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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

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Dear Ms. Bielstein:

Citigroup is pleased to have the opportunity to provide comments on the Board's Exposure Draft, *Proposed Interpretation, Consolidation of Certain Special-Purpose Entities, an interpretation of ARB No. 51* (the "Exposure Draft" or "Interpretation"). As a consultant to the Board for this project, we have been following its development closely and have provided written comments to the Board regarding several preliminary drafts of the Interpretation. Recognizing that the existing literature relating to special-purpose entities ("SPEs") is fragmented and incomplete, we continue to support the Board's goal of developing a cohesive and comprehensive standard for determining when consolidation of a special-purpose entity is appropriate.

We support the Board's attempt to move away from rules-based standards and toward principles-based accounting standards, but the principles in this Interpretation are not defined well enough and there are numerous rules embedded within its principles without adequate explanation. Notwithstanding this comment, we support the three-part approach (voting interests, variable interests, and financial SPEs) established in the Exposure Draft for evaluating whether an SPE should be consolidated. However, we still have significant problems with the proposed guidance that need resolution. Some of these problems arise because the Board has tried to integrate the numerous rules relating to qualifying special-purpose entities from Statement of Financial Accounting Standards No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities ("FAS 140"), into the definition of SPEs that hold certain financial assets ("financial SPEs"). Other problems arise from the rules for defining acceptable equity investments and market-based fecs.

We believe that financial statement preparers and their auditors should be encouraged to exercise reasoned judgment and also that any issued guidance should not attempt to explicitly answer all possible questions. In its effort to complete work on this Interpretation expeditiously, however, the Board should not underestimate the considerable difficulties that financial statement preparers will face in trying to

implement the Interpretation, especially if these implementation issues are not clarified. The last thing preparers and auditors want is to repeat the painful processes that accompanied the issuances of FASB Statements No. 125, 133 and 140 that necessitated voluminous interpretations post issuance. However, the preparer community has so many unanswered questions about the Exposure Draft that we fear a repetition of those earlier implementation difficulties, particularly considering the extremely short and, we believe, inadequate transition period the Board has proposed. We are concerned that the lack of clarity on many important issues will lead to vastly different conclusions by preparers, resulting in financial statements that are not comparable for companies with similar usage of SPEs.

We agree with the Board's statement that under the Interpretation, "SPEs that effectively disperse risks would not be consolidated unless a single party holds an interest or combination of interests that effectively recombines risks that were previously dispersed." However, we do not believe the Exposure Draft achieves this principle, because the principle outlined is not supported by the underlying rules. In our view, despite the Board's public statements, the Interpretation does not accommodate many legitimate, non-abusive, risk-dispersing securitizations of financial assets that are commonplace in the financial markets. Without significant and costly modifications of contractual terms and organization documents, a great many asset-backed commercial paper conduits ("CP conduits"), securitizations of collateralized debt obligations ("CDOs") and structured investment vehicles ("SIVs") will not meet the criteria for financial SPEs described in paragraphs 22 and 23.

We disagree with the Board's decision that consolidation of an SPE is appropriate when less than a majority of the variable interests are in the hands of one party. The Exposure Draft is not an interpretation of existing generally accepted accounting principles, but rather is an entirely new principle. Consistent with Statement of Financial Accounting Standards No. 94, Consolidation of Subsidiaries ("FAS 94"), we do not believe effective control can be achieved without holding at least a majority of the variable interests, particularly since the definition of variable interests includes many items such as derivatives that do not provide voting rights or decision-making authority. While FAS 94 does not require that the parent receive a majority of the risks and rewards, it does require the parent to hold a majority of the voting interests, thereby demonstrating real control of the subsidiary. Further, we believe the Board's concept that a party with a significant amount of variable interests, which interests constitute a significant portion of the significantly variable interests that are significantly more than those held by any other party is unworkable.

If the Board's objectives in issuing this Interpretation are achieved, more SPEs will be consolidated. However, if inappropriate (in our view) consolidation is required of entities that are not controlled, financial statements will be distorted. Balance sheets will include

assets to which creditors have no claim and liabilities for which the reporting entity has no obligation. As a result, financial statements will be less transparent than they are today and analysts will have to segregate such assets and liabilities in evaluating the reporting entity.

