

August 30, 2002

Letter of Comment No: 114
File Reference: 1082-200
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Via email

Ms. Suzanne Q. Bielstein
MP&T Director
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

RE: Proposed Interpretation – Consolidation of
Certain Special-Purpose Entities
File Reference: 1082-200

Dear Ms. Bielstein:

Wells Fargo & Company (Wells Fargo) is a diversified financial services company with over \$300 billion in assets, providing banking, insurance, investments, mortgage banking and consumer finance. As a financial services provider, Wells Fargo routinely enters into securitization transactions involving special-purpose entities (SPEs), invests in beneficial interests issued by SPEs and provides fiduciary and other services to SPEs. We appreciate the opportunity to comment on the above referenced Exposure Draft of a proposed interpretation (the "ED").

We commend the Board for acknowledging the characteristics of an SPE and appreciate the difficulty in promulgating consolidation principles applicable to those types of entities. We recognize the theoretical merits of the variable interests approach and believe it responds to the nature of SPEs and is sufficiently flexible to accommodate the many types of SPEs. However, we do not feel that the ED, as currently written, can be reasonably and consistently applied. As such, our comments, found in the attached document, Request for Clarification – Exposure Draft on Consolidation of Certain Special-Purpose Entities, focus on matters that we believe will improve an enterprise's ability to apply the provisions of the ED, promote a more consistent, smoother, less burdensome implementation process and produce more decision-useful results.

In summary, our primary concerns consist of the following:

- Certain terms that are critical in understanding and applying the ED should be more narrowly defined, specifically the guidance on what constitutes an SPE and a variable interest. We believe the current scope and required assessment should be amended to provide users and preparers of financial statements with:

- A clearer description of the types of entities that are within the scope of this document and explicitly exclude vehicles such as mutual funds, hedge funds, investment funds, and others for which this ED has not been modeled.
- A more restrictive definition of variable interests. Based on their lack of variability and/or cash flow priority of their settlements, we believe many items presumed to be variable interests in the ED (e.g., investment-grade securities issued by a SPE in a securitization) have been inappropriately included. An enterprise should not be required to apply the ED's very detailed consolidation assessment requirements only because of a single low-risk transaction with an SPE.
- The criteria to determine whether an SPE is subject to a consolidation analysis based on voting interests or on variable interests and the subsequent execution of each approach present conceptual and logistical challenges that can be easily eliminated or greatly streamlined. The ED requires an enterprise to perform extensive and frequent analyses based on several sets of criteria (some of which are ambiguous), data that is not readily available, and actions by third parties that are beyond the control of the enterprise holding the voting or variable interests. We recommend that the Board refine the assessment criteria to focus on that data that is more readily available to an enterprise and that which can be more directly linked to an enterprise's own activities. More specifically:
 - Subject only those SPEs whose nominal owners can vote on significant matters to the voting interests consolidation analysis. Also, provide more detailed guidance on the sufficiency of equity (i.e., 10-percent) test.
 - Replace the two-out-of-three conditions that remove an enterprise from the "financial SPE" exemption with existing QSPE concepts, which are understood and have been implemented.
 - Limit the consolidation test under the variable interests approach to the majority of the variable interests and delete the consolidation rule regarding significant portion.
 - Eliminate equity-method investees and other parties subject to significant influence as holders of variable interests of an SPE that could cause an enterprise to consolidate the SPE. Also, revise the definition of other financially dependent parties to ensure it does not inadvertently encompass more entities than intended.

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- Permit reassessment of the consolidation conclusion by an enterprise only when that enterprise changes its variable interests.
- Encourage the development of audit guidance regarding sufficient evidential matter that supports a consolidation conclusion.

We support the Board's intent to issue a final interpretation in 2002. We believe our attached comments and recommendations, which are limited to suggestions for simplification within the confines of the ED's SPE consolidation model, will assist the Board in reaching that goal.

We appreciate the opportunity to comment on the ED. If you have any questions, please contact April Bagnall of our Accounting Policy Team at 415/222-3545.

Sincerely,

Les Quock,
Senior Vice President and Controller

Attachment

REQUEST FOR CLARIFICATION

EXPOSURE DRAFT ON

CONSOLIDATION OF CERTAIN SPECIAL-PURPOSE ENTITIES

Following are Wells Fargo & Company's comments and recommendations related to the contents of the Board's exposure draft on the consolidation of certain special-purpose entities (SPEs), hereinafter referred to as the ED.

Our comments have been organized by topic in an order consistent with the respective topic's appearance in the ED.

