "out of the money" or

the Internal Revenue Service would disallow tax deductions. This paragraph will be extremely useful to reduce analysis on tens of thousands of common lease arrangements.

We recommend that an additional paragraph be introduced to clarify that tax benefits are variable interests in circumstances in which the availability of tax credits and deductions change the net income of an entity or its net asset value. *Variable interests* are defined in paragraph 2c of FIN 46 as contractual, ownership, or other pecuniary interests in an entity that change with changes in the entity's net asset value. We believe that the Board intended that preparers would use judgment to ascertain actual variable interests in an entity and apply judgment to determine which factors are relevant and might be considered variable interests in one entity but not in another. Examples of situations which we believe tax benefits factor into the value of assets and net income include true leases, tax-free exchanges of assets and tax credits for assets such as low income housing or alternative fuels. In tax-motivated lease arrangements, a purchaser of an asset will pay more for an asset because of the tax attributes assigned to such asset. These attributes may include, among other things, tax depreciation or an ability to defer capital gains through the use of like kind exchanges. In addition, accounting for earnings in tax oriented leveraged leases are specifically calculated using tax-affected cash flows throughout the life of a lease. Since both net book investment as well as the fair value of the asset in an open market can be affected by tax benefits, the Board should clarify that tax attributes may be variable interests.

Hierarchy of GAAP in the Proposed Interpretation

A number of FSPs have been issued and/or proposed since the issuance of FIN 46. It is our hope that FSP FIN 46-1 through 5 as well as the conclusion of proposed FSP FIN 46-c, d and f be incorporated into the new Interpretation and nullified, as applicable, by the issuance of the Interpretation. We look forward to the use of FSPs as originally intended - that is, as guidance from the FASB staff on implementation. We believe that they should not be used as a means for the Board to further the development of GAAP, notwithstanding the exposure required of FSPs.

Scope

We support the Board's decision to incorporate FSP FIN 46-1 into the proposed modification and to provide for two additional exceptions to the scope of FIN 46. However, we have certain concerns about the intent and operability of the newly proposed exceptions.

We appreciate the Board's efforts to provide an exception based on a variable interest holder's inability to obtain financial information to apply the variable interest model. However, we question the merits and cost-benefit trade-off of basing the exception on an "exhaustive effort" standard, particularly when the Board's use of that term is not defined in this new Interpretation or elsewhere in GAAP. We believe that the Board should consider using the same principle used in FIN 35 for non-controlling investments--i.e., the inability to obtain financial information to apply the equity method of accounting

generally indicates that an investor may not have significant influence over the investing or financing policies of an investee. We submit that, if an enterprise cannot obtain financial information about another entity after making a reasonably diligent effort to do so, such enterprise probably does not have a controlling financial interest in that entity.

More fundamentally, we are concerned that an “exhaustive effort” standard may place undue pressure on sponsoring enterprises to divulge confidential information. We note that bank regulatory rules as well as confidentiality agreements limit disclosures about customer information. We also note that customer lists and related information, such as exposures, constitute a valuable intangible asset. Accordingly, we believe that, if the Board decides to pursue the “exhaustive effort” standard, it should also address the appropriate legal and commercial reasons that a sponsoring enterprise may assert in limiting the nature and extent of information about the entity.

We support the Board’s decision to add an exception for mutual funds in the form of trusts and certain bank trusts. Leasing companies commonly sponsor leasing transactions through grantor trusts where the bank serves as trustee. The banks typically perform fiduciary and administrative duties pursuant to a trust agreement on behalf of the trust beneficiaries. Under the proposed language, it would appear that such trusts would be scoped out from the interpretation because they are organized and operated in a manner consistent with existing trust practices and are not used to circumvent the provisions of FIN 46. We request language in paragraph 4(h) clarifying whether trusts are scoped out from consideration for consolidation for the bank serving as trustee and/or a bank or other enterprise serving as a participant in the trust.

Identification of Variable Interest Entities

We concur that the proposed modifications to paragraphs 5-7 of Interpretation 46 contain important clarifications of the Board’s intent in the identification of variable interest entities. Based on the experience of our constituents in initially applying Interpretation 46, we recommend certain additional modifications.

The recommended additional modifications, as discussed below, intend to improve the cost-benefit economics in applying consolidation policy. We have learned that the limited commentary in Interpretation 46 about the conditions to be used in determining the appropriate consolidation model (voting or variable) has raised significant concerns about an enterprise’s exposure to “second guessing risk.” In addressing this risk, many of our constituents and their counterparties have been compelled to apply the variable interest model as an abundance of caution. We believe that the proposed modification should seek to mitigate this risk and rationalize the effort required in the selection of the relevant consolidation model.

In finalizing the proposed modifications, we believe that the Board should make a good faith estimate of the population of entities that would likely be identified as variable interest entities. If the estimated population significantly exceeds the population of entities previously identified as special-purpose entities, we believe that the Board should

either reconsider the proposed modifications or recognize the incremental cost burden in evaluating the cost-benefit economics.

Qualitative Considerations- paragraph 5 (a)

We concur with the Board that qualitative considerations may be important in determining the sufficiency of the total equity investment at risk rather than relying solely upon quantitative evaluation. Quantitative measures have been cumbersome, expensive and fraught with inconsistencies in assumptions when clear market indicators are not available. The Board has been clear that judgment should be exercised in application of these new consolidation standards. To support this approach, we encourage the development of additional examples in the text of a new Interpretation, new FSPs and any other issues finalized by the Board. The Board should also affirmatively clarify in the new Interpretation that the specific absence of an example, definition or related statements is not evidence to the contrary.

