

September 3, 2002

Ms. Suzanne Bielstein
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File Reference 1082-200

Proposed Interpretation, Consolidation of Certain Special-Purpose Entities, an Interpretation of ARB No. 51

Dear Ms. Bielstein:

Enclosed is our letter of comment on the FASB's Exposure Draft of a Proposed Interpretation, *Consolidation of Certain Special-Purpose Entities, an Interpretation of ARB No. 51*, dated June 28, 2002 (the "Interpretation").

If you have any questions concerning our comments, please contact John T. Smith at (203) 761-3199.

Yours truly,

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Interpretation of ARB No. 51**

Dear Ms. Bielstein:

We are pleased to comment on the FASB's Exposure Draft of a Proposed Interpretation, *Consolidation of Certain Special-Purpose Entities, an Interpretation of ARB No. 51*, dated June 28, 2002 (the "Interpretation").

We generally support the Interpretation, provided certain revisions are made, as an interim step, but urge the Board to consider a new standard that addresses the recognition and derecognition of assets and liabilities. Some standards already address the recognition or derecognition of certain subsets of assets and liabilities (for example, Statement of Financial Accounting Standards No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* ("Statement 140"), addresses the derecognition of financial assets and liabilities). However, the consolidation standards should be consistent with the standards on recognition and derecognition. The Interpretation amplifies the need for consistent standards on derecognition among financial and non-financial assets. We urge the Board to consider making the development of a comprehensive standard on recognition, derecognition and consolidation a priority. Until then, the standards on consolidation, recognition and derecognition will remain overly complex, and therefore difficult to apply consistently. We encourage the Board to work with the International Accounting Standards Board to provide a global solution to the difficulties arising from the current standards.

Consolidation under ARB 51 and FAS 94 is based on control. This interpretation is needed to fill the void in the accounting literature to address situations, typically involving SPEs, in which control cannot be assessed in the normal way, based on the voting interests. However, this interpretation does not accomplish that objective because its requirements for consolidation are not integrated with the control concept in ARB 51 and FAS 94. Paragraph 8c provides a scope exception for SPEs that are consolidated by SOEs. However, the exception is not specific to any consideration of control by the SOE. Additionally, paragraph 9 specifies conditions under which consolidation is evaluated based on voting interests. However, it is incongruent with ARB 51

and FAS 94 because it requires as a basis for consolidation not only control (the decision making ability of the voting interests) but also additional conditions (b through e) that are not specific to any consideration of control.

It is not clear whether the scope exception in Paragraph 8(c) is to be based on situations in which the SOE consolidates an SPE because the SOE: 1) meets the conditions in paragraph 9 of the interpretation, 2) meets the control requirements of ARB 51 and FAS 94, or 3) merely owns the majority of the voting equity interests of the SPE and no other entity has control. Without guidance, an SPE could meet the scope exception even if the SOE does not exercise control because control is relegated to a contract, the SOE has little residual investment in the SPE at risk, and the size of the SOE is small or even de minimis relative to the size of the SPE. If an SOE is permitted to consolidate an SPE simply because it created it or owns the majority of the voting interests in the SPE, consolidation becomes a matter of choice and form. An SOE may elect to consolidate an SPE to provide the basis for non-consolidation for all other entities involved with the SPE. Alternatively, a primary beneficiary of an SPE can avoid consolidation easily by introducing as an equity investor in the SPE any SOE that is willing to consolidate it. We have identified some potential abuses more fully with some specific examples in the Appendix to this document.

If the scope exception is not intended to be elective or open ended, the interpretation should specify the circumstances in which the SOE consolidates an SPE. Such circumstances could be based on meeting the conditions in paragraph 9, in which case the scope exception is not needed, meeting the control requirements of ARB 51 and FAS 94 if it can be evaluated, or meeting some other conditions based on an assessment of control, including control over benefits.