INTERPRETATION

Definition of Terms

SPEs:

The Board should more clearly define an SPE. An SPE is currently very loosely defined in the ED which appears to imply that the provisions of the ED applies to a very broad range of vehicles such as mutual funds, investment funds, hedge funds, certain partnerships, etc. We do not believe that the Board's intent is to require an enterprise to apply the provisions of this ED to such a wide range of entities.

We recommend that the Board incorporate language from the Financial Accounting Standards Advisory Council's (FASAC's) March 26, 2002 memorandum which includes the following language:

- An SPE has limited activities and purpose.
- An SPE's operating decisions are effectively specified in the SPE's governing documents and agreements, with limited or non-existent decision-making power by the parties involved with the SPE.
- An SPE's capital structure has significant leverage.
- An SPE is not a business as described in EIT Issue No. 98-3.

FASAC also noted that an SPE may not have all of these characteristics and that identification of an SPE requires professional judgment.

Variable Interests:

Paragraph 7.b. defines variable interests as "the means through which financial support is provided to an SPE and through which the providers gain or lose from activities and events that change the values of the SPE's assets and liabilities." We find this definition vague primarily because the term "financial support" seems broad. As currently defined, investment-grade

securities issued by a securitization SPE may be construed to represent financial support. However, based on Board deliberations leading to the ED, we do not believe this is the Board's intent. Further, avoidance of the term "financial support" may eliminate the need to bridge control-based definitions of an asset and a liability in Concepts Statements 6 and this ED's consolidation guidance.

* * *

Scope

The ED states that the Interpretation applies to any business enterprise that has an ownership interest, contractual relationship, or other involvement with an SPE with certain exceptions noted.

We believe that this scope is too broad and would result in an enormous implementation burden for many enterprises.

We believe that a more comprehensive definition of an SPE will enhance this section of the ED.

We also request that the Board include additional easily identifiable conditions that would trigger an automatic non-consolidation conclusion and eliminate the need for an enterprise to conduct exhaustive analyses in order to build supportable (and auditable) evidence for non-consolidation. We believe that such conditions are not reasonably limited to those items included in paragraph 8, items a through c, and that the conclusion of non-consolidation is similarly evident by the condition alone without additional analyses. An example of such a condition is an SPE where a beneficial interest holder's only involvement is through one or more investment-grade securities issued by a securitization SPE (as discussed above).

* * *

Consolidation Based on Voting Interests

Paragraph 9.a. states, "The nominal owner or owners have voting rights or similar rights that convey the current ability to make decisions and manage the SPE's activities to the extent they are not predetermined by the establishing documents of the SPE or by contracts or other arrangements." We believe the phrase "to the extent they are not predetermined by the establishing documents of the SPE or by contracts or other arrangements" conflicts with the idea that majority ownership presumes control. The documents establishing an SPE most often obviate the need for the nominal owners to make significant and meaningful decisions. This situation removes an SPE's nominal owners from the position typical of non-SPE owners. We recommend that either the Board delete that phrase or add a qualitative requirement that the types of decisions made by an SPE's nominal owners encompass those normally made by owners of a substantive operating enterprise.

Paragraph 9.b., and the related guidance in paragraphs 11 and 12, require an enterprise to make a judgment about the sufficiency of the equity investment in an SPE to determine whether it is

subject to the provisions of the ED. We do not understand the rationale behind creating two sets of sufficiency criteria--one when the equity investment is equal to or greater than 10 percent of the SPE's total assets and one when the equity investment is less than 10 percent of the SPE's total assets. The interplay between when to compare SPE equity to that of substantive operating enterprises or to expected future losses is confusing. In addition, in measuring total assets of the SPE, we are unclear as to whether the basis would be fair value or amortized cost and whether any specialized industry practices in measuring total assets would come into play. We also are uncertain as to whether the investment in the SPE would be measured as if it were an asset or equity.

Finally, we are very troubled that an SPE's equity would be "sufficient" as of one reporting date based on an assessment of data about comparable substantive operating enterprises but would be insufficient as of the next reporting date only because of changes in amounts of those comparable operations. If insufficient, the company would be required to assess consolidation under the variable interests approach. Theoretically, the company may be faced with consolidating and de-consolidating an SPE from period to period--only due to changes in third-party measures, not because of changes in its involvement in, control of or experience in the risks and rewards of the SPE.