Another consequence of consolidation is that many entities will be reporting assets that are marked to market (available-for-sale investments or trading account assets), while the newly recorded liabilities will be recorded at amortized historical cost. We see this imbalance becoming a particularly important issue for financial institutions. Thus, consolidation will introduce inappropriate volatility (that is, volatility that is created solely by accounting) into the primary beneficiary's financial statements – the income statement if the SPE's assets include securities that are classified as trading and the balance sheet if they are classified as available-for-sale.

In light of the above concerns and our more detailed comments below, we request that the Board revisit the issues, articulate its objectives more succinctly, clearly define the governing principles of the Interpretation, and then dispense with some of the detailed rules that give rise to many of our concerns.

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The remainder of this letter contains our specific comments on various aspects of the Exposure Draft.

Scope

The Interpretation should contain a definition of an SPE. We understand that the Board struggled with trying to develop a definition in earlier drafts of the proposal, but without a definition the scope of this interpretation seemingly applies to all entities that are not substantive operating enterprises ("SOEs"). SOEs themselves are only sketchily defined in the Interpretation. We believe clearer definitions are needed of both SPEs and SOEs.

Consolidation Based on Voting Interests

We note that paragraph 9 does not require that an equity investment must be equity in legal form as previous drafts of the Interpretation did. We support this change. As we have noted in our previous comment letters to the Board on this project, we believe that so long as an investment absorbs the first losses, is subordinate to all other interests in the SPE, provides its holders with voting or similar rights as described in paragraph 9(a) and meets the other conditions in paragraph 9, it should be eligible to be considered "equity" for purposes of this Interpretation.

We appreciate the Board's decision to soften the earlier proposed definitive 10% minimum equity investment by acknowledging that under certain circumstances a lesser amount of equity may be sufficient to demonstrate independence and financial substance. If an SPE can demonstrate that it can finance its own operations in the capital markets without reliance on variable interest holders even with less than a 10% equity investment OR has equity comparable to businesses that engage in similar transactions with similar risks, we think that should provide sufficient evidence to justify non-consolidation.

However, the third sentence in paragraph 12 imposes an additional requirement for determining the sufficiency of an equity investment. It says, "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." We believe this requirement is excessive. Given that the definition of an SPE is very broad, it may not be possible to compare an SPE's equity levels to comparable businesses that are not SPEs. Hedge funds and mutual funds are also likely to be considered SPEs under the Exposure Draft. While commercial or investment banks may conduct activities similar to an SPE, they conduct a broader range of activities than any SPE. The Interpretation is not clear about just how similar activities must be to be acceptable for comparison purposes.

We further believe that paragraph 9(e) is overly restrictive in precluding an equity owner from using the voting interests alternative for consolidation analysis if the owner holds any other interests in the SPE. For example, if an SPE has total equity equal to 25% of the SPE's assets and an asset manager charging the SPE a market-based fee (that would be deemed variable under paragraph 19 due to the asset manager's equity interest) holds a modest amount of that equity (say no more than 15% of the total 25%), why should such a holding nullify the legitimacy of the remaining equity (85% of the total 25%)? If sufficient unrelated third-party equity exists to demonstrate that the SPE can finance its operations independently, the SPE should not be forced to proceed to the variable interests alternative method.

Consolidation Based on Variable Interests

We believe that a party should not be designated the primary beneficiary if it has less than a majority of the variable interests as discussed in our introductory comments above.

We also think the requirement to determine whether *significant* variable interests comprise a *significant* portion of the total financial support that is *significantly* more than the support provided by any other party is virtually unworkable. While we do support preparers exercising reasoned judgment, there are so many judgments regarding the term "significant" to be made in applying this concept that we believe it is highly unlikely that preparers will apply this guidance consistently. Similar difficulties exist with other

aspects of the Interpretation that attempt to explain what a variable interest is and how to compare variable interests of various parties to the SPE (see *Identifying and Comparing Variable Interests* below).

