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Ms. Suzanne Bielstein
Director of Major Projects and Technical Activities
Financial Accounting Standards Board
401 Merrit 7
P.O. Box 5116
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Re: FASB File Reference No. 1082-200

1) Proposed FASB Staff Position No. FIN 46-c; "Impact of Kick-Out Rights Associated with the Decision Maker on the Computation of Expected Residual Returns under Paragraph 8(c) of FASB Interpretation No. 46, *Consolidation of Variable Interest Entities*"

2) Proposed FASB Staff Position No. FIN 46-d; "Treatment of Fees Paid to Decision Makers and Guarantors as Described in Paragraph 8 in Determining Expected Losses and Expected Residual Returns of a Variable Interest Entity under FASB interpretation No. 46, *Consolidation of Variable Interest Entities*"

Dear Ms. Bielstein:

Eaton Vance Corp. ("Eaton Vance" or "the Company") appreciates the opportunity to comment on the above-captioned proposed staff positions. Eaton Vance is an investment advisory firm based in Boston with approximately $64.3 billion in assets under management. We are a public company whose stock is listed on the New York Stock Exchange (EV). We are one of the largest managers of floating rate bank loan and high yield bond funds in the country, with approximately $12.1 billion in bank loan and high yield bond fund assets under management.

As part of its investment management business, Eaton Vance acts as an investment manager of collateral securing debt issued by Collateralized Debt Obligation entities ("CDO entities"), where the collateral is bank loans and high-yield debt. A CDO entity issues non-recourse debt and equity securities, which are sold in a private offering by an underwriter to institutional and high-net-worth investors. The CDO debt securities issued by the CDO entity are secured by collateral in the form of high-yield bonds and/or floating-rate income instruments that the CDO entity purchases with proceeds from its

issuance of non-recourse debt and equity securities. At July 31, 2003, the Company managed the collateral for five CDO entities with approximately $1.5 billion of assets.

Eaton Vance has minority equity investments of 20 to 25 percent of the total equity in four of the five CDO entities for which it acts as investment adviser. The Company holds no equity in the fifth CDO entity. These investments totaled $12.4 million at July 31, 2003 and represent the Company's entire exposure to risk of loss from its involvement with these CDO entities. In two of the five CDO entities where the equity is greater than the expected losses, there are outside equity investors who hold more than 50 percent of the equity (and thereby would absorb the majority of any expected losses). As a result, there are currently three CDO entities with assets of $0.8 billion and liabilities of $1.0 billion that are potentially subject to consolidation under the provisions of FIN 46.

1) Proposed FASB Staff Position No. FIN 46-c; *"Impact of Kick-Out Rights Associated with the Decision Maker on the Computation of Expected Residual Returns under Paragraph 8(c) of FASB Interpretation No. 46, Consolidation of Variable Interest Entities"*

In the above captioned staff position, the Board indicated that the existence of kick-out rights does not affect the status of a decision maker in the application of paragraph 8(c). However, we believe that if the collateral manager can be terminated without cause, and that termination is reasonably possible, the collateral manager is not a decision maker for the purposes of paragraphs 8(c). Accordingly, market-based advisory fees paid to the collateral manager should be excluded from the calculation of expected residual returns for the purpose of determining the primary beneficiary of the CDO entity.

The removal clauses in place in each of the CDO structures for which the Company acts as collateral manager are market-negotiated agreements designed to strike a balance between competing investor needs. Removal is a commercial reality, which can be a function of key man risk, poor performance, or philosophical disagreements between the investors and the collateral manager. The ability of a majority (generally two-thirds, with at least 75% of those voting) of each class of the debt and equity holders voting to remove the collateral manager, without cause and without the vote of any securities of the VIE held by the collateral manager, effectively renders the collateral manager an agent of the decision makers (i.e., the debt and equity holders) and takes away the collateral manager's "right" to any expected residual returns. As a result, the collateral manager cannot be deemed to be the decision maker, nor to "control" these returns.

In the absence of deal stress, the contracts the Company has entered into with the majority of the CDO entities for which it acts as collateral manager can be terminated without cause at any time by a 66 2/3 percent vote of non-affiliated equity and note holders. When the overcollateralization ratio (a measure of financial strength) deteriorates in periods of deal stress, the right to remove the collateral manager often transfers to the Controlling Class (usually the most senior class of note holders). In such instances the voting requirements for removal of the collateral manager are even easier to satisfy, as investors within the same class would have very similar objectives.

