

**VIA E-MAIL (director@fasb.org ) & FEDERAL EXPRESS**

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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: Exposure Draft on Consolidation of Certain Special-Purpose Entities**  
**File Reference No. 1082-200**

Dear Ms. Bielstein:

This letter is submitted by Financial Security Assurance Inc. ("FSA") on behalf of the following members of the Association of Financial Guaranty Insurers ("AFGI"): ACE Guaranty Re Inc. ("ACE"), FSA, MBIA Insurance Corporation ("MBIA"), Radian Reinsurance Inc. ("Radian Re"), RAM Reinsurance Company ("RAM Re") and XL Capital Assurance Inc. ("XLCA"). Time constraints did not permit a formal submission on behalf of AFGI itself. The undersigned, however, represent six of the nine AFGI members.

We support the FASB mission to establish and improve standards of financial accounting and reporting for the guidance and education of the public, including issuers, auditors and users of financial information. As such, we believe the comments, observations and suggestions herein are consistent with the FASB's mission statement, particularly considering the needs of financial guarantors and users of their financial information.

In our view, the financial components approach, originally articulated in Statement of Financial Accounting Standards No. 125, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities" ("FAS 125") as replaced by Statement of Financial Accounting Standards No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities" ("FAS 140") is the best approach for accounting for financial asset securitization transactions involving SPEs. That is, each participant in such a transaction should account for its own contractual interest with the entity under financial reporting rules as appropriate. For example, financial guarantors would account for the financial guaranty contract and other interests held, as applicable. Paragraph 112 of FAS 125 (paragraph 146 of FAS 140) states, in part, that:

The Board concluded that the key to applying the financial-components approach can be summarized as follows:

- a. The economic benefits provided by a financial asset (generally, the right to future cash flows) are derived from the contractual provisions that underlie that asset, and the entity that controls those benefits should recognize them as its asset.

\* \* \*

- d. *Each liability should be recognized by the entity that is primarily liable and, accordingly, an entity that guarantees another entity's obligation should recognize only its obligation to perform on the guarantee.* [emphasis added]

Furthermore, paragraph 113 of FAS 125 (paragraph 147 of FAS 140) states "Most respondents to the Exposure Draft generally supported the financial-components approach, especially as it applies to securitization transactions."

We believe that accounting and financial reporting issues relating to the recognition, measurement and disclosure of certain contractual relationships (mostly financial assets and/or financial liabilities) have already or will be addressed in other FASB projects, such as the FASB's project on Fair Value and Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended ("FAS 133"). The FASB specifically addressed financial guaranty contracts in paragraph 10d of FAS 133 and concluded that financial guaranty contracts should be excluded. The FASB is currently deliberating an amendment to FAS 133 that will further clarify which contracts will qualify for this scope exclusion. We do not believe that this proposed accounting standard solves any actual or perceived deficiencies that exist in the current accounting for the financial components of a structured finance transaction (that is, financial assets and/or financial liabilities). We believe that the current accounting requirements for financial guaranty contracts properly reflects the risk and rewards associated with these transactions.

The application of the FASB's existing voting interest model, as indicated by the title of the standard and its provisions, in Statement of Financial Standards No. 94 "Consolidation of All Majority-Owned Subsidiaries" ("FAS 94") to transactions involving special-purpose is at best strained. Paragraph 1 of FAS 94 states:

Accounting Research Bulletin No. 51, *Consolidated Financial Statements*, adopted by the Committee on Accounting Procedure of the AICPA in 1959, concisely describes the purpose of consolidated financial statements in its first paragraph.

