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FIAC

Financial Institutions Accounting Committee

July 23, 2002

Ms. Suzanne Bielstein
Director of Major Projects and Technical Activities
File Reference: 1082-2000
Financial Accounting Standards Board
401 Merritt 7, P.O. Box 5116
Norwalk, CT 06956-5116

Re: Exposure Draft – Proposed Interpretation on Consolidation of Certain
Special Purpose Entities

Dear Ms. Bielstein:

The Financial Institutions Accounting Committee (FIAC) is pleased to have the opportunity to provide you with our comments and observations related to the Exposure Draft (ED)–Proposed Interpretation on Consolidation of Certain Special-Purpose Entities.

FIAC is a group of 16 financial professionals working in executive level positions in the thrift and banking industries and is a standing committee of the Financial Managers Society. FIAC's primary responsibility is to evaluate those accounting and regulatory matters that affect financial institutions. The comments within this letter are representative of the FIAC as a whole and do not necessarily reflect individual views of the institutions represented on the Committee.

We are pleased that the FASB is attempting to achieve more consistent application of consolidation policies to SPEs. We believe this guidance is long overdue. While we support the guidance included in this interpretation, and particularly the concept of measuring variable interest, there still exists some confusion as to if this guidance is congruent with the control-based approach proposed in Statement of Financial Accounting Standards (SFAS) No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* or whether the guidance is more congruent with a risk and rewards approach.

We believe that the concept of a variable interest is more congruent with a risk and rewards approach, and that the FASB should clearly articulate this point in the final draft of the Statement.

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In addition, we believe that further examples and clarifications are needed in order to appropriately implement this proposal as regards to paragraph 23a and 23b. Specifically, the term “sufficient discretion in the purchase and/or sell of assets” is vague, subjective and needs clarification. We also believe the phrase “other form of liquidity, credit or asset support that is subordinate to the interests of other parties” needs clarification.

The following are some issues discussed in the proposed interpretation that we would like to address further with you. These comments form the basis of the discussion we would like to have in our meeting scheduled for Friday, August 2nd.

Applicability to QSPEs under SFAS 140

FIAC strongly agrees with FASB’s decision, as stated in paragraph 8a, to continue to allow a transferor of financial assets to a qualifying SPEs not to consolidate the QSPE. QSPEs are common structures used in securitizations and structured transactions. They isolate assets or cash flows and insulate the SPE from potential bankruptcy of the originator and its overall credit risk, allowing investors to take on the isolated risk in the transaction rather than the potentially greater risk that would likely be present in direct equity or debt investments of the originator. There is typically no primary beneficiary in these types of QSPEs, and therefore it is not appropriate for the transferor to consolidate the related assets of a QSPE.

Having said that, it would be very helpful if there were a separate section in the document specific to QSPEs. Although variable interest holders in a QSPE would generally not need to consolidate the QSPE, there are certain conditions under which one of the variable interest holders may have to consolidate. For example, if a party holds variable interests that result in a recombination of the risk, that party would have to consolidate the QSPE. Also, it is unclear if the disclosure requirements specified in paragraphs 24 and 25 apply to QSPEs or just to SPEs. A separate section outlining the guidance related to QSPEs would add clarity in this area.

Clarity and appropriateness of criteria

Paragraphs 13 to 21 outline the conditions to be met in determining whether or not an SPE shall be evaluated for consolidation based on variable interests. We are uncertain as to how several of these conditions are to be interpreted, and would like the opportunity to discuss these items with you in greater depth to get a better understanding of the intention of this proposal.

Identifying and Comparing Variable Interests

As stated above, we acknowledge the theoretical merits of the variable interests approach. Unfortunately, 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, for each reporting period, to:

1. Identify all other variable interests.
2. Determine whether their holders are related or financially dependent parties. And, if they are and if those relationships imply more than one primary beneficiary, apply the separate “tie-breaker” guidance.

3. Measure the variable interest based on their expected future losses and rank them based on subordination and dominant risk.
4. Assess whether fees are market-based, and if variable, whether the service provider made a significant incremental investment in its business in order to earn the fees.

We understand the Board does not expect a variable interest holder to obtain perfect knowledge. However, the Board needs to define the difference between a comprehensive search and an exhaustive search.

As an alternative, we recommend the Board explore an approach that focuses on information already gathered for the voting interests approach. For that analysis, it is likely an enterprise already estimated or obtained the expected future losses of the SPE. If the enterprise's variable interests, at any quarter-end, exceed 50 percent of the SPE's expected future losses, consolidation would be appropriate. The advantage of this type of approach is that an enterprise's accounting is not determined by the activities of third parties. 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, which consequences it can control through its own actions, decisions and analyses.