Paragraph 9 specifies a number of preconditions needed to apply ARB 51 and FAS 94. It eliminates control as the primary basis for evaluating consolidation of an SPE. While it has the effect of forcing the evaluation of consolidation of an SPE on the basis of risk, it is incongruent with the consolidation literature and introduces a number of tests that seem to have no conceptual underpinnings. The same result (forcing the evaluation on the basis of risk) could be accomplished by identifying the circumstances in which control based on voting interest is not substantive or can be assessed only marginally, thereby requiring an evaluation based on the control over the benefits manifested based on risk. Rewriting paragraph 9 to provide a basis for determining whether control can be evaluated in a meaningful way would also provide a better means of assessing whether control of an SPE by a SOE is sufficient to avoid the assessment of risk under the interpretation as the basis for evaluating consolidation.

The Interpretation, as currently drafted, does not clearly provide a means for an enterprise to determine whether a given entity is within the scope of the Interpretation. Specifically, more detailed guidance needs to be provided on the definition of a substantive operating enterprise, and the scope exception for special-purpose entities ("SPEs") consolidated by substantive operating enterprises.

We agree with the Board's decision that SPEs that effectively disperse risks would not be consolidated unless a single party holds an interest or a combination of interests that effectively recombines risks that were previously dispersed. However, we believe that the definition of SPEs that hold certain financial assets ("Financial SPEs" or "FSPEs") is too restrictive. We

agree with the Board's decision to allow FSPEs more discretion to acquire and sell assets than qualifying SPEs ("QSPEs") in Statement 140. However, we do not agree that FSPEs should be prohibited from holding a derivative unless it is passive in nature (as defined in Statement 140), and it pertains to beneficial interests (other than another derivative financial instrument). We understand that one of the reasons for this restriction in Statement 140 was that if a derivative were not passive, it would require decision making (a notion inconsistent with the QSPE). However, one of the distinctions between a QSPE and an FSPE is that the activities of an FSPE may be managed (i.e., assets may be purchased and sold), which requires decision making. Therefore, we do not believe that derivatives in an FSPE should be limited to those that do not require decision making. We understand that another reason for the restriction on derivative holdings for QSPEs in Statement 140 was a concern that derivatives could be transferred into a QSPE to avoid the accounting required under Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities* ("Statement 133"). However, the proposed amendment to Statement 133 would require bifurcation of embedded derivatives for the holder of the beneficial interests of many SPEs. In fact, the required bifurcation of the embedded derivatives from the beneficial interests may result in certain derivative holdings of SPEs to not be a permitted holding of a QSPE (and therefore not a permitted holding of an FSPE).

Additionally, we would encourage the Board to address the permitted activities of an FSPE as it relates to the issuance of beneficial interests. Currently, this issue as it relates to QSPEs under Statement 140 is being addressed by the Emerging Issues Task Force in EITF Issue No. 02-12, *Permitted Activities of a Qualifying Special-Purpose Entity in Issuing Beneficial Interests under FASB Statement No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. We believe an FSPE should have discretion over the types of beneficial interests to be issued and should have discretion over the re-issuance of beneficial interests (e.g., in revolving structures), regardless of whether the EITF reaches a consensus that discretion over the issuance of beneficial interests is not a permitted activity of a QSPE.

We also don't believe that the application of the criteria in paragraph 23 of the Interpretation results in the determination that previously dispersed risks have been recombined. We are concerned that there is no requirement that an enterprise that meets two or more of the conditions of paragraph 23 must also hold a majority of the variable interests or even a significant portion of variable interests that is significantly more than any other party in order to consolidate the SPE. An enterprise that has the authority to purchase and sell assets of an SPE and has sufficient discretion in exercising that authority should not be required to consolidate the SPE if it does not significantly participate in (primarily benefit from) the revenues, expenses, gains and losses of the SPE. For example, if a collateral manager for a collateralized debt obligation ("CDO") holds a portion of the preferred shares in a CDO, even if that holding would not be considered to represent a significant variable interest in the CDO, we believe the application of paragraph 23 would result in the collateral manager consolidating the CDO (assuming no other party meets two or more of the conditions in paragraph 23), even though it would not be considered the Primary Beneficiary under the variable interests model for non-Financial SPEs.