"The purpose of consolidated statements is to present, primarily for the benefit of the shareholders and creditors of the parent company, the results

of operations and the financial position of a parent company and its subsidiaries essentially as if the group were a single company with one or more branches or divisions. *There is a presumption that consolidated statements are more meaningful than separate statements and that they are usually necessary for a fair presentation when one of the companies in the group directly or indirectly has a controlling financial interest in the other companies.*" [emphasis added]

Paragraph 13 of FAS 94 states, in part, that:

The usual condition for a controlling financial interest is ownership of a majority voting interest, and, therefore, as a general rule ownership by one company, directly or indirectly, of over fifty percent of the outstanding voting shares of another company is a condition pointing toward consolidation. However, there are exceptions to this general rule. A majority-owned subsidiary shall not be consolidated if control is likely to be temporary or if it does not rest with the majority owner (as, for instance, if the subsidiary is in legal reorganization or in bankruptcy or operates under foreign exchange restrictions, controls, or other governmentally imposed uncertainties so severe that they cast significant doubt on the parent's ability to control the subsidiary).

All majority-owned subsidiaries--all companies in which a parent has a controlling financial interest through direct or indirect ownership of a majority voting interest--shall be consolidated except those described in the last sentence of paragraph 2.

It is our understanding that a less than majority variable interest holder, not necessarily an owner, may be required to consolidate under the provisions of the Exposure Draft. Accordingly, we view this Exposure Draft not as an interpretation of existing accounting literature but as an amendment. Accordingly we recommend that the basic tenets of FASB's consolidation literature (majority voting control) be carried forward in any final interpretation. Furthermore, the accounting model developed in the Exposure Draft presumes that the majority variable interest holder or a significant variable interest holder that maintains a variable interest that is significantly more than other parties is economically compelled to control the SPE. This control may not be manifested by actual voting control but instead by designing and/or negotiating the incorporation documents of the SPE and providing the variable financial support to the entity. Financial guaranty insurers such as the AFGI members, are typically guarantying or reinsuring guaranties of senior tranches of asset-backed securitization transactions and, as such, at the inception of the transaction are not exposed to the majority of the expected losses. In fact, we believe that the financial guarantor would not be deemed to have a variable interest. There are several parties that maintain subordinated interests or provide credit support before a financial guarantor would be called upon. Similar to senior lenders or senior beneficial interest holders, the financial guarantor negotiates certain protective rights that would serve to mitigate the financial guarantor exposure to its

insurance loss which as noted above will only occur after all subordinated interests have been substantially eliminated.

It is our understanding that, under the Exposure Draft, the evaluation of consolidation should be performed periodically. As a result, financial guaranty insurers could be required to consolidate an SPE if the subordinated interests are eliminated as a result of unforeseen extraordinary losses on the assets. In our view, the conceptual underpinnings of the SPE accounting model is inconsistent because the Exposure Draft requires reassessment of the party who is economically compelled to control the entity when the documents have not been changed. The financial guarantor may simply be exercising the rights already existing in its contractual arrangement. Moreover, consolidation of SPEs in these circumstances does not enhance financial reporting and is not in the best interest of investors in financial guaranty insurers simply because transactions are performing poorly and the subordination is eroded.

We recommend expanding the "Financial SPE" definition to include more transactions that currently exist in the marketplace, such as Collateralized Debt Obligation ("CDO") transactions. The derivative limitations in FAS 140's qualifying special-purpose entity are too restrictive for most CDO transactions as these entities may be designed to purchase subordinated asset-backed securities or may purchase a limited amount of synthetic securities. Moreover, we believe that the tests in paragraph 23, requiring consolidation of a Financial SPE, of the Exposure Draft should be expanded to include an additional test that assesses whether an enterprise has a majority of the variable interests.

In addition to the comments on paragraph 23 above, we have several detailed comments and/or observations regarding paragraph 23 of the Exposure Draft. It is unclear in paragraph 23a of the Exposure Draft whether the FASB intended as a general principle to include parties, such as financial guaranty insurers, that may exercise certain protective rights included in their financial guaranty contract, such as the replacement of the servicer of the assets or requiring sale of the assets to mitigate loss. We do not believe these rights should meet such a test as the guarantor can only require sale and not purchases and the discretion exercised is to limit losses, not recognize gains.