Reconsider Consolidation Decision at Each Reporting Date

In our view, the requirement to reconsider the determination of which party is the primary beneficiary at each reporting date is excessive. We believe it would be appropriate to reevaluate this decision only when there is a triggering event that affects the variable interests of the party making the determination. Changes may occur to the variable interests held by other parties without the knowledge or consent of the party making the determination. In such a case, we do not see how the party making the determination could possibly be deemed to have become the primary beneficiary or to have acquired effective control of the SPE.

Moreover, as a major financial institution, Citigroup would have to reconsider whether its consolidation determination continues to be appropriate for close to a thousand SPEs. This would involve reviewing changes to our own variable interests as well as those of all parties to the thousand SPEs that have variable interests. Such information may not be available, nor would we necessarily know the identity of all of these parties. However, if a "majority of variable interests" standard was the rule, it would be easier to determine whether we held that majority, because we would not also have to consider whether any other party held a significantly larger minority of the interests than we did.

Market-based Fees

Fees should not be presumed to be non-market-based. Rather, we think the Board should set an objective standard for determining whether a fee is market-based or not. Further, we fail to see how financial institutions could "get away" with charging non-market-based fees for any significant portion of the SPEs to which it provides services. Why would investors continue to invest in vehicles that overcharge them when there are many other possible investment opportunities? The CP conduit market, for example, is highly competitive. Several institutions compete to become the administrator for each deal. However, this bidding is not an open process and each institution does not know what other interested institutions offered. In other SPEs, fees are negotiated with investors or their representatives.

We believe that the determination of whether a fee is market-based should be an objective decision and should not be overridden when considering other relationships that a fee recipient has with the SPE. It should be acceptable to demonstrate that a fee is market-based in one of several ways, including by reference to competitors' fees, by a bidding process, and by reference to fees an institution charges to other entities. Once a fee is

determined to be market-based, the fee should be excluded from the comparison of the variable interests of all parties to the SPE, including related parties of the fee recipient. Paragraph 19 says that "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...." We believe the presence of other variable interests held by a service provider should not preclude fees from being considered to be market-based fees. Accordingly, we think the words "unless the holder has an investment at risk" should be removed.

An earlier draft of the Interpretation said that a fee that was a residual interest was not market-based. However, a market-based fee could be a residual or a portion of the residual, if it was a performance fee. Such a fee could well be comparable to fees of other competitors. The earlier language is absent from the Exposure Draft. In one of our earlier comment letters to the Board, we noted that many performance fees are calculated based on a percentage of the entity's results. The equity investors are entitled to the remainder of the results. We believe such a performance fee should not prevent a fee from being considered to be market-based, and that the Board needs to clarify this point.

Silos Within a Legal Entity

We believe that all parties to an SPE that meets the conditions of paragraph 17 (that is, "if contractual or other legal provisions or agreements substantially restrict an enterprise's rights and obligations to specifically identified assets of an SPE and the interests of the creditors of the SPE apply equally to all of the SPE's assets") should evaluate whether they are the primary beneficiary using the same basis for analysis. For example, in a multi-seller CP conduit, each seller's rights and obligations are limited to the assets it transferred into the conduit. Accordingly, each seller would evaluate whether it is the primary beneficiary by comparing its variable interests to the pro rata share of the variable interests of other parties to the conduit that relate to the assets the seller transferred (a "silo"). However, it should be made clear that the administrator (or other parties) should also evaluate whether it is the primary beneficiary for the CP conduit on a silo-by-silo basis. Because it is not clear that the administrator can also make this analysis on a silo-by-silo basis, it would be possible for each seller to consider itself the primary beneficiary of its silo while the administrator considers itself the primary beneficiary of the entire CP conduit, resulting in more than one party consolidating the same silo. In paragraph B19, the Board appropriately notes that one of its objectives is to avoid reporting the same assets and liabilities in the consolidated financial statements of two (or more) unrelated entities. Unless the Board fixes paragraph 17, that outcome will be possible.

Identifying and Comparing Variable Interests

We do not understand how a referral agreement could be a variable interest (paragraph 18(e)). The referring party will earn a fee if a client is referred to the SPE, but earns no fees if no referrals are made. The referring party has no risk of loss and would not need to make any significant investment in order to earn its fee.

