Marriott International

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MP&T Director
Financial Accounting Standards Board
401 Merritt 7
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Dear MP&T Director,

We are pleased to have the opportunity to submit comments on the June 28, 2002 Exposure Draft (the "ED") of a Proposed Interpretation, *Consolidation of Certain Special-Purpose Entities* - an Interpretation of ARB No. 51. Our comments are as follows:

Summary discussion of control by the primary beneficiary

In the Summary section of the ED, one of the premises on which the ED is founded is that a primary beneficiary can control a SPE, even through the primary beneficiary may not have the direct ability to make decisions about the use of the assets. We strongly disagree with this premise. We believe there are various circumstances in which a primary beneficiary (as defined in the ED) has absolutely no control over the SPE. For example, a non-equity holder may provide a non-recoverable guarantee of a fixed return on equity to the owners of an SPE. The SPE cannot be evaluated for consolidation based on voting interests as the equity investment is not subordinate to all other interests (i.e. the non-recoverable guarantee fundings are the first interest subject to loss). Moving to the determination of the primary beneficiary, the expected losses of the guarantor may exceed the expected losses of the individual equity holders and therefore the guarantor would be the primary beneficiary under the Interpretation. However, the guarantor has absolutely no ability to control the operations of the SPE. In this case, while it is appropriate for the guarantor to assess the need to record a liability for future losses under the provisions of SFAS 5, it is not appropriate for the guarantor to consolidate an entity that it does not control. We believe this fundamental premise needs to be re-visited.

Exclusion from the ED for subsidiaries of substantive operating enterprises

We strongly concur with paragraph 8c of the ED, whereby no enterprise can be determined to be the primary beneficiary of a subsidiary of a substantive operating enterprise. We believe that this provision will help to preclude the same SPE from being consolidated by two or more enterprises, which would be contrary to the goal of improved financial reporting.

Application of the definition of a substantive operating enterprise to the real estate industry

In the real estate industry, it is common for funds or trusts to be established for the purpose of investing in income-producing assets (office buildings, hotels, etc). Each real estate asset that the fund or trust owns is typically acquired through a newly established entity (LP, LLC, etc.) which has its activities limited to owning the property in question. The fund or trust typically hires an asset manager to manage the administration of the fund or trust and a property or hotel management company to manage the operations of the individual asset. We believe that a fund or trust as described above with sufficient equity to finance its operations without support from any other enterprise or entity except its owners should be considered a substantive operating enterprise. Further, we believe such a fund or trust should not be excluded from that definition solely because it chooses to outsource its administrative functions instead of hiring its own employees and conducts it business operations through the use of SPEs.

Application of the ED to certain real estate joint ventures

We believe that there are unique characteristics to certain real estate joint ventures that need to be specifically addressed in the ED. As discussed above, in the real estate industry, it is typical for an income-producing asset (office building, hotel, etc.) to be placed in a newly established entity which has its activities limited to owning the property in question, both to reduce overall business risk and to meet the requirements of lenders. A typical real estate special purpose entity will be capitalized through a combination of debt and equity. Cash flows from operations are distributed to the equity holders as a return on their investment. Such cash distributions usually exceed GAAP income, typically due to depreciation expense. Consequently, book equity will generally decline in these situations, even though the cash distributed is generated solely from operations, and does not economically represent a return of capital.

Under the ED, in Paragraph 9b, in order to determine if consolidation is appropriate based on voting interests, the amount of the equity investment must be sufficient to allow the SPE to finance its activities without relying on financial support from variable interest holders.
Per paragraph 12, "an equity investment shall be presumed to be insufficient to allow the SPE to finance its activities without relying on financial support from variable interest holders unless the investment is equal to at least 10 percent of the SPE's total assets...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."

In the case of the SPE described above, equity investments above the 10% threshold at inception will be reduced below that level over time due to depreciation expense. SPEs as described above finance their activities without relying on financial support from the variable interest holders. However, it may be difficult for the equity holders to find persuasive evidence that an equity investment of less than 10% is comparable to the equity of businesses that are not SPEs, since SPEs are the preferred vehicle for such investments. To the best of our knowledge, there is no significant population of non-SPEs that engage in similar transactions with similar risks.

In summary, we believe that an SPE that meets the 10% third party requirement at inception and solely distributes cash flows generated from operations to equity holders as a return on their investment should be determined to meet the requirements of paragraph 9b of the ED.

Real estate debt refinancings

In addition to the unique characteristics of certain real estate joint ventures discussed above, it is also common in real estate joint ventures to refinance the senior debt once the property in the SPE has reached a stabilized level of operations. As the amount of a refinancing is based on the fair value of the asset and the fair value of a real estate asset generally increases with stabilization and through the passage of time, the refinancing proceeds are frequently in excess of the remaining balance of the initial senior debt. These excess proceeds are often distributed to the owners as a return of their initial investment. Consequently, as a result of the refinancing, while the initial equity investment will be reduced, the total capital amount (i.e. debt + equity) remains the same, and the overall economics of the SPE are unchanged. Although the initial equity may now be reduced below the 10% level, we do not believe that the distribution of excess proceeds from refinancing changes the control environment of the SPE.

We believe that an SPE that meets the 10% third party requirement at inception and distributes cash to owners in the future from an arm's length third party refinancing should be determined to meet the requirements of paragraph 9b of the ED.