We believe that by stressing the importance of qualitative considerations, the Board should recognize the need to provide more robust implementation guidance to clarify its significance. For example, the Board may want to consider the framework used with respect to the equity method of accounting. In that situation, quantitative results should lead to a rebuttable presumption that should prevail absent evidence to the contrary. The Board may also want to include a non-exclusive list of illustrative examples where the presumption can be overcome. Finally, the Board may find it appropriate to state that it may be necessary to evaluate the facts and circumstances over a period of time before reaching a judgment.

Decision Making Ability – paragraph 5 (b)(1)

We believe that the Board should clarify the circumstances, if any, where limitations on the equity holders' decision-making ability indicate that they lack this characteristic of a controlling financial interest. We request that the Board address the following issues in the modified guidance:

- Do the equity holders as a group have the requisite decision-making ability contemplated under 5(b)(1) if they can change the operating, financing, or investing activities of the entity through voting rights or similar rights without the participation of other variable interest holders?
- Do the equity holders lack decision-making ability if other variable interest holders have significant protective rights?
- Should decision making ability be interpreted as absent if the entity has entered into transactions with market terms that limit the nature and extent of the independent

decision-making by the equity holders where the counterparties do not have a significant variable interest with participative rights in the entity?

Residual Returns – paragraph 5(b)(3)

We believe that the Board should clarify when the equity investors' return should be considered as capped. Should the assessment of residual returns only consider existing assets? Or should the assessment consider an enterprise's fee generating activities and reinvestment opportunities? If only existing assets should be considered, then certain financial institutions (e.g., lenders) would lack this characteristic and become subject to variable interest analysis. Similarly, a leasing entity with a portfolio of leases subject to fixed priced purchase options may lack this characteristic unless the probability of non-exercise is considered, or the entity's fee generating and reinvestment opportunities should also be considered.

Disproportionate Voting Rights – last sentence of paragraph 5(b)

We support the Board's proposed clarifying guidance in the evaluation of entities with disproportionate voting rights. We support the notion that the various interests of the parties should be considered, not only its equity investment at risk.

On the other hand, we are concerned about the absence of clarifying guidance about how to determine whether substantially all of the entity's activities either involve or are conducted on behalf of an investor that has disproportionately fewer voting rights. We believe that, since this criterion generally would determine the nature of such entities as voting or variable interest entities, the Board should provide further clarification. We believe that the considerable diversity in practice could result without it. Given that the "on behalf of" concept has no quantitative benchmark, we believe that the Board should provide either indicators or examples to ensure consistency in its application.

The Apparent Exception – Paragraph 6

At paragraph 6, FIN 46 provides that "an enterprise is not required to determine whether an entity with which it is involved is a variable interest entity if it is apparent that the enterprise's interest would not be a significant variable interest" and if the enterprise was directly or indirectly involved in forming the entity. We note that the examples in Appendix B made the "apparent" exception somewhat operational. We are concerned that the deletion of these examples may weaken the effectiveness of this exception.

We note that the discussion at B3 and B10 formed the basis for certain participants to appropriately limit the extent of their FIN 46 application work. At B3, the Board stated that senior beneficial interests in VIEs and senior debt instruments with fixed interest rates or other fixed returns "normally have little expected variability and usually would not, by themselves, make the holder the primary beneficiary of the issue." The guidance at B3 also provided a discussion of other facts and circumstances that should be

considered in assessing the variability of senior interests. We believe that such guidance has served to rationalize the work of senior lenders in applying FIN 46. Similarly, we believe that the clarifying guidance at B10 with respect to “normal” leases has served to rationalize the application work for a broad class of participants (lessees).

Reconsideration of an Entity as a Variable Interest Entity

We approve of the Board’s efforts to clarify when changes in an entity that was not previously subject to the Interpretation would trigger reconsideration. We would suggest the following modification in addition to the ones proposed in order to clarify what the intended effect of a “significant” change may be. In the proposed paragraph 7a, the terms “change significantly” at the end of the sentence should be appended to state “such that the original conclusion regarding whether the entity is subject to the Interpretation is no longer valid.”

We also request that the Board clarify the meaning of “additional” activities or assets as used in describing the third reconsideration event. Many have apparently interpreted the use of the term “additional” to refer to any portfolio additions or deletions, any fee generated or any other activities (a strict quantitative interpretation). If this is the appropriate interpretation, then most parties would need to perform a quarterly reassessment. Others have suggested that the Board may also intend “additional” activities to encompass both quantitative and qualitative considerations. For example, if the sponsoring entity has not lowered its risk underwriting standards, then it arguably has not proportionately increased its expected losses.

De Facto Agency Relationship

We are concerned that the modifications to paragraph 16 may have unintended consequences in causing unrelated enterprises to become related parties under the Interpretation and affect consolidation onto one or the other’s balance sheet without a preponderance of economic risks or rewards being expected by such party. We can understand confusion that arose in application of paragraph 16 to de facto agents in determining the primary beneficiary of an entity involving related parties. While we appreciate the Board’s reasoning that parties involved in a common endeavor must share decision-making reflective of their interests, the language inserted in section (d) of that paragraph is so broad as to be misconstrued by users beyond the original intent of the Board.

Arrangements between parties to constrain a party’s ability to manage economic risk are common. This is a basic economic reality and procedure to provide protection to partners or parties bound together in a single endeavor. It is the degree to which each party can control the decision-making that is significant. Our suggestion is that qualitative assessment and judgment should be applied as a primary step. Second, the relative significance of approval rights must be a benchmark rather than any specific approval right. We encourage you to modify and expand upon paragraph 16(d).

Sincerely,

Michael Fleming
President, Equipment Leasing Association