We believe that the removal provisions are substantive in nature and should affect the status of the collateral manager as a decision maker in the application of paragraph 8(c) for the following reasons:

- The 66 2/3 percent threshold required for removal of the collateral manager without cause can be reasonably obtained given the relatively small number of participating equity and debt holders and the dispersion of ownership and the minimum requirement of a 75% vote;
- There are no penalties, significant or otherwise, in the majority of the CDO structures that will be incurred by the non-affiliated equity and debt holders if the Company is removed as collateral manager;
- There are no administrative or logistical impediments to calling a vote and the administrative support necessary to effect the vote has been provided for in each deal;
- Collateral manager removal is a commercial reality in these structures and is therefore a reasonably possible event.

In the three CDO entities that are potentially subject to consolidation there are no financial penalties or make-whole provisions associated with terminating the collateral manager, no limits on the time of month or year that a vote can be called and no restrictions on the frequency of the vote. The Company is not allowed to participate in the voting process, which restricts the Company's ability to directly influence the outcome of the vote in any way. The Company is not allowed to restrict any investors from calling a vote and has no proxy authority to vote for investors. The Company is either not entitled to vote in the naming of a successor manager or cannot reasonably withhold consent where it has the right to vote. As a result, the Company cannot be obstructionist in the removal process.

SOP 78-9, EITF 96-16 and, ultimately, EITF 98-6 introduce the concepts of "important rights" and "substantive participating rights" that overcome the presumption of control requiring consolidation in voting interest entities and general partnerships. In EITF 98-6, the Task Force noted that if a partnership agreement provides for the removal of a general partner by a "reasonable vote" of the limited partners, without cause, and without the limited partners or partnership incurring a significant penalty, there is a strong indication that the general partner does not "control" the limited partnership entity and therefore should not consolidate. This definition of control is echoed in the concept of "important rights" introduced in SOP 78-9. SOP 78-9 defines "important rights" by example as the right to replace the general partner or partners in a limited partnership structure. EITF 96-16 introduces the concept of "substantive participating rights," which are also defined by example as the right to select, terminate and set the compensation of management responsible for implementing the investee's policies and procedures. In both SOP 78-9 and EITF 96-16, "important" and "substantive participating" rights held by investors can overcome the presumption of manager control and consolidation introduced in ARB No. 51 and SFAS No. 94, "Consolidation of All Majority-Owned Subsidiaries."

The rights of the equity and note holders in the CDO very much mirror the "important" or "substantive participating" rights described above. The non-affiliated equity and note

holders in each of these CDO entities have the right to remove the Company as collateral manager without cause. We would further note that it is at least reasonably possible that the events or circumstances that could necessitate such an action on their part could occur. As a result, the rights of non-affiliated equity and note holders overcome the presumption of both control and consolidation by the Company in each instance.

The existence of reasonably executable kick-out rights is somewhat similar to a contract that requires reappointment of the collateral manager on a periodic basis. In both instances, the continuing engagement of the collateral manager requires the support of the investors. Consider a situation in which the Company has an agreement that provides for the period election of the collateral manager by vote of the debt and equity holders. Since the collateral management agreement expires periodically, is the collateral manager a decision maker? Further, if the term of the collateral management agreement expires, absent reappointment by the investors, what amount of fees should be included in the calculation of residual benefits? In other words, should the residual benefits be limited to the initial term of the agreement or must reappointment(s) be presumed? If reappointment is presumed, what assumptions should be made about terms? We urge the FASB clarify the definition and critical aspects of a decision maker.

2) Proposed FASB Staff Position No. FIN 46-d; *"Treatment of Fees Paid to Decision Makers and Guarantors as Described in Paragraph 8 in Determining Expected Losses and Expected Residual Returns of a Variable Interest Entity under FASB interpretation No. 46, Consolidation of Variable Interest Entities"*

In the above-captioned proposed staff position, the Board concluded that "Because decision making is an indicator of the primary beneficiary, fees paid to decision makers and guarantors are added to the variability components of expected residual returns, increasing the likelihood that the decision maker or guarantor will be identified as the primary beneficiary." Irrespective of the kick-out rights discussed above, we believe that there are a number of limitations on the activities of the collateral manager that support the view that the collateral manager is not a decision maker for the purposes of paragraph 8(c) and, accordingly, that the fair value of the collateral management fees should not be included in the calculation of expected residual returns. These limitations are as follows:

- ***Investment policies:*** The collateral manager does not set the overall investment policies. The investment policies are determined at the inception of the deal at the insistence of various debt and equity investors who are trying to achieve a specific return objective within a specified risk tolerance. These investment policies are outlined in the Indenture that is created at the inception of the CDO structure. The ability of the collateral manager to influence the terms of the Indenture is limited as the rating agencies must also approve the Indenture before they will assign a rating to the Notes issued by the CDO entity.