Certain SPEs that Hold Financial Assets

If an enterprise were to meet two of the three conditions listed in paragraph 23, the enterprise would be required to assess its variable interests under the general guidance, not under the special circumstances regarding SPEs that hold certain financial assets. We believe that conclusion conflicts with the reasons in paragraph B19 for providing the separate guidance for risk-dispersing SPEs. Paragraph B19 states:

In its deliberations, the Board acknowledged that while many SPEs benefit a primary beneficiary, some SPEs effectively diversify risks and potential benefits related to certain assets or activities. In SPEs that diversify risks, a portfolio of assets is held by an administrator, trustee, or servicer, and the various rights and obligations that arise from those assets and any liabilities incurred to hold those assets are allocated to various parties in accordance with their tolerance for risk. No individual party controls the SPE's assets or is responsible for the SPE's liabilities. Each party 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.

FIAC supports the view expressed in paragraph B19. Therefore, we are confused by the provisions in paragraph 23 that effectively preclude reaching the intended result expressed in paragraph B19 for SPEs that effectively diversify risks and potential benefits. By definition, if an SPE falls under the scope of paragraphs 22-23, "it is inappropriate for any party to consolidate the assets and liabilities of the SPE."

Applicability of Paragraph 23 criteria to Collateralized Bond Obligation SPEs

Based on deliberations leading to the ED, we understand the Board believed that meeting two of the three conditions described in paragraph 23 effectively achieves control. During the deliberations, the three conditions had been defined as:

1. Have broad discretion in purchasing and selling assets for the SPE
2. Provide guarantees or back-up borrowing arrangements
3. Receive fees that are not market-based

We note that the most recent version of the ED revised item 1 to be “sufficient discretion” and revised item 2 to add “or other forms of liquidity, credit or asset support that is subordinate to the interests of other parties.”

Most Collateralized Bond Obligation (CBO) SPEs provide the SPE administrator with sufficient but not broad discretion to purchase or sell assets. In addition, most CBO SPE administrators provide some form of “liquidity, credit or asset support that is subordinate to the interests of other parties,” but do not provide guarantees or back-up borrowing arrangements. Therefore, because of the revisions to the original draft of the ED, the special provisions for certain SPEs that hold financial assets and meet the criteria in paragraph 22 are not applicable to most CBO SPEs. Thus, the Board’s intent, as described in paragraph B19, for certain SPEs that effectively diversify risks and potential benefits, is effectively thwarted by the revised restrictions in paragraph 23.

Ability to Purchase and Sell Assets

Paragraph 23a states that a condition for evaluating if an enterprise provides significant financial support is whether the enterprise “has authority to purchase and sell assets for the SPE.” An early draft of the ED read as follows: “has authority to purchase or sell assets for the SPE.” There are many SPEs that have some authority to purchase assets but not the authority to sell assets and vice versa. Therefore, the distinction between “purchase and sell” and “purchase or sell” is an important distinction which must be clarified.

Market Based Fees

We are uncertain as to how to determine whether or not fees are market-based, as described in paragraph 23c. If a market exists and we can demonstrate that the fees received are in line with what others charge for similar services, for example, 2% to service credit card receivables, we would assume that they are market-based fees. This information is available in prospectuses if others sell publicly similar assets. We believe that there are other fees which should be considered to be market-based if a market exists, even if the information is not readily available or disclosed by others. We are uncertain as to why the proposal requires that fees are assumed to not be market-based unless proven otherwise.

Disclosures And Effective Date

We feel that disclosures under paragraphs 24, 25 and 27 are very onerous. Trying to determine all related parties of variable interest holders and to report on the asset and liabilities of these entities would involve a significant undertaking, especially since we do not believe that these disclosures will help financial statement users assess an enterprise’s risk.

Paragraph 27 encourages pro forma disclosure of the effect this proposal would have had on assets, liabilities, and income in periods reported prior to the first application of the proposal. It would be extremely difficult to provide this information. Related parties change continually, and to find out the related parties for current and each prior period presented is not beneficial in relation to the time and cost to do so.

As to the effective date, we believe that there should be a period of 6 months from the date of issuance to the effective date of the standard. Much clarification is still needed, and companies will need time to read and understand the final document and ensure legal documents are adjusted appropriately to comply with the final proposal.

Conclusions

We agree that the board should make an explicit exception to basing consolidation on control when a SPE does not have sufficient equity investment. In addition, however, the Board should unambiguously indicate that consolidation is based on assessment of risks and rewards--represented by the approach to consolidation based on variable interests. By providing that foundation, we expect implementation issues may be resolved consistently and within a rational framework, thereby improving the comparability of financial statements and alleviating the costs of applying new rules.

As mentioned earlier, while we agree that further guidance is needed on consolidating SPEs, we believe that the proposed approach, particularly paragraphs 23a and 23b, is very subjective, and can lead to inconsistent application of consolidation policies.

Further clarification of the above noted items and implementation guidance are essential to achieve consistent application of the proposed consolidation guidelines.

We look forward to the opportunity to discuss these and any additional matters you may wish to address in our meeting on August 2, 2002.

Sincerely,
Richard M. Levy
Chairman

cc: Ron Lott, Financial Accounting Standards Board
Halsey Bullen, Financial Accounting Standards Board
Zane Blackburn, Office of the Comptroller of the Currency
Gerald Edwards, Federal Reserve System
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