Generally, we do not believe the Interpretation is sufficiently concepts-based. For example, there is a presumption that the voting equity must generally be equal to at least ten percent or

Page 4
Ms. Suzanne Bielstein
July 9, 2002

more of total assets in order to be considered sufficient for an SPE to be evaluated based on voting interests. This presumed minimum of ten percent does not have a conceptual basis (although ten percent may be insufficient based on the conceptual notion that it may be insufficient to allow the SPE to finance its activities without relying on support from other variable interest holders). Furthermore, the criteria for determining who may have to consolidate FSPEs also does not appear to be consistent with the conceptual reason for requiring such SPEs to be consolidated (i.e., the application of the criteria in paragraph 23 may result in an enterprise consolidating an FSPE even though the previously dispersed risks have not been effectively recombined).

Our specific comments relating to the Interpretation for your consideration are presented in the Appendix to this letter.

If you have any questions regarding our response, please contact John T. Smith at 203-761-3199.

Sincerely,

APPENDIX
DELOITTE & TOUCHE LLP COMMENTS
FASB EXPOSURE DRAFT, PROPOSED INTERPRETATION, CONSOLIDATION
OF CERTAIN SPECIAL-PURPOSE ENTITIES, AN INTERPRETATION OF ARB
NO. 51

Definition of Substantive Operating Enterprise (SOE):

We believe the consolidation model in the Interpretation should be applied only when control over an entity cannot be determined in the normal way (i.e., through voting rights) because the decisions to be made are not meaningful or determinative in the operation of the entity. Thus if the voting equity of an entity allows the owners (equity holders) to make meaningful decisions, the entity is an SOE and is scoped out of the Interpretation. Some of these concepts are in the basis for conclusions, but we believe they should be incorporated in the definition of an SOE in the body of the Interpretation. More specific comments follow.

Provide a clearer definition of an SOE. The definition of an SOE, which is currently in paragraph 7a, should probably focus on whether the entity meets the definition of a business. Consider the indicators in EITF Issue No. 98-3, *Determining Whether a Nonmonetary Transaction Involves Receipt of Productive Assets or of a Business*. In addition, one of the indicators of an SOE that is in the proposed Interpretation is that an SOE "has sufficient equity to finance its operations without support from any other enterprise or entity except its owners." We believe this requirement needs clarification in the Interpretation. For example, does this imply that any entity that issues debt with guarantees from parties other than its owners is not an SOE (and therefore is an SPE)? Assume a manufacturing business decides to build a plant in West Virginia. The plant construction will be funded by a bond offering, which is guaranteed by the state of West Virginia (the state agreed to do so to entice the manufacturing business to build its plant there). Would this then imply that the manufacturing business is not an SOE because it issued debt guaranteed by another party? Now consider highly leveraged companies (including venture capital funded companies). Many companies rely on preferred stock offerings (sometimes convertible into common) that may also be redeemable. Under the Proposed Statement of Financial Accounting Standards, *Accounting for Financial Instruments with Characteristics of Liabilities, Equity, or Both*, and the *Proposed Amendment to FASB Concepts Statement No. 6 to Revise the Current Definition of Liabilities, an Amendment of FASB Concepts Statement No. 6*, redeemable preferred stock would be classified as a liability (and therefore not be considered equity). Does this mean that companies that rely on redeemable preferred stock won't meet the definition of an SOE because they receive support from non-equity owners?

Additionally, the requirement for an SOE to have employees does not seem meaningful. An entity could easily add employees to meet this criterion. We are also concerned that an entity that we believe should be an SOE (like a real estate investment trust) might not meet this criterion if the management of the properties is outsourced for a management fee. If this requirement is retained, some clarification is required. For example, do the employees have to be devoted solely to the SOE? Many SOEs that are under common

control (including brother/sister subsidiaries of a consolidated entity) share employees for certain functions. Additionally, a holding company that consolidates several businesses may not have employees of its own.

The requirement that an SOE generally issues financial statements also does not seem meaningful. An entity could easily issue financial statements for no other reason than to qualify as an SOE. Additionally, entities that were intended to be in the scope of this Interpretation may already issue financial statements. For example, a research and development joint venture usually issues financial statements periodically for each of the venture partners.

Scope:

Paragraph 8 states that this Interpretation applies to any “business enterprise” that has an ownership interest, contractual relationship, or other involvement with an SPE. Without a definition of a business enterprise, it is unclear what is inside the scope of the Interpretation.

