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**Letter of Comment No: 75**  
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Ms. Suzanne Bielstein  
Director of Major Projects and Technical Activities  
Financial Accounting Standards Board  
401 Merritt 7 P.O. Box 5116  
Norwalk, Connecticut 06856-5116

Re: File Reference No. 1082-200  
Exposure Draft on Consolidation of Certain Special Purpose Entities, a Proposed  
Interpretation of ARB No. 51

Dear Ms. Bielstein:

FleetBoston Financial (Fleet) is writing this letter to express our views with regards to the Exposure Draft on Consolidation of Certain Special Purpose Entities, a Proposed Interpretation of Accounting Research Bulletin No. 51 (the Exposure Draft). We commend the Financial Accounting Standards Board (the Board) and its staff for their efforts to develop accounting standards that will provide useful and transparent information to users of financial statements.

We do, however, have several comments that are discussed in more detail below. Most significantly, we believe that, *contrary to the intended result*, the Exposure Draft would result in the inappropriate consolidation of certain SPEs that have effectively diversified risks. As stated in Appendix B of the Exposure Draft, when no individual party controls an 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. We believe, however, that the proposed guidance does not sufficiently build upon these principles, and we provide suggested modifications below.

## **Dispersion of Risks**

In the introductory summary and in Appendix B, the Board acknowledges that some SPEs effectively diversify risks and potential benefits such that consolidation is inappropriate. The introductory summary indicates that SPEs should be consolidated if they do not effectively diversify risks, but should not be consolidated unless a single party holds an interest or combination of interests that effectively recombines risks that were previously dispersed. Paragraph B19 indicates that it is inappropriate for any party to consolidate the assets and liabilities of an SPE in which no individual party controls the SPE's assets or is responsible for the SPE's liabilities. We believe that these principles should be a cornerstone of the final Interpretation of ARB No. 51 (the Interpretation). However, the consolidation guidance in the Exposure Draft does not explicitly require consideration of whether an SPE effectively diversifies risks. As a result, we believe that the guidance will result in the inappropriate consolidation of many SPEs.

*We urge the Board to provide specific guidance as to when there is sufficient diversification of risk and benefits to make consolidation inappropriate, and to incorporate that guidance directly into the criteria for consolidation.*

Most importantly, as discussed below, we believe that the standards for identifying the primary beneficiary should be more rigorous. Further, we believe that only an entity that would otherwise qualify as the primary beneficiary should be required to consolidate an SPE that holds certain financial assets, as defined in the final Interpretation.

## **Criteria for Identifying the Primary Beneficiary**

The current standard for consolidation of a substantive operating entity is ownership of a majority voting interest. The Exposure Draft appropriately acknowledges that voting interests are not always meaningful in the context of an SPE. As noted in paragraph B14, variable interest holders protect their interests and manage their risks either by establishing predetermined limits on the SPE's activities or by wielding decision-making authority in some form other than a voting interest. We concur with the Board's conclusion that, in the absence of sufficient independent equity, a determination as to whether consolidation is appropriate should be based on an analysis of the variable interests that provide financial support to an SPE rather than voting interests.

However, the proposed guidance requires that an entity consolidate an SPE if it holds either a majority of the variable interests in the SPE, or if it holds a "significant" amount of variable interests that is "significantly more" than the amount held by any other individual party. We do not believe that holding a significant amount of variable interests is a sufficiently rigorous test. Instead, we believe that an entity should be the primary beneficiary and thus be required to consolidate an SPE only if it holds a majority of the variable interests.

*If the Board ultimately retains the "significant portion/significantly more" concept in the Interpretation, we strongly believe that the Interpretation should set forth a bright line benchmark as to what is a significant variable interest.*

To that end, we propose that an entity must hold at least 25% of the variable interests of an SPE before it must undertake to determine whether it is the primary beneficiary and potentially has to consolidate the SPE. The corollary of this is that if no entity holds 25% or more of the variable interests in an SPE, that SPE will not have a primary beneficiary. This test will require consolidation of SPEs that do not disperse effectively the risks and potential benefits of the SPE at a meaningful threshold while simultaneously providing more certainty, clearer standards and greater ease of administration of the Interpretation's guidance.

### **SPEs That Hold Certain Financial Assets**

We applaud the Board's efforts to provide a simplified analysis for SPEs that hold portfolios of financial assets and distribute the risks and benefits of those assets to various parties in accordance with their tolerance for risk. However, we believe that the guidance, as written, will provide relief for only a limited number of these SPEs. We have two general concerns. Before we address those concerns, we would like to note that, if the final Interpretation adopts the recommendation above, such that the primary beneficiary is the entity that holds a majority of the variable interests, the special provisions for SPEs that hold certain financial assets would no longer be needed.

First, the criteria in paragraph 22 are so restrictive that many SPEs, which effectively diversify risks and benefits, will not qualify for the consolidation analysis set forth in paragraph 23. In particular, the prohibition against holding equity securities and restrictions on the use of derivatives are problematic. Paragraph B24 states that the Board did not want to extend the analysis in paragraph 23 to SPEs that hold equity securities because they may not all effectively diversify risk. Presumably, this reasoning also lies behind the restrictions on the use of derivatives. We believe that such a presumption is punitive and should not result in the exclusion of SPEs that hold equity securities or actively manage their derivative portfolios from the definition of an SPE that holds financial assets (financial SPE). Instead, we ask the Board to provide guidance as to when a financial SPE effectively diversifies risk. For example, we believe that, if an individual entity holds a majority of the variable interests in a financial SPE, that SPE has not effectively diversified risks and should not qualify for the analysis in paragraph 23. We therefore recommend that the narrow criteria set forth in paragraph 22 be expanded to include all SPEs that hold financial assets, provided that the risks and benefits attributable to the assets in such SPEs have been effectively diversified.