* * *

Identifying and Comparing Variable Interests

We acknowledge the theoretical merits of the variable interests approach, however, we believe it will be nearly impossible to implement it as apparently envisioned in the ED. We believe it is unrealistic to expect a variable interest holder, at each reporting period, to:

1. Identify all other variable interests and the parties to those interests. For example, Wells Fargo frequently enters into a freestanding interest rate swap with a securitization SPE that issues beneficial interests. The swap is our only involvement in the SPE and typically the terms of the swap do not preclude the SPE from achieving qualifying SPE status. In addition, periodic settlement under the swap by the SPE ranks near the top of the priority of cash flows, generally senior to all other beneficial interest holders. In that case, the fact pattern--by itself--supports the expectation that we would not become the SPE's primary beneficiary at any time during the life of the SPE. However, technically the ED requires us to identify all other variable interests of the SPE in order to support that conclusion.
2. Determine whether the holders of other variable interests are related or financially dependent parties, and if so, determine if those relationships imply more than one primary beneficiary. In the event that two or more primary beneficiaries are identified, an enterprise must apply separate "tie-breaker" guidance to determine which primary beneficiary should consolidate the SPE.

Paragraph 15 requires an enterprise to consider the variable interests held by FAS 57 related parties, which include equity-method investees and other parties subject to significant influence by the enterprise. Including equity-method investees and parties subject to

significant influence makes sense for FAS 57 disclosure purposes, because the reporting entity knows its FAS 57 related parties and the counterparties to its transactions and the reporting entity has readily available information about related party transactions. However, the extent of data-gathering necessary to determine whether an equity-method investee, or other party subject to significant influence, holds variable interests is overwhelming and most likely not practicable.

Paragraph 15 also requires an enterprise to determine variable interests held by several other parties. Paragraph B27 better explains the nature of those other parties. It states, “Those other parties (a) are financially dependent on a variable interest holder, (b) cannot sell, transfer, or encumber their interests without the approval of a variable interest holder, (c) receive the investment or the funds to make the investment from a variable interest holder, or (d) provide significant amounts of professional services or other similar services to a variable interest holder.” We recommend the Board replace the list in paragraph 15 with that in paragraph B27.

We believe the B27 list is clearer and will not inadvertently encompass more entities than probably intended. For example:

- “A party that cannot fund or finance its operations without support from the enterprise” could include any financially troubled entity.
- “A party that received its interests as a contribution from the enterprise” makes sense if the contribution recipient is related to the enterprise, e.g., a benefit trust established solely for the enterprise’s employees. However, it does not make sense if the contribution recipient is a well established, nationally recognized, self-sufficient not-for-profit organization.
- “A party that has a de facto agency relationship with the enterprise as a result of providing significant amounts of professional or other services or because of other business arrangements” is vague. It is unclear whether “significant” is from the perspective of the enterprise, service provider, or both. We do not believe it is practical to require an enterprise to determine whether the extent of services it receives from all of its service providers are significant to the service provider.

In general, we believe that the Board has an unrealistic expectation that an enterprise can effectively adopt accounting guidance that is so heavily weighted on the actions of distantly related third parties. Related parties as identified by FAS Statement 57 should be excluded from the final Interpretation.

3. Measure all variable interests based on their expected future losses and rank them based on subordination and dominant risk. We doubted the feasibility of a variable interest holder successfully completing this step unless it was closely involved in the pricing of the SPE’s transactions at inception of the SPE. To test that theory, we applied the guidance to selected transactions with SPEs and found that only in those cases where we participated in structuring the SPE and in establishing its initial transactions did we have sufficient and

readily obtainable information about expected future losses. We also noted that such information could become obsolete in a subsequent reporting period and that we would be unduly challenged to obtain the then current information under a less-than-exhaustive search.

4. Determine whether fees are market-based, and if also variable, whether the service provider made a significant incremental investment in its business in order to earn the fee.

In our opinion, a company should presume that its fee from an SPE is not market-based only when a service provider receives other interests in the SPE at no cost or at favorable prices in addition to or in lieu of its cash fees. It is unwarranted to require all service providers to document whether or not its fee is comparable to fees in similar observable arm's length transactions or arrangements. Alternatively, the Board could add another presumption that if the SPE relates to a securitization in which beneficial interests were rated by a rating agency, the fees, both fixed and variable, are presumed to be at market.

Paragraph 19 states, "Contracts to provide services to an SPE in return for a fee negotiated at arm's length under competitive conditions (a market-based fee) are not variable interests unless the holder has an investment at risk or can be required in certain circumstances to transfer assets or issue its own equity or debt instruments to the SPE or a party with an interest in the SPE." We recommend replacing "holder" with "service provider."