Additionally, in its July 1, 2002, press release the FASB stated that the proposed guidance would not apply to not-for-profit organizations. If the consensus reached in EITF 90-15 is nullified, what guidance, if any, would apply to entities that are not business enterprises? Also, are there some not-for-profit organizations that would be deemed to be equivalent to business enterprises? Paragraph 5 of Appendix B of the AICPA Audit and Accounting Guide from Health Care Organizations states:

FASB Statements No. 116 and No. 117 apply to all not-for-profit enterprises, regardless of whether or not the entity is a business enterprise. The majority of tax-exempt health care organizations, however, operate as business enterprises (i.e. are essentially self-sustaining from fees charged for goods and services).

FASB Concepts Statement No. 4, *Objectives of Financial Reporting by Nonbusiness Organizations* (“CON 4”), provides characteristics of a nonbusiness organization in paragraph 6. Additionally, paragraph 8 of CON 4 states:

Some organizations have no ownership interests but are essentially self-sustaining from fees they charge for goods and services. Examples are those private nonprofit hospitals and nonprofit schools that may receive relatively small amounts of contributions and grants but finance their capital needs largely from the proceeds of debt issues and their operating needs largely from service charges rather than from private philanthropy or governmental grants. As a result, assessment of amounts, timing, and uncertainty of cash flows becomes the dominant interest of their creditors and other resource providers and profitability becomes an important indicator of performance. Consequently, the objectives of Concepts Statement 1 may be more appropriate for those organizations.

Should the proposed Interpretation be applied to not-for-profit entities that have characteristics of a business enterprise?

Paragraph 8(a) should also apply to transferors to qualifying special-purpose entities (“QSPEs”) as defined in Statement of Financial Accounting Standards No. 125, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (“Statement 125”), if they meet the grandfathering provisions of Statement of Financial Accounting Standards No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (“Statement 140”).

Paragraph 8(b) provides that an employer shall not consolidate an employee benefit plan subject to the provisions of FASB Statements No. 87, *Employers’ Accounting for Benefit Plans*, No. 106, *Employers’ Accounting for Postretirement Benefits Other Than Pensions*, “and” No. 112, *Employers’ Accounting for Postemployment Benefits*. [Emphasis Added] Change the “and” to “or”.

We are concerned that the scope exception for special-purpose entities (“SPEs”) consolidated by SOEs provided in paragraph 8(c) is a form over substance provision that will provide an area for potential abuse, effectively allowing companies to rent their balance sheets. A result of this exception is that the sequencing of transactions can impact the accounting result. Consider the following 2 examples:

- Structure #1: An SPE is established for the sole purpose of financing the acquisition of property to lease to Company ABC (a synthetic lease). ABC provides a residual value guarantee and has a fixed price purchase option on the property.
- Structure #2: Willing Consolidator establishes a subsidiary (ShellCo) with \$1,000 of equity contributed. Willing Consolidator consolidates ShellCo because it owns 100% of the equity. Subsequently, ShellCo acquires property with non-recourse debt, and leases the property to Company ABC. ABC provides a residual value guarantee and has a fixed price purchase option on the property. Willing Consolidator is a substantive operating enterprise, but is small when compared to the size of ShellCo.

The SPE in Structure #1 falls within the scope of the Interpretation (and will likely be consolidated by ABC, while ShellCo (Structure #2) qualifies for the scope exception in paragraph 8(c) because Willing Consolidator already consolidates it. Additionally, ShellCo could be used to house multiple “silo” SPEs to avoid creating silo SPEs that are subject to the Interpretation.

Clarify whether the scope exception in paragraph 8(c) may be applied if the potential consolidating SOE does not follow generally accepted accounting principles in the United States of America (“US GAAP”), or does not prepare US GAAP financials (like an individual who does not prepare personal financial statements). While we do not conceptually agree with the scope exception in paragraph 8(c), if it is retained, we believe that this evaluation should be performed as if the potential consolidator would follow US GAAP. In other words, if the SPE would be consolidated by a foreign enterprise or an individual under US GAAP, then it is not subject to this Interpretation.