It is unclear whether the FASB intended, in paragraph 23b of the Exposure Draft, that guarantors of the senior most debt class would be considered subordinate to the interests of other parties when in fact the transaction had been designed with significant subordination before the guaranty. We suggest that the FASB recognize the involvement of third-party rating agencies and the substance of these transactions. For instance, the underlying ratings of the guaranteed beneficial interest or bonds could be used to determine whether or not the guaranty is considered effectively a subordinated interest or not. An underlying rating of the senior note that is high investment grade would indicate significant subordination before consideration of any guaranty.

We believe paragraph 23c (including paragraph 19) is meant to address only service contracts (such as servicing or asset management) as financial guaranty contracts require the delivery of an asset and would always fail the market-based fee test as a financial

guaranty contract is seen as a variable interest. We recommend that additional language be added to paragraph 23c of the Exposure Draft to clarify that point.

We believe that additional disclosures would enhance a readers understanding of the nature of any financial interest or contract that was not initially considered a variable interest resulting in the enterprise being considered a primary beneficiary. We do not believe that requiring consolidation and perhaps later deconsolidation of SPEs serves the interests of readers of financial guarantors' financial statements. For instance, additional disclosure could be required detailing the nature of assets underlying financial interests or contracts involving troubled transactions rather than consolidating those assets and subjecting the consolidating entity to financial accounting principles and their related mixed attributes (assets may be at fair value or require further declines in value to be reported as impairment losses whereas liabilities are at cost). The Securities and Exchange Commission's Staff Accounting Bulletin No. 60 ("SAB 60") already requires disclosures in the financial statements of financial guarantors. SAB 60 states, in part, that:

The staff believes that the disclosure should cover matters such as the following:

A general description of the type of obligations guaranteed (e.g., corporate, municipal general obligation, industrial revenue, etc.), the relative amount and range of maturity dates of each, and the degree of risk involved.

The amount of exposure with respect to the debts of others guaranteed at the date of each balance sheet presented including a discussion of how the participation by other parties and other factors that may reduce exposure are treated in determining the amount reported.

The manner in which the registrant recognizes revenue with respect to the guarantees.

The amount of unearned premiums as of the date of each balance sheet.

Whether the registrant provides a reserve for losses by charges against income and, if so, the basis for the reserve and its amount at each balance sheet date.

Any other information that may be necessary to adequately describe the nature and extent of the obligations guaranteed and the degree of risk related to the guarantees.

We believe the FASB should reconsider the transition provisions in the Exposure Draft due to the disruption that will be caused in the marketplace. We suggest a transition

similar to the one provided by the FASB in its deliberations of FAS 140. Paragraph 25 of FAS 140 provides that:

A formerly qualifying SPE that fails to meet one or more conditions for being a qualifying SPE under this Statement shall continue to be considered a qualifying SPE if it maintains its qualifying status under previous accounting standards, does not issue new beneficial interests after the effective date, and does not receive assets it was not committed to receive (through a commitment to BIHs unrelated to the transferor) before the effective date. Otherwise, the formerly qualifying SPE and assets transferred to it shall be subject to other consolidation policy standards and guidance and to all the provisions of this Statement.

We believe this rationale could be utilized as a transition rule for this standard. SPEs that do not accept further transfers that have not already been committed before the effective date and do not issue new beneficial interests after the effective date would be subject to existing consolidation guidance.

If a representative of the Financial Accounting Standards Board wishes to discuss the contents of this comment letter or other matters that may arise during the re-deliberations of this proposed financial reporting guidance, please contact Bruce E. Stern, General Counsel and Managing Director of FSA, at (212) 339-3482 (Bstern@FSA.com).

Sincerely,



Bruce E. Stern,  
General Counsel and Managing Director of  
Financial Security Assurance Inc.,  
on behalf of the following AFGI Members:

ACE Guaranty Re Inc.  
Financial Security Assurance Inc.  
MBIA Insurance Corporation  
Radian Reinsurance Inc.  
RAM Reinsurance Company  
XL Capital Assurance Inc.