- ***Deal amendments***: The collateral manager cannot amend the deal or any investment restriction/guideline without approval of the equity and debt holders (in most cases, 100 percent approval is required.)

- ***Issuance of debt or equity:*** The collateral manager cannot compel or force the CDO entity to issue new debt or equity, refinance the debt or make any capital decisions whatsoever.

- ***Trading flexibility:*** The collateral manager has very limited trading flexibility. Generally, discretionary trading is limited to 20-25 percent of the portfolio per year, subject to such trades meeting restrictive covenants in the Indenture. This limited discretionary trading is generally revoked if the deal becomes stressed.

- ***Investment returns:*** The collateral manager is limited in its ability to affect the returns of the vehicle. Returns are established within a range based on the asset mix and collateral requirements, which are defined by the investors at the inception of the deal. The upside is limited by nature of the asset class and investment restrictions. Since the collateral generally consists of either fixed income securities (i.e., high-yield bonds) or loans, there is a maximum contractual cash flow implied by the initial asset mix assuming a static collateral pool (i.e., under a zero default scenario) that would place a practical limit on the returns.

The underlying objective of the Interpretation is to consolidate entities that do not effectively disperse risks or where a single party can recombine previously dispersed risks. The Company's role as collateral manager is never taken on in an effort to protect its minority equity investment and, in fact, impairs some of the Company's rights as an equity holder. The collateral management agreement simply provides for a fee for service, and is negotiated on an arms-length basis without regard for any contemplated equity investment by the Company. The distinction between the Company's role as collateral manager and its participation as a minority equity investor is illustrated by the fact that the terms governing our role as collateral manager (including fee structure) for CDO entities in which the Company *is not* a minority equity participant are largely the same as the CDO entities in which the Company *is* a minority equity participant.

The distinction between the Company's role as collateral manager and its participation as a minority equity investor is further illustrated by the fact that there is no appreciable difference between the Company's role as an investment manager for a registered investment company and the Company's role as a collateral manager for a CDO entity - the service provided, the assets managed and the fees collected are all comparable. The Interpretation and the proposed staff position re-characterize the collateral management contract as something other than an arms-length, independently negotiated fee-for-service contract. The resulting consolidation treatment is, at best, inconsistent.

Conclusion

In Paragraph C5, the Board notes that, "Some enterprises have entered into arrangements using variable interest entities that appear to be designed to avoid reporting assets and liabilities for which they are responsible, to delay reporting losses that have already been incurred, or to report gains that are illusory." It is our understanding that the objective of the interpretation was to put an end to this practice and, as noted in the Introduction, to

"provide more complete information about the resources, obligations, risks and opportunities of the consolidated enterprise."

If Eaton Vance were forced to consolidate the CDO entities under discussion, the Company believes that it will be reporting assets and liabilities for which they are not responsible, reporting losses that the Company will never incur, and reporting subsequent gains that are, in fact, illusory since they will represent reversals of the earlier bookkeeping of the losses it never incurred. It is difficult to comprehend how the Interpretation provides for greater financial transparency in such circumstances given the overriding objectives of the Board.

The Interpretation does contemplate situations where consolidation is not the answer. In its Introduction, the Board notes, "variable interest entities that effectively disperse risks will not be consolidated unless a single party holds an interest or combination of interests that effectively recombines risks that were previously dispersed." The Company believes that CDO entities do, in fact, effectively disperse risks among the parties involved and the Company, in its role as collateral manager, cannot recombine risks that were previously dispersed. We are interested in obtaining clear guidance on the approach to consolidation and would encourage the FASB to defer the implementation date of FIN 46 until clarity around all of these issues is resolved.

If you have any questions regarding our comments, please do not hesitate to contact the undersigned at (617) 598-8527.

Very truly yours,

/s/ Laurie G. Hylton

Laurie G. Hylton
Chief Accounting Officer