Consolidation Based on Voting Interests:

Paragraph 9 states that an SPE shall be evaluated for consolidation based on voting interests instead of the variable interests provisions of this Interpretation if one or more parties hold equity investments that meet all of the conditions in that paragraph. Please clarify whether the equity must be legal form equity to qualify.

Paragraph 9(a) uses the term “nominal owner or owners”. If an entity is capitalized with equity that is in the form of voting preferred shares and common shares, do the preferred shareholders meet the definition of a nominal owner? We understand that it is common for an SPE to have only a de minimis amount of common stock issued. We believe that the voting equity to be evaluated under paragraph 9 should include all voting equity classes. If each class is evaluated separately, it would appear that any voting equity that is not the most residual class of equity would not meet the current conditions in paragraph 9(c), which states “the equity investment is subordinate to all other equity investments and other interests for the entire life of the SPE.” If the Board does not agree that all classes of voting equity should be considered, then we believe that an exception should be made for circumstances where the common stock is de minimis, in which case the second most residual class should be evaluated under the remainder of paragraph 9. Otherwise, the SPE would never qualify to be evaluated for consolidation based on voting interests because the most residual class of equity (the de minimis common equity class) would not be sufficient to allow the SPE to finance its activities without relying on financial support from variable interest holders (paragraph 9(b)).

Paragraph 9(b) states “the equity investment should be greater than or equal to the expected future losses of the SPE at all times during the SPE’s existence.” This could be interpreted to mean that if this condition is failed once, but subsequently corrected, the SPE does not qualify to be evaluated based on voting control (because the equity was not sufficient “at all times”). If the purpose of adding “at all times during the SPE’s existence” was to reinforce the concept that these conditions need to be evaluated on a continuous basis, that is already accomplished by paragraph 11. We suggest the paragraph 9(b) citation above be changed to “the equity investment should be greater than or equal to the expected future losses of the SPE during the SPE’s remaining existence.”

Footnote 3 to paragraph 9(b) states that “Expected future losses” refers to a probability-weighted estimate of losses without considering possible gains. We also believe that the timing of the expected future losses should be considered (i.e., the losses should be discounted back). The example in the footnote appears to ignore the timing of the loss. We believe some specific examples of analyses of expected future losses would provide helpful guidance.

Paragraph 11, which provides additional guidance on paragraph 9(b), states that in making the judgment about the sufficiency of the equity investment in an SPE, “an enterprise shall compare the amount of the equity investment with the amount of equity invested in substantive operating enterprises with similar assets and liabilities, similar activities, and similar risks if that information is available.” We are concerned that the

concept of a comparable SOE is not operational without further clarification as to what the Board means by “comparable.” Also, many comparable businesses have much different leverage profiles (including enterprises that are highly leveraged). May an enterprise judge the sufficiency of the equity investment in an SPE by comparing that equity investment with the lowest amount of equity in several comparable businesses?

Paragraph 12 discusses the presumption that an equity investment is generally considered to be insufficient if it is not at least equal to 10 percent of the SPE’s total assets. Paragraph 12 states, “the presumption is overcome only if there is persuasive evidence that an equity investment of less than 10 percent of total assets is comparable to the equity of businesses that are not SPEs and that engage in similar transactions with similar risks.” We believe that other evidence should be able to overcome the 10 percent minimum presumption. For example, assume an SPE issues only 2 classes of beneficial interests (an 8% equity class, and a 92% debt class), and the debt is rated AAA. Wouldn’t this imply the equity is sufficient?

Paragraph A2, which provides guidance on paragraph 9(c), states (in footnote 10) that “guarantees and other arrangements that protect lenders to the SPE after the equity owner has suffered a total loss of its investment do not prevent the equity owner from having substantive risks of ownership.” We believe clarification is needed of what types of guarantees or protections are acceptable. For example, assume an SPE is formed that holds 10 different corporate bonds with the same maturities and notional amounts. Also assume the SPE enters into a credit default swap (purchased) to protect it against a credit loss on 9 of the 10 bonds. The 10% equity holder can still lose all of its investment based on the unhedged bond in the SPE. In this case, the credit default swap also protects the equity holder because the unhedged bond would have to incur losses of 100% for the equity holder to suffer a total loss of its investment. We believe that even though the equity holder may suffer a total loss of its investment, the equity would not qualify under paragraph 9(c) because the credit default swap would also provide protection for the equity holder (it is protected from credit losses on 9 of the 10 bonds). However, may an SPE engage in any hedging transactions without violating paragraph 9(c)? For example, would an SPE not qualify to be evaluated for consolidation based on voting interests if it held an interest rate swap to convert variable rate assets to fixed rate assets? Please provide guidance as to whether any risks may be hedged.

