Philip Ameen

September 5, 2002

Ms. Suzanne Bielstein
Director of Major Projects and Technical Activities
Financial Accounting Standards Board
401 Merritt 7
P. O. Box 5116
Norwalk, CT 06856-5116

Letter of Comment No: 121
File Reference: 1082-200
Date Received: 09/05/02

Subject: File Reference No. 1082-200

Dear Ms. Bielstein:

GE appreciates the opportunity to provide its views on the proposed interpretation of ARB No. 51 (the "Interpretation"), *Consolidation of Certain Special Purpose Entities.*

The Interpretation is complex. While complexity occasionally corresponds to precision, it is more often associated with characteristics we have grown to mistrust in accounting – rule-based pronouncements that fail to achieve anything more positive than concentration of decision-making in the hands of a few experienced experts.

Consolidation decisions, particularly those related to SPEs, require assessments of a vast array of matters of both legal precision and nuance, providing evidence that must be weighted and interpreted. It is not reasonable to expect that the Board can specify all of the relevant facts for this deliberation, nor is it reasonable to expect that the Board can describe the weight to be assigned to the factors. And even if it could, terms of arrangements with SPEs will evolve in ways not originally contemplated, rendering the guidance ineffective and difficult to maintain. If more specificity is deemed necessary, such guidance should be provided in the form of examples that illustrate the concept.

Our specific comments follow.

Variable Interests as a Surrogate for Equity

The central issue in this document is whether a parent-subsidiary relationship exists between the reporting entity and an SPE. Previous attempts by the EITF to resolve this issue in the context of various SPE arrangements have failed to develop a framework that parallels the analysis of voting interests under ARB 51. Instead, deliberations have devolved to a series of requirements and prohibitions. The Board appears to be moving in the direction of a framework with this Interpretation, based on the comments in paragraph B11 of the exposure draft. That paragraph identifies two attributes that are indicative of a "parent-subsidiary" relationship: (1) the parent's responsibility or willingness to provide financial support (and suffer losses if the subsidiary does not generate profits); and (2) the ability to realize a rate of return limited only by the nature of the assets held by the entity and the parent's ability to use those resources effectively. However, the definition of variable interests in paragraph 18 seems to focus solely on the

first attribute. For reasons described below, we believe that the Board should focus on the entire distribution of returns available to holders of variable interests – both positive and negative – and link those returns to a majority interest concept underlying ARB 51.

The draft Interpretation is very unclear on the critical concept, "expected losses." It was only through discussions with a Board member that we understood that this term refers to the absorption by variable interest holders of net operating losses in circumstances in which the SPE is losing money. Since essentially all SPE's are constructed carefully to avoid losses, this requirement hinges on extraordinarily low probability scenarios. Even the most ardent supporters of Concepts Statement No. 7 (not, we concede, GE) would concede that "expected cash flow" means nothing even remotely close to this, but rather deals with expected values across the entire range of possible outcomes. We certainly do not believe the Interpretation's novel approach is useful for purposes of determining whether an SPE should be consolidated. But we also do not believe the criteria are presented in this Draft with anything remotely close to the clarity necessary for the Board to be able to rely on the results of this exposure process.

Voting equity, with very few exceptions, has economic risks and rewards and most often the two are symmetrical, at least until the equity is exhausted. Variable interests, either singly or in combination, will ordinarily be far more tailored, and thus do not share the return profiles of equity interests. Investors, of course, do not expose themselves to losses without appropriate reward potential. However, it simply incorrect to presume, as does the draft Interpretation, that all such arrangements include implied returns that are analogous to an equity interest. The objective of the Interpretation's requirement should be the identification of the surrogate for the controlling equity interest and that necessarily requires an assessment of returns as well as risks.

We also believe that consolidation should only be required when the reporting entity has a majority (not simply a plurality) of the variable interests. The requirement for each participant to analyze the variable interests of others to determine relative interests is neither operational nor conceptually supportable. Similar to our previous point, there should be symmetry between this requirement and an analysis based on voting interests, where consolidation is generally required if a majority of the voting equity is owned. Difficulties in applying the proposed approach become evident in the common case in which the variable interests are tranched, widely dispersed or even publicly traded. Similar issues arise with respect to derivative arrangements with SPEs.

Given that this document is an interpretation of ARB 51, we strongly believe that the variable interest rules articulated must be consistent with and abide by the principles of consolidation in that standard. We find nothing in ARB 51 that would lead to consolidation when the reporting entity does not have an existing financial interest with a majority of the risks and rewards in another entity's assets and liabilities. The proposed requirements abandon ARB 51's familiar construct in favor of effective control. Recognizing the time pressure the Board has placed on itself, ARB 51 cannot coexist with an Interpretation of doubtful scope built on an entirely alien concept. Thus, we find ourselves believing that the Board has no choice but to amend rather than interpret ARB 51, and in so doing to resolve what will be incredible confusion in the scope of this new approach.

Financial SPEs

We agree with the Interpretation that there are SPE structures that effectively disperse risks and rewards such that it does not maintain a subsidiary relationship with another entity. The Interpretation however does not address satisfactorily the most common conduit and Collateralized Debt Obligations arrangements that exist today. It would be productive for the staff to work with structured finance experts to identify acceptable existing arrangements and/or characteristics of new structures that all parties agree are consistent with this concept. Those examples should be the basis of unambiguous description. Properly constructed, economically viable "safe harbor" structures could, much like QSPE's, alleviate an enormous amount of fruitless energy that will otherwise be spent analyzing how to apply this document. We are pleased to offer the expertise of our Capital Markets Services staff to assist the Board in that endeavor.

Transition

The effect of this Interpretation on financial statements is difficult to estimate, but could be quite significant. Cognizant of that fact, APB 20 requires retroactive restatement of all periods presented when the reporting entity is changed. We recognize that the Board views the Interpretation's prospective application as a practical expedient and necessary because some entities will not be in a position to restate prior year results. On the other hand, some entities have the necessary data readily available and, following discussions with their users, may prefer to restate, avoiding what could otherwise be a dramatic effect in the financial statements, potentially reflected in an accounting period without any corresponding activity. We would therefore suggest that the Board acknowledge the usefulness of the APB 20 alternative and permit, but not require, companies to restate retroactively.

In the event the Board decides to stay with the transition guidance in the draft, it should address at least conceptually the nontrivial questions of how fair value recognition should work, whether minority interests should be recognized for variable interests held by other parties, and what the subsequent accounting should be for the SPE assets and liabilities.

Effective Date

We do not believe that it will be feasible for most companies to adopt the Interpretation as of the beginning of the fiscal period beginning April 1, 2003. For calendar year companies, that timetable would be very difficult to meet and it is not clear that an interim period would be an appropriate time to make wholesale changes to the financial statements. We believe ~~investors~~ users will be in a better position to understand the changes if they are implemented in the fiscal fourth quarter so that the full annual financial statements would be provided along with the change. This also would allow companies more time to understand and apply these requirements.

We look forward to participating in the FASB's future deliberations on this topic in any way that might be constructive. Particularly, as noted above, we shall be pleased to provide our assistance on ways to clarify the principles sufficiently such that a workable standard might be completed as quickly as possible. Please feel free to contact me at (203) 373-2458.

Sincerely yours,