Paragraph 18.j. of the Exposure Draft identifies derivative instruments as one way that a variable interest can arise. We think this is inappropriate for many derivative financial instruments, since derivatives are already accounted for under FASB Statement No. 133, Accounting for Derivative Instruments and Hedging Activities ("FAS 133") (see our other comments on Derivative Financial Instruments below). In fact, for a counterparty to a derivative with an SPE to consolidate the SPE solely because of the derivative would often amount to the counterparty's recording the notional amount of the derivative on its balance sheet, a result which FASB specifically rejected in developing FAS 133. The Exposure Draft would effectively be creating two separate standards for accounting for derivatives, one for derivatives entered into with SOEs and a different standard for derivatives entered into with SPEs. We think this would be inappropriate.

As noted above, we believe that the characterization of a market-based fee as variable or not variable should not depend upon other connections the recipient has to the SPE. The measurement of variable interests should include only interests that actually are variable, such as an equity investment or a guarantee. Combining non-variable interests with variable interests for purposes of aggregating and comparing the total variable interests of parties to the SPE is unfairly biasing the determination of the primary beneficiary.

The Board defines a variable interest 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 do not understand how a fee or an incremental investment can provide the SPE with the financial support required by the Board's definition. A fee is earned if work is performed, but in the event the SPE has losses no support is forthcoming from the fee recipient. In the worst case, the fee will simply not be paid. Similarly, an incremental investment could be lost; however, investors receive no support as a result of the incremental investment. Therefore, an incremental investment does not seem to meet the Interpretation's definition of a variable interest in paragraph 7(b).

We continue to disagree with the notion that making a significant incremental investment in a business in order to earn a fee has an equivalent risk of loss as purchasing an equity interest in an SPE. Nor should such an incremental investment change the determination of whether a service provider's fee is variable or not. All businesses make investments in staff and facilities. However, this concept penalizes the service provider for the first SPE

to be established in a product line, while subsequent SPEs using the same service provider would not have any significant incremental investment since the service provider uses the infrastructure set up for the first SPE.

Paragraphs 20 and 21 ought to make it clear that, if two enterprises have comparable expected losses, it is possible that neither enterprise is the primary beneficiary, since neither has significantly more variable interests than the other. In the introductory summary, the Board states that SPEs that effectively disperse risks would not be consolidated unless a single party holds an interest or combination of interests that effectively recombines risks that were previously dispersed. The Basis for Conclusions (paragraph B16) also discusses this in relation to certain SPEs as described in paragraphs 22 and 23. This guidance is important and should be part of the standard itself, not just the summary and the appendices.

We believe the guidance in paragraph 21 is unnecessary. If two parties have similar expected future losses (calculated in accordance with Statement of Financial Accounting Concepts No. 7, *Using Cash Flow Information and Present Value in Accounting Measurements*) arising from their variable interests, the relative subordination or dominance of those interests would have been taken into account in determining the probabilities of various future loss scenarios. Thus, neither party will have significantly more variable interests than the other and neither party would be the primary beneficiary.

SPEs That Hold Certain Financial Assets ("financial SPEs" or "FSPEs")

We support the Board's objectives in creating FSPEs as a special category as explained in paragraphs B19 and B20:

B19. 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 [emphasis added].

B20. The Board believes that appropriate application of the provisions of this Interpretation would not result in consolidation of SPEs that effectively disperse risks. However, to simplify implementation and improve consistency, the Board decided to provide additional, more specific guidance on how to analyze one class

of risk-dispersing SPEs, which are described in paragraph 22. That class of SPEs hold certain financial assets, have limits on their activities and the interests they can issue, and are legally isolated from the enterprises that hold interests in them [emphasis added].

With the exception of the clause in B20 that discusses legal isolation¹, we believe this guidance is critical to evaluating FSPEs and it belongs in the actual standard, not only in the Basis for Conclusions.