Paragraph 9(e) states that “the equity investment was not provided directly or indirectly by the SPE *or other parties with variable interests in the SPE.*” [Emphasis Added] Paragraph A2(f), which provides guidance on paragraph 9(c), seems to state that an equity owner may not own other variable interests. We don’t understand how if an equity owner also owns other variable interests or receives fees impacts whether an entity should be evaluated for consolidation based on voting interests. The Board should provide its rationale for this requirement.

Consolidation Based on Variable Interests:

Paragraph 21 requires the dominant risk to be considered if two enterprises have variable interests of similar size, and neither is subordinate to the other. The dominant risk

evaluation should be more important than just a tiebreaker. We believe the evaluation of variable interests should focus only on the dominant risk or risks. Additionally, we do not understand the purpose of having tiebreakers. If two parties have similar variable interests, and one is now deemed to be more variable than the other through the tiebreaker in paragraph 21, could it have significantly more variable interests than the holder it was just tied with? If two variable interests of similar size are evaluated based on dominant risks, does the variable interest with more exposure to the dominant risk still need to meet the criteria under paragraph 13(c) in order for its holder to be considered the Primary Beneficiary?

Paragraph 20 states in part that "the relative size of variable interests shall be determined by comparing expected future losses from the interests." Paragraph 18 cites ten examples of ways in which variable interests arise. It is unclear how to determine expected future losses from the following variable interests cited in paragraph 18: d. Management contracts or other service contracts; e. Referral agreements; f. Options to acquire assets; g. Purchase contracts; j. Derivative instruments. Please provide examples or at least a principle to be followed.

When an enterprise is evaluating its variable interests in an SPE for relative size under paragraph 20, should it look at the total cash flow of the aggregate position under each scenario? For example, if it holds a junior variable interest and a senior variable interest, should it add the cash flows and evaluate the total for loss under each scenario (because under a particular scenario, one of the interests might generate cash/gain that helps offset the loss on another position)? In some loss scenarios, a servicer might still be entitled to some senior fees that would offset losses on an equity position it holds. Another example would be an enterprise that holds both an interest only strip and a principal only strip. Can it evaluate the two interests together, similar to a basic bond that is less sensitive to prepayments than the interest only strip alone (and ignoring the gain on the early recovery of the principal only strip)?

Paragraph 14 requires continuous assessment of whether the SPE should be consolidated by an enterprise. The Board should provide guidance on accounting for consolidation of an SPE subsequent to inception of the SPE. Consider that paragraph 55 of Statement 140 provides guidance for circumstances subject to Statement 140. Also consider that the EITF is currently discussing issues relating to Statement 140 repurchases and re-consolidations in EITF Issue No. 02-09, *Accounting for Changes That Result in a Transferor Regaining Control of Financial Assets Sold*.

Clarify whether the analysis required under paragraph 20 (i.e., determining the relative size of variable interests by comparing expected future losses from the interests) that is performed subsequent to inception should consider gains that have occurred since inception of the SPE. For example, if gains have already been recognized in an SPE, but those gains have been distributed to the variable interest holders, can they be used to offset expected future losses? In other words, should the analysis consider cumulative expected losses over the life of the SPE, or expected losses over the remaining life of the variable interest? We believe that the analysis should consider expected losses over the

remaining life of the variable interest (including possible reductions of undistributed gains).

Paragraph 14 states, in part, “All factors influencing consolidation decisions shall be reconsidered at each reporting date using all evidence that the enterprise possesses or would be reasonably expected to possess.” Footnote 5 to paragraph 14 also states that an entity is not required to perform an exhaustive search to determine whether actions of other parties has caused it to become the primary beneficiary. We suggest that the words “or obtain” should be added to the end of the first sentence of paragraph 14, which would eliminate the requirement for footnote 5.

