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Financial Accounting Standards Board
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Letter of Comment No: 40
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Re: File Reference No. 1082-200

Proposed Interpretation, *Consolidation of Certain Special Purpose Entities, an Interpretation of ARB No. 51*

Dear Ms. Bielstein:

ABN AMRO in North America (ABN AMRO) is a provider of diversified financial services including commercial, investment and retail/consumer banking; brokerage and trust services; and investment management. We have a substantial role in the multi-seller asset-backed commercial paper market as an administrative agent, are engaged in the collateralized debt obligation market as the trustee for many customer transactions, and are active in various other securitization and leasing activities involving special purpose entities. More importantly, we are a major user of financial statements and rely on their integrity and transparency as a commercial lender and investment manager. As both a user and an issuer of financial statements, ABN AMRO is pleased to present our views regarding the Financial Accounting Standards Board's (FASB or Board) Proposed Interpretation, *Consolidation of Certain Special Purpose Entities, an Interpretation of ARB No. 51* (the Proposed Interpretation).

ABN AMRO strongly supports the Board's efforts to improve the transparency and comparability of financial statements by addressing accounting consolidation rules applicable to special purpose entities (SPEs), and we appreciate the urgency with which the Board has recently addressed these consolidation issues. We agree with the Board's position that most SPEs serve valid business purposes, and that the Board's objective should not be to restrict their use, but to ensure that an enterprise's involvement with SPEs is clearly and consistently communicated to financial statement users.

While we support the Board's objectives, we believe that the Proposed Interpretation requires significant revision to adequately meet those objectives. We are concerned that the Proposed Interpretation is so complex, requires so many estimates (that are likely to vary from enterprise to enterprise) and presumes access to information that is often not available, that there will be little consistency among financial statement issuers in applying the Proposed Interpretation.

We strongly support principles-based accounting standards that have broad application, rather than standards that provide an inventory of rules to apply because inevitably, an inventory of rules will not

adequately address every possible situation in practice. The Proposed Interpretation uses too many rules-based criteria, and establishes a complex web of rules designed to address specific transactions and prevent structurers from circumventing the rules. We believe that a more productive approach would be to establish key principles and an underlying conceptual framework that preparers should use to address these consolidation issues.

Finally, we are concerned that the conclusions reached under the Proposed Interpretation do not improve the transparency of financial statements. The Proposed Interpretation focuses primarily on the recent high-profile problems of nonconsolidation of SPEs and requires consolidation of SPEs, even in the absence of a controlling financial interest. We encourage the Board to consider the problems associated with *overconsolidation*, as well those of *underconsolidation*. While false negatives (where no consolidation is required by a party that does hold a controlling financial interest) impair transparency by omitting assets and liabilities that are material to an enterprise's financial condition and results of operations, false positives diminish transparency by including assets and liabilities in the consolidated statements of an enterprise that has no rights to the assets, and no responsibility for the liabilities. This requires users of financial statements to sort through the balance sheet to determine what assets are legally available to the enterprise, and what liabilities are legal obligations of the enterprise.

In the following sections, we address our major concerns and provide our recommendations to the Board.

Complexity of the Proposed Interpretation

The Proposed Interpretation is too complex and will be difficult to interpret and apply with consistency. We believe that a successful principles-based standard must set forth clearly what those principles are and must follow those principles consistently. Instead, the Proposed Interpretation requires application of multiple sets of rules for different categories of SPEs without any unifying concept. For example, SPEs must be classified as voting interest SPEs, variable interest SPEs, qualifying SPEs and SPEs that hold certain financial assets. We believe categories and various models have been created to address certain specific transactions by drawing distinctions without substantive differences, resulting in a confusing and inconsistent standard. We are concerned that financial statement preparers will have difficulty applying the Proposed Interpretation with consistency.

If even the most sophisticated financial statement preparers have difficulty interpreting the Proposed Interpretation, the vast majority of financial statement users will have little chance of comprehending its results. Without detailed knowledge of the consolidation rules and a complete understanding of an entity's transactions involving SPEs, a financial statement user will be at a loss to understand what causes consolidation or deconsolidation of an SPE, and how the entity's reported accounting results relate to its true financial position.

This complexity is even more problematic because of the brief transition period. There will be little time for practice issues to surface and be resolved before preparers need to apply the Proposed Interpretation.

To encourage consistent application, we believe it is incumbent on the Board to resolve these ambiguities and provide clearer guidance before issuing the Proposed Interpretation.

SPEs That Hold Certain Financial Assets

General Purpose

We understand that the Board recognizes that “while many SPEs benefit a primary beneficiary, some SPEs effectively diversify risks and potential benefits related to certain assets or activities” and that the special provisions of paragraph 22 and 23 were intended to avoid the consolidation of this class of SPEs. However, we believe that the Proposed Interpretation could actually require the consolidation of these SPEs, even in circumstances where the general variable interest approach would not require consolidation. We disagree with this conclusion and in particular, do not believe that the consolidation of multi-seller SPEs by the administrative agent would improve the transparency of its financial reporting. We do not believe that the complex financial SPEs the Board is attempting to address can satisfactorily be defined by fixing a finite set of rules or criteria. Instead, we encourage the Board to pursue a more conceptual approach by more clearly articulating the underlying principles for non-consolidation of financial SPEs, and providing examples of SPE structures that are consistent with these principles. However, if the Board retains a criteria-based rule for financial SPEs, below we provide some suggestions for improving the criteria specified in paragraph 22.

