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Ms. Suzanne Q. Bielstein
Director of Major Projects and Technical Activities
File Reference No. 1082-200
Financial Accounting Standards Board
401 Merritt 7
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Norwalk, Connecticut 06856-5116

Dear Ms. Bielstein:

The FDIC staff is pleased to submit its comments on the Exposure Draft (ED) of the Financial Accounting Standards Board's (FASB) proposed Interpretation, *Consolidation of Certain Special-Purpose Entities*. The objective of this proposed Interpretation is to provide principles for determining when a business enterprise should include the assets, liabilities, and results of activities of a special-purpose entity (SPE) in its consolidated financial statements.

As paragraph 1 of the proposed Interpretation notes, Accounting Research Bulletin No. 51, *Consolidated Financial Statements* (ARB 51), "states that consolidated financial statements are 'usually necessary for a fair presentation when one or more companies in the group directly or indirectly has a controlling financial interest in the other companies.'" ARB 51 further provides that "the usual condition for a controlling financial interest is ownership of a majority voting interest." However, paragraph 1 observes that "[m]any SPEs are arranged in a manner that precludes establishing a controlling financial interest through ownership of voting interests." Therefore, the Interpretation would clarify the application of ARB 51 to certain special-purpose entities (SPEs) when the usual condition for consolidation does not apply because an SPE has no voting interests or otherwise is not subject to control through ownership of voting interests.

Under the proposed Interpretation, when an SPE cannot be evaluated for consolidation based on voting interests, it must be evaluated for consolidation based on "variable interests." As defined in paragraph 7(b), "*variable interests* are the means through which financial support is provided to an SPE and through which the providers [of financial support] gain or lose from activities and events that change the values of the SPE's assets and liabilities." Examples of variable interests include loans, debt securities, guarantees, residual interests in transferred assets, management and service contracts, and certain equity investments. When the evaluation of an SPE is based on variable interests, each enterprise involved with the SPE must determine whether it is the "primary beneficiary" of the SPE. According to paragraph 7(c), the term "*primary beneficiary* refers to an enterprise that has a controlling financial interest in an SPE that is established by means other than holdings of voting interests."

Paragraph 13(b) of the proposed Interpretation indicates that an enterprise that provides financial support to an SPE through a variable interest is the primary beneficiary if no other parties provide financial support. Paragraph 13(c) then states that

If other parties provide financial support, the enterprise is the primary beneficiary if it provides a majority of the financial support or a significant portion of the total financial support that is significantly more than any other party. That is, the enterprise shall determine whether it has either (1) a majority of the variable interests or (2) a variable interest that is a significant portion of the total variable interests and that is significantly more than the variable interests held by any other individual party.

The enterprise that determines that it is the primary beneficiary of an SPE must consolidate that SPE.

Different Accounting Outcomes Resulting from Evaluations of Voting Interests Versus Variable Interests

Under the accounting model proposed in the Interpretation, when an SPE is evaluated for consolidation based on variable interests, it will either have a primary beneficiary or have no primary beneficiary. This means that the SPE will either be consolidated by one enterprise or will not be consolidated by any enterprise. In contrast, when an entity, including an SPE, is evaluated for consolidation based on voting interests, ownership of a majority voting interest in the entity is normally the condition necessary for a controlling financial interest and, hence, for consolidation of the entity by the majority owner. Paragraph 3(c) of Accounting Principles Board Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock* (APB 18), also indicates that the power to control and, hence, a requirement to consolidate, may exist with a less than majority ownership interest in an entity. However, absent the power to control, APB 18 directs an investor to follow the equity method of accounting when its "investment in voting stock gives it the ability to exercise significant influence over operating and financial policies of an investee even though the investor holds 50% or less of the voting stock." In this regard, APB 18 establishes the presumption that an investment of 20% or more of an investee's voting stock provides the investor the ability to exercise significant influence over the investee.

Thus, when an owner of a voting interest in an entity must evaluate this interest to determine the appropriate accounting treatment for it, consolidation and the equity method of accounting are possible outcomes depending on whether the owner's investment gives it control or only the ability to exercise significant influence. Under the proposed Interpretation, however, the possible accounting outcomes for an enterprise's variable interest in an SPE do not parallel these possible voting interest outcomes. In particular, consolidation is the only accounting outcome when an enterprise holds "a variable interest that is a significant portion of the total variable interests and that is significantly more than the variable interests held by any other individual party." However, from our review of the proposed Interpretation, it was not evident why such a variable interest would always represent a controlling financial interest in an SPE. In other words, while the most significant variable interest (when no variable interest holder has a majority of the variable interests) may be a controlling financial interest in an SPE in some cases,

in other cases it may only provide the holder of this interest the ability to exercise significant influence over the SPE. In these latter cases, consistent with APB 18, an accounting outcome other than consolidation would appear to be appropriate. If such an accounting outcome were incorporated into the proposed Interpretation for variable interest holders that exercise significant influence, but not control, over an SPE, the Interpretation should also ensure that these variable interest holders disclose the assets and liabilities of the SPE and nature of their relationship to it.

Evaluation of Variable Interests in a "Silo"

Paragraph 17 of the proposed Interpretation introduces the concept of a "silo." Under this concept, if an enterprise's rights and obligations are substantially restricted "to specifically identified assets of an SPE and the interests of the creditors of the SPE apply equally to all of the SPE's assets," the enterprise would treat the specifically identified assets and a corresponding portion of the SPE's liabilities as a separate SPE. However, it appears that those holders of variable interests in the entire SPE whose rights and obligations are not similarly substantially restricted must evaluate their variable interests in relation to the entire SPE. Consequently, the interplay between the variable interest evaluations that focus on the silo and those that focus on the SPE of which the silo is a portion is not clearly evident. This suggests that, despite the statement in paragraph 16 that "[a]n SPE can have only one primary beneficiary," it may be possible for the assets and liabilities of a silo to be consolidated by two parties. Presuming such an outcome was not intended, we would recommend that this aspect of the proposed Interpretation be clarified.

"Day Two" Accounting for a Consolidated SPE

According to paragraph 18 of the proposed Interpretation, "[v]ariable interests generally subject the holder to a risk of losing an investment in the SPE or incurring a loss as a result of a contingent obligation to transfer assets or issue securities to the SPE." As the ED is written, the primary beneficiary of an SPE is required to consolidate the SPE, which means that the primary beneficiary will include all of the assets, liabilities, and results of the activities of the SPE in its consolidated financial statements. However, when the enterprise that is the primary beneficiary accounts for the results of the consolidated SPE's activities in periods after it becomes the primary beneficiary, it is possible for the enterprise to report losses in its income statement that exceed the maximum amount of losses to which it is exposed through its variable interest. Therefore, we would recommend that the proposed Interpretation be revised to include guidance on the so-called "day two" accounting for a consolidated SPE that ensures that such an anomalous result does not occur.

Thank you for considering our comments. Should you have any questions or wish to discuss our comments further, please contact Mr. Robert F. Storch, Chief of the Division's Accounting Section.

Sincerely,

George French
Deputy Director