5. Compute its percentage of variable interests relative to the total variable interests to determine if its variable interests consist of the majority of variable interests or if they represent a significant portion of the total variable interests that is significantly more than the variable interests held by any other individual party.
6. Consolidate or de-consolidate an SPE based on the results of steps 1 through 5.

In our opinion, the Board could simplify the variable interests approach to consolidation and produce a workable methodology by making only a few revisions to the ED, as follows:

- Focus on variability of outcomes from a variable interest. We support a consolidation assessment based on variability, comprising both gains and losses, rather than one based on losses alone, because it is consistent with the concept of the risks and rewards of ownership and with economic reality (i.e., investors expect a chance to reap the benefits of ownership as well as to incur losses from the same).
- Measure financial support based on potential significant variability. We support emphasis on potential significant variability in favor of one of expected future losses and dominant risk. Stressing the importance of potential variability would make it clear that variable interests exclude items such as investment-grade beneficial interests and all contracts under which the payments rank on par with, or ahead of, all other beneficial interests. We agree with the ED regarding the importance of subordination of variable interests.
- Require consolidation only if an enterprise holds a majority of the variable interests and delete the consolidation rule based on significant portion. Consolidation resulting solely

from a majority holding is consistent with the ED's voting interests approach to consolidation and with ARB 51. We understand that existing accounting guidance literally does not require consolidation based on majority ownership. However, in practice, the presumption regarding majority ownership is rarely overcome. Further, our recommendation also eliminates one of the most complex steps in the complicated consolidation assessment, providing substantial improvement in consistency and implementation relief.

- Trigger reassessment of the initial consolidation conclusion only when an enterprise changes its level of variable interests, at which time, the enterprise also should make a reasonable attempt to update information about other variable interests. Our suggestion is consistent with consolidation based only on holding a majority of interests. Also, it will address our concern that it will be nearly impossible to gather the necessary information on a timely basis. Most of the information that an enterprise would need would not be contained in its own records, thus necessitating inquiries of multiple third parties, most of whom will be engaged in completing their own reporting processes.
- Provide additional guidance on the extent of work an enterprise should perform regarding variable interests held by third parties. The ED contains guidance on that topic, indicating that “[a]n entity is not required to conduct an exhaustive search for information about the actions of other unrelated parties that might cause the entity to become the primary beneficiary or to cease to be the primary beneficiary.” We appreciate the Board's acknowledgement of the practical problems with obtaining information about variable interests held by third parties. We recommend that guidance be expanded to include related parties for the reasons above. Further, to ensure consistency in the application of the guidance in practice, we recommend the Board encourage the establishment of auditing guidance on sufficient evidential matter to support a preparer's assertion that it complied with GAAP in this area. We believe any auditing guidance should be finalized before the final interpretation becomes effective.

In addition, we would benefit if the Board provides some guidance on subsequent accounting in the final interpretation. Paragraph 14 requires an SPE's assets, liabilities and non-controlling financial interests to be measured at fair value when an enterprise becomes a primary beneficiary. That requirement appears consistent with paragraph 14 of FAS 141, which essentially requires purchase accounting when an investor increases its voting ownership such that the equity method no longer applies and the investee should be consolidated. If that is the case, we recommend the Board so state and indicate the extent to which purchase accounting should be applied (e.g., identification and recording of intangible assets).

Also, we note that a variable interest resulting in consolidation of an SPE may not be a cash security or other asset. It may be a service contract or a guarantee accounted for as a liability. Because consolidating an SPE without an existing investment in subsidiary balance is unusual, we recommend the Board provide a detailed example of the journal entries an enterprise would make upon first-time consolidation of an SPE after the initial application of the final interpretation.

Finally, the ED addresses the initial measurement when an enterprise becomes a primary beneficiary but is silent about measurement upon de-consolidation of an SPE when the enterprise no longer is the primary beneficiary. We recommend the Board address the basis of accounting for de-consolidation and provide a detailed example with journal entries.

Adopting our recommendations above should significantly lessen the impact that the actions of third parties will have on the accounting of variable interest holders and eliminates some of the ambiguities in the assessment guidance. Further, we strongly believe an enterprise should be able to determine the accounting consequences, including consolidation, of a transaction in advance of entering into the transaction. This not only provides an enterprise the opportunity to make an assessment at a point where it still has some control over the consequences of its actions, but it also eliminates some steps in the consolidation assessment process, which should improve users' understanding of the conclusion reached and preparers' burden and costs of implementing and complying with the final interpretation.