However, paragraphs 22 and 23 fail to fully achieve these objectives. The paragraphs fail because they adhere too closely to the model for qualifying SPEs ("QSPEs") presented in FAS 140. We describe our views below on how the Board can remedy the matter. Further, we request clarification on aspects of both the definition of an FSPE and the criteria in paragraph 23.

Because the Board's objective is that risk-dispersing SPEs not be consolidated, we believe that it should be easier for a party to an FSPE to meet criteria for non-consolidation under paragraphs 22 and 23 than under the variable interests approach. However, that is often not the case. The FSPE concept is incomplete because it ignores other parties that may have variable interests as described in paragraphs 13-21 and, indeed, may hold a majority of the variable interests as described in those paragraphs while not failing two out of the three criteria in paragraph 23. This creates an opportunity for SPE "arbitrage" under which a sponsor/creator will set up an SPE to be an FSPE (or not) based on its evaluation of which party, if any, may need to consolidate. More importantly, because paragraph 23(a) does not require that the authority to purchase and sell assets significantly benefit the party evaluating whether it should consolidate the FSPE, and because paragraph 23(b) contains no minimum threshold level of subordinated interests, it also creates a possibility that a party with a trivial amount of the subordinated variable interests (as defined in the main body of the Interpretation) could end up consolidating – a result that we strongly oppose.

To fix this problem the Board should revise paragraph 23 to require that parties that meet its criteria are the only parties *eligible* to consolidate. That does not mean, however, that those parties should consolidate. Instead, an eligible party would consolidate the FSPE only if it was also the primary beneficiary of the FSPE.

We recommend this solution because we sense the Board's goal is to require those parties that manage an SPE's assets *primarily for their own benefit*, to consolidate. We agree

¹ Legal isolation is a concept from paragraph 9 of FAS 140 that relates only to the criteria that a transferor of financial assets must meet to obtain sales treatment for the transfer. It does not apply to qualifying SPEs or to other parties to a securitization transaction. A more appropriate statement might be that an FSPE is demonstrably distinct from the various parties to the transaction.

with this objective; however, at times the Exposure Draft's current model captures all parties that manage assets, even those that do not benefit from this management activity or benefit only in secondary or tertiary ways. For example, consider the manager of an investment company that invests in bonds that charges a fee that is a fixed percentage of assets. The fund manager does benefit, but only secondarily, to the extent that its investment performance is superior. Assume further that it is not possible to overcome the assumption that the fee is not market-based. Under the Exposure Draft, the management company would consolidate – a result that we consider highly inappropriate, because it is the investors that principally benefit from the investment management services and, as a class, hold the great majority of the variable interests.

Definition of an FSPE

We disagree with the Board's general approach of basing the definition of an FSPE on that of a QSPE as defined in FAS 140. We note that FSPEs are permitted greater discretion in asset management than a QSPE and we agree with that proposal. It seems to us that it is equally appropriate that an FSPE be permitted greater discretion in the areas of liability management and investments in derivative instruments. We fear that, unless the Board clarifies the definition of an FSPE in the manner we suggest, few actual SPEs can meet the Board's definition of an FPSE (except those that are already QSPEs not holding equity instruments).

Liability management: It is quite common in some SPEs (like CP conduits), for the administrator to be able to exercise some discretion in issuing or rolling over beneficial interests in the SPE. We understand that the Emerging Issues Task Force is seeking to clarify the appropriate level of discretion that a QSPE can have with respect to liability management in Issue 02-12, Permitted Activities of a Qualifying Special-Purpose Entity in Issuing Beneficial Interests under FASB Statement No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities. It seems quite appropriate that FSPEs be afforded greater discretion in this area, just as they are permitted greater discretion in purchasing and selling assets. Having the ability to select various maturities for beneficial interests does not alter the risk-dispersing nature of an FSPE, nor does it necessarily benefit the party with the discretion. For example, in our CP Conduits, any variability in interest rates paid to investors is borne by the sellers to the conduit, not by the administrator.