Second, the application of paragraph 23 could require that an entity consolidate an SPE that falls within the scope of paragraph 22 (a financial SPE) even though that entity would not be the primary beneficiary under the variable interests approach. For example, an entity that has the ability to buy and sell assets held by a financial SPE and also provides some level of subordinated credit support to that SPE would be required to consolidate the SPE, even though another entity that does not provide services to or receive fees from the SPE holds a majority of the variable interests in that SPE. This would appear to be an inappropriate result.

We therefore recommend that paragraph 23 be modified to require that an entity consolidate a financial SPE only if the entity meets both of the following criteria:

- The entity would be the primary beneficiary under the variable interests tests; and
- The entity either meets the criteria in paragraph 23(a) or paragraph 23(c), subject to additional comments below .

The criterion in paragraph 23(a) relates to an entity's authority to buy and sell assets for the SPE. Since this authority does not in and of itself constitute a form of financial support to an SPE, we believe that the Board views it as an indication of a controlling financial interest. We agree that this may be an appropriate factor to consider in determining whether to consolidate a financial SPE. However, an entity's authority to buy and sell assets may be significantly limited by investment guidelines or trading restrictions that cannot be changed unilaterally. We believe that such limitations may be significant enough that the entity's ability to buy and sell assets does not represent a controlling financial interest. We therefore ask that the Board provide guidance as to circumstances in which an entity's authority to buy and sell assets is sufficiently limited that it should not impact the consolidation decision.

The criterion in paragraph 23(c) is the receipt of a non-market-based fee. We believe that this criterion is intended to demonstrate whether an entity provides financial support to an SPE through such a fee arrangement. As set forth in paragraph 19, a fee is to be considered non-market based unless it is demonstrably comparable to fees observed in similar arm's length transactions. Since SPE structures are often highly creative and specialized, we do not believe that a lack of demonstrable comparability should be viewed as a prima facie indicator that a fee serves as a form of financial support for an SPE. We would recommend instead that a fee be analyzed to determine whether it does indeed serve as a form of financial support. Examples might include a fee that is significantly less than a market fee, or a fee that is in effect a subordinated return on investment. In addition, if a service provider can be terminated without financial penalty to the SPE, that should be viewed as evidence that the fee is market-based.

In summary, we believe that the criteria in paragraphs 22 and 23 should be modified to ensure that the results of their application will be no more stringent than the results that would be obtained under the variable interests approach and will ensure that no party consolidates a financial SPE if that SPE effectively diversifies risks and rewards.

### **Definition of an SPE**

We believe that the proposed Interpretation should include a definition of the term "Special Purpose Entity". The Exposure Draft suggests, but does not explicitly state, that an SPE is any enterprise other than a substantive operating enterprise. Without a clear definition, we believe that entities that were not intended to fall within the scope of the Exposure Draft, such as mutual funds and investment partnerships that are funded entirely by equity investments, could be required to comply with the final Interpretation.

In the briefing memo for the March 26, 2002 Financial Accounting Standards Advisory Council meeting (the "March 26 Memo"), a description of an SPE was provided. The March 26 Memo stated that the characteristics of an SPE include:

- It has limited activities and purpose;
- Its 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;
- Its capital structure has significant leverage; and
- It is not a business as described in EITF Issue No. 98-3.

We recommend that the Board include a similar description of SPEs in the Interpretation.

### **Disclosure**

Paragraph 25 requires that an enterprise that provides administrative services to an SPE but is not the primary beneficiary shall disclose certain information about the SPE. We believe that this is appropriate for an entity that holds a variable interest in an SPE and also provides substantive services, such as collateral management, to the SPE. We do not believe the suggested disclosures are appropriate for an entity that holds no variable interests in an SPE and merely provides custodial or administrative services, such as collecting or distributing cash.

### **Transition**

To the extent that existing SPEs that have not been consolidated previously will have to be consolidated going forward, we believe it will be difficult to apply the new standards by April 1, 2003. Accounting records may not be maintained by the consolidating entity; fair value data may be difficult to obtain or evaluate; and accounting policies may need to be established or evaluated. We therefore request that the implementation deadline for SPEs in existence prior to the effective date of the final Interpretation be extended to interim periods beginning after September 15, 2003. This would give entities involved with SPEs sufficient time to evaluate their involvement while still ensuring full compliance with the new guidance in annual financial statements for 2003.

We also strongly urge that consideration be given to excluding from the scope of the proposed Interpretation any SPE as to which

- The sponsor has made an irrevocable decision to liquidate the SPE;
- The SPE has commenced the necessary corporate mechanics to implement liquidation; and
- It is expected that the SPE will be fully liquidated within a short time period, say six months, after the effective date.

We believe this would facilitate an orderly transition in the financial markets without creating the confusion that might result from consolidation of an SPE for only a short period of time. In fact, we are troubled by the possibility that an SPE might be consolidated under the new guidance, yet at the same time be reported as a discontinued operation; and without restatement of prior periods.

**Re-evaluation of Variable Interests**

Paragraph 13 states that an entity shall determine “at each reporting date” whether it is the primary beneficiary of an SPE. We believe that the determination should be made only at inception of the SPE, unless there are significant changes in the variable interests held by the entity performing the analysis. Absent such changes, an ongoing evaluation is unduly burdensome and could add unwarranted complexity to financial statements.

We appreciate the opportunity to comment on the Exposure Draft and would be pleased to discuss any of the points in this letter in more detail.

Sincerely,



Lee Puschaver  
Chief Accounting Officer  
FleetBoston Financial Corporation