* * *

SPEs That Hold Certain Financial Assets

For many types of SPEs, we agree with the rationale behind concluding a significant portion of the variable interests can ultimately equate to a controlling financial interest. It begins with the idea stated in paragraph 4 that "the provider (or providers) of the financial support to an SPE would not be willing to provide that support if the nominal owner retained effective decision-making power." The Board recognized that for SPEs possessing the characteristics in paragraph 22, now being commonly referred to as FSPEs, that thought process breaks down. If an enterprise does not meet two of three conditions, no enterprise consolidates that SPE. If an enterprise meets two of three conditions, that enterprise must assess its variable interests under the general guidance.

The FSPE criteria key off of those for a FAS 140 qualifying SPE (QSPE). We agree with this approach because it is pragmatic and takes advantage of the existing accounting knowledge base. We are pleased to note that the Board seemed to attempt to deviate as little as possible from the QSPE criteria, and, we agree with the exceptions it proposes in paragraph 22.

We also understand the Board's concern that aggregating a combination of variable interests of an FSPE could confer control to the enterprise holding those interests. We believe the Board could address that concern by modifying the "demonstrably distinct" requirements of FAS 140 that presently relate only to transferors, their affiliates and their agents. We believe that approach is more straightforward and subject to less judgment and interpretation than the guidance in paragraph 23. The paragraph 23 guidance is difficult to understand given its evolution since the Board's tentative decisions in May 2002. During those deliberations, the Board discussed whether an entity that meets more than one of the following conditions should still be exempt from consolidation:

1. Provide administrative services including servicing assets and placing issued interests.

2. Have broad discretion in purchasing or selling assets for the SPE.
3. Provide guarantees or back-up borrowing arrangements.
4. Receive fees that are not market-based.
5. Hold other significant variable interests.

The Board had tentatively decided that items 1 and 5 above should not cause an enterprise to consolidate an FSPE. However, subsequently, it revised item 3 (paragraph 23.b. in the ED) to consist of “a guarantee, a back-up lending arrangement, or other form of liquidity, credit, or asset support that is subordinate to the interests of other parties.” In our opinion, addition of “asset support that is subordinate to the interests of other parties” is inconsistent with earlier tentative decisions to exclude item 5 (i.e., other significant variable interests). Based on our experience and as stated in paragraph B19, each holder of beneficial interests issued by a risk-dispersing SPE “should account for its rights and obligations related to the assets in the SPE, but it is inappropriate for any party to consolidate the assets and liabilities of the SPE.”

In paragraph 23a, the ED changed item 1 from “broad discretion” to “sufficient discretion” and “or” to “and.” We believe those changes could have a significant impact on the types of FSPEs that would remain subject to the general guidance on consolidation based on variable interests. Rather than debate those nuances, we believe the Board should adopt the approach recommended above.

DISCLOSURE

Paragraph 25 requires the following:

An enterprise that (a) provides significant administrative services to an SPE such as collecting and distributing cash or placing interests issued by the SPE and (b) is not the primary beneficiary shall disclose the assets and liabilities of the SPEs that it serves and shall describe the purpose of those SPEs.

We strongly disagree with the Summary of the ED which indicates this proposed disclosure would “help financial statement users assess an enterprise’s risks.” Instead, we believe the disclosures will obfuscate the reporting entity’s risks from SPEs for the following reasons:

- The reporting entity will disclose information about entities over which it has no control (either directly through majority ownership of equity or indirectly from holding variable interests that impart the risks and rewards of ownership). We do not believe asset/liability information or the purpose of SPEs will provide users with meaningful volume statistics or assist them in understanding the extent to which the reporting entity is involved in SPEs. It is

likely several service providers would disclose the same information about the same SPEs, so users could not even obtain an overall indication of SPE usage among U.S. GAAP reporters. We do not understand the decision-usefulness of the information.

- We are unclear as to whether the “assets and liabilities of the SPEs” disclosure requirement relates to quantitative (or the basis for measurement thereof) or qualitative information.
- Wells Fargo provides administrative services to SPEs and places interests issued by SPEs. Particularly in the latter case in which our involvement may end after formation of an SPE, gathering the data will be a time-consuming manual task. Further, as a provider of administrative services, we expect third-party reporting entities that place interests issued by SPEs will ask us to provide them with the required information. The cost for us to support this disclosure requirement would be high and would not give the users of our financial statements further insight into our company's exposure from an SPE to which we provide administrative services.

We strongly urge the Board to delete the paragraph 25 requirement in the final interpretation.