Derivative Financial Instruments: We believe that, since an FSPE is not limited to a buy and hold investment strategy (although this flexibility is constrained by the paragraph 23(a) criterion), it should not be limited by FAS 140's restrictive provisions related to derivative instruments contained in paragraphs 39 and 40. For example, FAS 140 says that QSPEs can enter into derivative contracts only at the time when beneficial interests are issued. If assets can be added or removed from the FSPE at any time, why should

entering into derivatives be restricted to when beneficial interests are issued? Moreover, if the investment management does not have to be passive, why do derivatives have to be passive?

It is not that we observe many SPEs conducting what we would describe as "active" derivatives trading programs, but rather that derivative financial instruments often are an integral part of the risk management or investment strategy of several common types of SPEs. For example, in a typical CP conduit, the administrator is required to manage foreign exchange or interest rate risk prudently. The administrator typically has (and requires) greater discretion than that permitted a QSPE in FAS 140. Similarly in many CDOs, a portion of the investments are in credit default swaps. Such investments are common in many CDOs, since they enable the CDO to diversify synthetically into credit risks that would otherwise be unavailable in the marketplace. We note that when a CDO purchases a credit default swap, that CDO is dispersing the risk of the underlying reference credit to the investors in the CDO. Accordingly, under the Board's view that risk-dispersing SPEs should not be consolidated by any party to the SPE (paragraph B19), CDOs issuing credit linked notes should qualify as FSPEs if other FSPE criteria are met.

In particular, we request that FSPEs be allowed the same level of discretion to enter into derivatives as is proposed for purchases and sales of financial assets. Further, under FAS 140, a derivative financial instrument in a QSPE is not allowed to "pertain" to risks resident in other derivative financial instruments in the QSPE. With the increased bifurcation of embedded derivatives resulting from the proposed Amendment to FAS 133, there will be a greater number of instances where a derivative in an SPE will be deemed to pertain to other derivatives in that SPE. We believe this soon-to-be requirement should be loosened for FSPEs. We do not understand why such a restriction is necessary for FSPEs. We would agree, however, that total return swaps would not be appropriate for FSPEs, since they concentrate the risks of the assets in one party. In addition, deep-in-the-money call options on all of an SPE's assets would also be inappropriate for an FSPE, because such a call option gives the holder effective control over the SPE's assets.

After having evaluated many of our SPEs under the Board's proposal, we are very concerned that few, if any SPEs actually comply with the existing derivative restrictions for QSPEs. For example, our CP conduits have the right to enter into prudent derivative transactions that do not met FAS 140's restrictions on derivatives in QSPEs. Thus, they would not fit into the FSPE category we believe the Board created for such vehicles. A second large class of SPEs – CDOs – often enter into derivative financial instruments that are either not strictly passive (in managed CDOs) or arguably "pertain" to other

derivative financial instruments². Our point is that the universe of FPSEs as the Exposure Draft defines them is much smaller than we believe the Board intends.

Criteria for Determining a Potential Consolidator

23(a) Purchases and Sales of Assets – We do not believe this test is specific enough. Typically, an asset manager that can purchase and sell assets will be able to affect the revenues, expenses, gains and losses of the SPE to some extent and perhaps even significantly. We do not see that as the relevant question. A more relevant test would be whether the asset manager directly and significantly benefits from the activity. We agree with the Board's wording requiring that the party have discretion over purchases and sales, since without authority to conduct both activities there is little ability to control the SPE.

23(b) Guarantees, Liquidity Facilities and Asset Support – The intended meaning of this paragraph is unclear to us. Does the phrase "... that is subordinate to the interests of other parties" modify only "asset support" or does it also modify the whole previous portion of the sentence? Also does paragraph 23(b) contemplate indirect forms of credit support, like back-to-back guarantees, or residual equity interests? We believe that the Board intends to include instruments that provide indirect liquidity or asset support in this test only if these facilities are subordinated. However, that is not clear from the document. We do note that most liquidity facilities are not subordinated to the beneficial interest holders. All these facilities are very common, so it would be quite helpful if the Board would clarify its intentions with respect to this paragraph.

We think it is critical that the Board establish a minimum threshold for applying this criterion. As it is currently worded, the existence of any subordinated facility would be sufficient to cause a party to fail the criterion. There should be some recognition that when a credit facility is senior to other asset protections in the SPE, the expected losses under these senior interests could be nil. Just as in the variable interests approach where a variable interest has to be a significant amount before it is included in the primary beneficiary evaluation, a minimum level should exist here as well for the interest to be disqualifying for an FSPE.