Application of the ED to operating lessees of income producing assets

SPEs are sometimes formed to operate an income-producing asset held under an operating lease from the asset's owner. The assets of the SPE can be minimal, consisting of working capital required to operate the income-producing asset. The existing guidance in EITF 90-15 does not specify whether the 3 percent minimum acceptable investment should be based on the assets of the SPE or the value of the leased asset. We believe that the general interpretation of EITF 90-15 has been that the 3 percent relates to the value of the leased asset. Paragraph 12 of the ED, in our opinion, clarifies this point (and comes to a different conclusion) by stating that the equity investment must be at least 10 percent of the SPE's total assets. Therefore, in the case of an operating lessee SPE, the required equity investment of at least 10 percent of the SPE's working capital will be a minimal amount.

We concur with this conclusion since the level of capital required to operate such businesses is minimal. We believe that specific clarification of how the 10 percent relates to operating lessee SPEs may be warranted due to a potential change from current practice.

Guarantees of a return on equity

In the real estate industry, it is common for the purchaser of an income-producing asset (often a SPE) to require a guarantee by the seller of a return on equity for a certain period of time. Assuming the guarantee is non-recoverable, the seller/guarantor is subject to the first risk of loss, and therefore consolidation based on voting interests is not allowed under the Interpretation. Under the ED, if the guarantor's expected losses exceed the expected losses of the individual equity holders of the SPE, the guarantor is the primary beneficiary under the ED and will consolidate the SPE, even though after the sale to the SPE the guarantor is no longer in control of the asset. This is in direct conflict with SFAS 66, which, in paragraph 28, allows a seller to provide a guarantee of a return on the buyer's investment for a limited period of time to achieve sale accounting, provided operations of the property cover all operating expenses. SFAS 140 also allows for a transfer of a financial asset subject to a guarantee to be recorded as a sale, with a liability established for the fair value of the guarantee. Due to this apparent conflict with existing literature, we recommend that guarantees issued in conjunction with the sale of real estate or assets sold to an SPE be excluded from the ED.

Definition of primary beneficiary

Paragraph 16a of the ED states that "only a party that is a substantive operating enterprise can be a primary beneficiary." However, it appears that this rule applies only in the limited circumstances described in paragraph 15 (i.e. where two or more related parties hold variable interests that would, if held by a single party, identify that single party as the primary beneficiary).

We believe that paragraph 16a is open to the incorrect interpretation that all primary beneficiaries must be substantive operating enterprises and we recommend that the final interpretation state affirmatively that a variable interest holder does not need to be a substantive operating enterprise.

Definition of expected future losses

Paragraph 20 of the ED states that the relative size of variable interests shall be determined by comparing expected future losses from the interests. We interpret "future losses" as meaning future P&L charges, as opposed to future outflows of cash, with which we concur. However, we believe this will result in the party with the largest exposure to loss no longer being the primary beneficiary once it has recorded a charge for the expected losses.

For example, assume that Investor A has a variable interest of $25 with expected future fundings under a non-recoverable guarantee of $10. Investor B has a variable interest of $25 with expected future P&L charges of $1. Also, assume that on Day 1 Investor A records a $10 reserve for estimated future losses, while Investor B does not. Investor A's new expected future P&L exposure is $0, while Investor B is the primary beneficiary with an expected future P&L charge of $1. Conversely, if "future losses" essentially means future cash outflows, then Investor A is the primary beneficiary since he still anticipates funding $10, compared to expected future fundings of $1 for Investor B. We believe that the FASB staff should have further discussions surrounding these implications and specifically clarify the intended meaning of "future losses".

Management contracts as variable interests

Paragraphs 18 and 19 of the ED identify circumstances in which a management contract can be considered a variable interest, and therefore, if it is determined that the service provider is the primary beneficiary, the service provider would have to consolidate the SPE. The issue of whether the holder of a management agreement has a controlling financial interest without having ownership of a majority of the outstanding voting shares was previously addressed by the FASB in EITF 97-2. While EITF 97-2 specifically addresses physician practice management entities, the FASB stated that the guidance in EITF 97-2 is appropriately applied to other industries with contractual management arrangements similar to those addressed in the EITF. We believe that management contracts should either be excluded from the ED or the guidance in EITF 97-2 and the ED should be integrated.

SPEs That Hold Certain Financial Assets

Paragraph 23c of the ED states that an indicator of significant financial support is a fee which is not market based. Referring to paragraph 19, the ED states that because it can be difficult to determine whether a fee is market based, an enterprise shall presume that its fee from an SPE is not market based unless it can be demonstrated to be comparable to fees in similar observable arm's length transactions or arrangements. To the best of our knowledge, similar arm's length transactions are conducted between private parties and the fees are not publicly disclosed, thus rendering proof out of reach for most companies. We believe that companies should be able to apply standard valuation techniques to determine if the fee received from an SPE is market based.

Further, in conjunction with a sale of financial assets, a company may retain a beneficial interest, in addition to a servicing obligation. The company allocates the previous carrying amount between the assets sold and the retained interests, including the servicing asset, based on their relative fair values at the date of transfer, in accordance with paragraphs 10 and 56-60 of SFAS 140. We believe that as the servicing asset is recorded at fair value, then by definition the servicing fee is market based. We believe that servicing assets arising from such allocations should either be excluded from the ED or the guidance in SFAS 140 paragraphs 56-60 and the ED should be integrated.

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Thank you for your consideration of these matters. We look forward to a final interpretation that results in greater clarity and consistency in financial reporting.

Sincerely yours,

Michael J. Green,
Vice President, Finance and
Principal Accounting Officer
Marriott International, Inc.