Paragraph 15(e) includes as a “related party” a party that has a de facto agency relationship as a result of providing significant amounts of professional services or similar business arrangements. Clarify how “significant” should be evaluated (i.e., from the perspective of which party)? We believe it should be significant to the service provider in order to make the service provider a de facto agent.

Paragraph 17 requires an enterprise to evaluate a “silo” SPE for consolidation if the contractual or legal provisions or agreements substantially restrict an enterprise’s rights and obligations to specifically identified assets of an SPE “and” the interests of the creditors of the SPE apply equally to all of the SPEs assets. Read literally, if the interests of the creditors of the SPE do not apply equally to all of the SPEs assets (i.e., there is no cross collateralization), the enterprise does not need to evaluate its silo SPE for consolidation. Change “and” to “even if” to reinforce the fact that cross-collateralization does not prevent evaluating “silo” SPEs.

Additionally, paragraph 17 only focuses on the transferor/lessee. It is unclear how it impacts the administrator/sponsor of the conduit. Is it possible for an administrator to consolidate a conduit, but separate transferors each consolidate their respective portions of the assets and liabilities? We believe that if a silo SPE is consolidated by a transferor, the administrator should not consolidate that portion of the conduit.

At a previous Board meeting, the Board tentatively decided (1) the ability to replace the service provider without cause is an indicator that the fees are market-based and (2) arrangements that provide that an incentive fee is the equivalent to “net income” are not market-based. These conclusions do not appear in the Exposure Draft. Does the Board continue to support these two conclusions? We believe that if the service provider can be fired without cause, and it is reasonably possible that the service provider could be fired, these conditions indicate that a fee is market-based. For example, if replacement of the service provider requires unanimous vote of a widely dispersed group of equity holders, the equity holders theoretically have the ability to remove the service provider, however, this ability may not indicate that the fees are market-based as obtaining unanimous approval in a vote is never likely. Further, it is important to consider whom does this ability to terminate the servicer pertain to (e.g., owners of equity only, debt holders, parties subject to the most variability of returns, etc.).

SPEs that hold Certain Financial Assets (FSPEs):

It would be helpful if the paragraphs in FAS 140 that are referred to were reproduced as an appendix. Additionally, address the following QSPE concepts and how they apply to FSPEs, in light of the fact that there may not be a transferor (paragraph references refer to paragraphs in FAS 140):

- Demonstrably distinct from *transferor* (paragraph 35(a)).
- Permitted activities may only be changed with the approval of holders of beneficial interest holders “other than the *transferor*, its affiliates, and its agents” (paragraph 35(b)).
- Passive derivatives that pertain to beneficial interests issued or sold to parties “other than the *transferor*, its affiliates, or its agents.” (paragraph 35(c)(2)). As noted in our letter, we believe this restriction should be removed.
- Financial assets that would reimburse it if others were to fail to adequately service financial assets “*transferred* to it” or to timely pay obligations due to it and that it entered into when it was established, “when assets were *transferred* to it”, or when beneficial interests were issued by the SPE. (paragraph 35(c)(3)).

We suggest paragraph 22(a) be removed, as it appears to be unnecessary. We cannot think of an FSPE that would qualify under paragraph 22(a) that would not also qualify under paragraph 22(b). Read literally, an SPE that is precluded from holding equity securities (even temporarily) may not have the abilities described in paragraphs 22(a)(2) and 22(a)(3).

In the Summary the Board discusses FSPEs by stating “SPEs that effectively disperse risks would not be consolidated unless a single party holds an interest or a combination of interests that effectively recombines risks that were previously dispersed.” Paragraph 23 provides that if an enterprise meets at least two of its three conditions, it is considered to provide significant financial support (and may therefore have to consolidate the SPE). We do not believe that the application of paragraph 23, as currently drafted is consistent with its stated objectives. We believe that if an enterprise meets at least 2 of the 3 conditions in paragraph 23, it should only consolidate the SPE if 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. In other words, we think that if an enterprise would not be required to consolidate an SPE under the model for non-financial SPEs, it should not be required to consolidate the SPE because it meets the definition of an FSPE.