23(c) Market-Based Fees - See our comments above.

Disclosure

We support the disclosures required in paragraph 24. However, we think the paragraph 25 requirements are too inclusive. We would not support providing this information for

² Although this issue to some degree depends on the Board's deliberations on its project to amend Statement 133.

services such as custodial services, payment agent, trustee, or registrar and transfer agent services that might be considered "administrative." We do not really think the Board intended to include such services in the scope of paragraph 25, but this needs clarification. Moreover, we do not support providing such disclosures for placement agents. Placement agents may not have continuing relationships with an SPE that would justify the proposed disclosure, unless they also agree to make a market in the SPE's beneficial interests. In this case, the relationship with the SPE is no different than with numerous other non-SPE issuers in whose securities the placement agent makes a market. Also, if the placement agent had no continuing involvement with the SPE, would the proposed disclosures be required only in the period the SPE issued beneficial interests to investors?

Effective Date and Transition

We continue to believe that it is unfair to penalize existing securitization transactions that do not serve to hide losses, entered into in good faith in reliance upon current accounting guidance, and think there should be some grandfathering provisions in the Interpretation. These SPEs should be allowed to continue being treated as off-balance-sheet entities without performing the analysis required under the Interpretation as long as they do not expand their activities by entering into new deals.

Paragraph 26 requires immediate application to new SPEs upon issuance of a final Interpretation by the FASB. While we understand and support the Board's general objective here, it is not reasonable to expect market participants to appropriately interpret and *immediately* apply such a complex document to highly detailed fact patterns. Many transactions are quite complicated in structure and take a significant period of time to close. Requiring immediate application will force market participants to guess what the final Interpretation will say. This would be very disruptive to the markets. Instead, we ask that the Board provide a short period (say six months) from the date of final issuance that will allow market participants to read, digest and fully incorporate the new provisions into their structures. We also request that the Board address this portion of the transition guidance early in its redeliberations to remove uncertainty in the marketplace. We note that this will not help those seeking to avoid the Interpretation's provisions (or at least not for long) since no grandfathering is provided.

Similarly, existing structures will need time to evaluate whether they comply with the conditions for non-consolidation under one of the three approaches in the Interpretation. If not, they will need to evaluate what changes could be made to the SPEs to bring them into compliance. Such changes could require investor and rating agency approvals, changes to all the contracts and legal documents, and possibly new registration statements or offering memoranda. This process will need to be repeated for hundreds of SPEs in the major financial institutions. Completing this process by the second quarter of 2003

will be extremely difficult. We would therefore request the Board to extend the effective date to the fourth quarter of 2003. We support the Board's decision to report the initial application of this Interpretation as a cumulative effect of a change in accounting principles.

The Interpretation should also clarify that changes needed to bring existing SPEs into compliance would not disqualify a financial SPE from eligibility to be considered an FSPE, because those provisions were not in place from inception of the SPE. Such guidance was made explicit in FAS 140's transition guidance and should also be included in this Interpretation.

Appendix A

Paragraph A3 includes "acting as a counterparty to a derivative contract" as an activity subject to the Interpretation. We believe this is too inclusive. Significant participants in the derivatives markets have thousands of derivative positions on their books at any given time. Our derivative counterparty records are not organized in such a way that it is possible to easily determine which counterparties are SPEs. It would be a massive task for many major participants in the derivatives markets to have to evaluate each derivative trading position to determine whether there was any possibility that the participant could be considered the primary beneficiary. Accordingly, we think that the scope of this paragraph should exclude derivatives where the reporting entity's only involvement with the SPE is as a counterparty to a derivative contract other than a total return swap or a deep in the money purchased call option. As we have noted above, a total return swap is a risk concentrating instrument that should be evaluated as a variable interest, while a deep-in-the-money call option gives the holder effective control over the asset that is subject to the call.

We would be pleased to discuss our comments with you at your convenience.

Sincerely,

George C. Schleier

Vice President and Deputy Controller

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