Paragraph 23(a) currently describes an enterprise that “has the authority to purchase and sell assets for the SPE and has sufficient discretion in exercising that authority to significantly affect the revenues, expenses, gains, and losses of the SPE.” We do not believe this indicates significant financial support unless the enterprise with the authority and discretion to manage the assets also significantly participates in (primarily benefits from) the results of those actions.

Additionally, paragraph 23(a) discusses an enterprise that has the authority to purchase “and” sell assets for the SPE. As written, an enterprise could have the ability to purchase assets but not have the ability to sell assets, thus affecting the revenues and expenses, but not the gains and losses of the SPE. In that case, the enterprise would not meet the condition in paragraph 23(a). We believe that if the Board allows an FSPE to enter into derivative transactions other than passive derivatives (as we suggest) the condition in paragraph 23(a) should be reworded to consider the fact that if an enterprise that has the ability to purchase assets but does not have the ability to sell the assets of an FSPE, it might purchase a derivative that effectively sells the assets of an FSPE (e.g., an offsetting derivative or a total return swap), thus affecting the revenues, expenses, gains and losses of the SPE.

Clarify what is “asset support that is subordinate to the interests of other parties” described in paragraph 23(b). Is this consistent with the definition of a variable interest in paragraph 18 or does it only represent contingent obligations to provide assets to the SPE?

Paragraph 23(c) describes an enterprise that receives a fee that is not market-based, and makes reference to paragraph 19. Paragraph 19 states that if an enterprise owns a variable interest and receives a fee that is presumed to be market based, the fee should be considered a variable interest (it does not explicitly state that the fee is presumed to be non-market based). We believe that if a fee is presumed to be market-based, and the enterprise can be fired without cause (which would result in the enterprise no longer being entitled to the fee), this condition would generally not be met (considering the comments we make above regarding the ability to fire without cause).

Disclosure:

If an SPE is evaluated based on voting interests (i.e., it meets all the conditions in paragraph 9), do the disclosure requirements apply? Read literally, an SPE that is evaluated for consolidation based on voting interests is not scoped out of the Interpretation, and therefore the disclosures apply. Please clarify.

Additionally, do the disclosures requirements apply for parties involved with a QSPE (including the transferor), as defined in Statement 140? Paragraph 8(a) only states that a transferor to a QSPE shall not consolidate the QSPE, but it does not scope the QSPE out of the Interpretation.

We do not understand the purpose or usefulness of the disclosures required by paragraph 25, especially in the context of servicing activities like collecting and dispersing cash for an SPE or placing beneficial interests for a commercial paper conduit. We recommend that either paragraph 25 be removed or that the Board provide their basis for requiring these disclosures.

Effective Date and Transition:

Initial reporting of adoption requires any effect on equity in the primary beneficiary’s consolidated financial statements of initially reporting the assets, liabilities, and

noncontrolling equity interest of a consolidated SPE shall be reported in a manner "similar to" the cumulative effect of a change in accounting principle. Be more specific that this is consistent with the requirement in paragraph 19 of APB Opinion No. 20, *Accounting Changes*, except that compliance with paragraph 19(d) is not required.

We agree that the provisions of the Interpretation should apply immediately to all SPEs created after the date the Interpretation is issued. However, we are concerned that the transition date for pre-existing SPEs is too soon. We believe that because of the implementation effort for existing SPEs, in conjunction with the implementation efforts necessary for other existing proposals expected to be finalized shortly (i.e., the Proposed Statement of Financial Accounting Standards, *Accounting for Financial Instruments with Characteristics of Liabilities, Equity, or Both*, and the *Proposed Amendment to FASB Concepts Statement No. 6 to Revise the Current Definition of Liabilities, an Amendment of FASB Concepts Statement No. 6*, the Amendment to Statement of Financial Accounting Standards No. 133, *Accounting for Derivatives and Hedging Activities*, and the Proposed Interpretation, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of the Indebtedness of Others, an Interpretation of FASB Statements No. 5, 57, and 107*) the effective date for existing transactions should be at least six months after the date a final Interpretation is issued.