It is not clear to us that the types of SPEs the Board intended to address by this special model will in fact fit the criteria identified in paragraph 22. The restrictions on a qualifying SPE, as defined in FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, may be so restrictive that most multi-seller SPEs and SPEs used in collateralized debt obligation (CDO) transactions will not achieve qualifying status. For example, EITF Issue 02-12, “Permitted Activities of a Qualifying Special-Purpose Entity in Issuing Beneficial Interests under FASB Statement No. 140,” is expected to address whether a qualifying SPE may manage its beneficial interests by determining the terms of new beneficial interests, or by prepaying existing beneficial interests. Depending on the resolution of that issue, certain multi-seller SPEs may not be able to achieve qualifying status, and would not fall within the scope of paragraph 22. We recommend that the Board consider the outstanding practice issues regarding qualifying SPEs to ensure that paragraph 22 adequately captures the population of SPEs used to disperse risks and potential benefits related to financial assets.

Liquidity, Credit and Other Asset Support

Unlike the general variable interest model, which bases the consolidation conclusion on a variable interest that is significant and significantly larger than others, it is not clear that paragraph 23.b. has any absolute or relative size requirement for a variable interest that would require consolidation. So an enterprise holding a variable interest (for example, liquidity, credit or other asset support) that is very small as measured in terms of expected future losses, would nevertheless be required to consolidate the SPE if the enterprise also either has the discretion described in paragraph 23.a. or receives a non-market based fee, regardless of size.

Frequently, the administrative agent for a multi-seller SPE provides all or a portion of the program credit enhancement facility for the SPE as a whole, as well as transaction-specific liquidity facilities that provide liquidity for one transaction or silo of the SPE. These facilities are very rarely drawn upon, and provide protection only after the first loss interests retained by a transferor or held by another third party have been exhausted. So neither type of facility is expected to bear losses, and the providers of these credit enhancement and liquidity facilities receive fees that are consistent with this level of credit risk.

We recommend that the only interests taken into consideration under paragraph 23.b. be those interests that are expected to bear losses in the expected or base case, or if no interest is expected to bear losses in the base case, the first variable interest that bears unexpected losses. When measured on a silo basis, this recommendation would normally identify the first loss interests retained by the transferor, and exclude the program-level credit enhancement and liquidity facilities typically provided by the administrative agent to a multi-seller SPE.

Market-Based Fees

It is not clear to us what the Board intends by a *market-based fee*. In the first sentence of paragraph 19, the Proposed Interpretation refers to a fee negotiated at arm's length under competitive conditions. However, the last sentence requires that an enterprise assume a fee is not market-based unless it can find comparable fees in observable transactions. These are two very different standards. Certain classes of SPEs have very unique structures and compensation arrangements and there may be no similar observable transactions in the market. We disagree with the implication in the Proposed Interpretation that such a fee would be *prima facie* not market-based, even though it may have been negotiated between unrelated parties and investors, or resulted from a formal competitive bidding process.

General Variable Interest Model

Majority of Variable Interests as the Presumptive Consolidation Criteria

The Proposed Interpretation requires consolidation by an enterprise that provides a "significant portion of the total financial support that is significantly more than any other party." This criterion poses major operational challenges because it may be difficult or impossible to ascertain the investments of other parties involved in an SPE. In addition, we believe that there is little conceptual basis for one enterprise to change its consolidation conclusion based on the actions of an unrelated enterprise.

We suggest that the Board adopt an approach similar to that in ARB No. 51, *Consolidated Financial Statements*, and require consolidation by any enterprise that has a *majority* of the variable interests. Although we agree with the Board's comments in paragraph B17 that "a parent has never been required to have a majority of the risks and benefits from its subsidiary in order to consolidate that subsidiary," we believe that the variable interest concept in the Proposed Interpretation is very different from existing consolidation concepts and principles. EITF Issue No. 97-2, "Application of FASB Statement No. 94 and APB Opinion No. 16 to Physician Practice Management Entities and Certain Other Entities With Contractual Management Arrangements," and EITF Issue No. 96-16, "Investor's Accounting for an

Investee When the Investor Has a Majority of the Voting Interest But the Minority Shareholder or Shareholders Have Certain Approval or Veto Rights," both acknowledge that there are situations where a significant financial interest alone is not necessarily sufficient to require consolidation.

If the Board remains uncomfortable that a majority variable interest criteria would adequately capture all SPEs that should be consolidated, we recommend that the Board consider whether equity-method accounting may be appropriate in situations where the investor is at or near the consolidation margin under the Proposed Interpretation.

Should the Board ultimately retain the "significant portion/significantly more" concept in the Interpretation, we strongly believe that for simplicity, consistency and comparability, the final Interpretation should look to existing standards and practices for an analogy and set forth a benchmark as to what is a significant variable interest triggering first, the inquiries and analysis that the holder must perform and ultimately, potential consolidation. In this regard, we recommend that a party must hold at least 20% of the SPE's variable interests before it must conduct the analysis to determine whether it is the primary beneficiary and potentially has to consolidate the SPE. Use of 20% as a benchmark is consistent with the determination of significant influence for use of the equity method of accounting.¹ The corollary of this is that if no party holds 20% 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 proposed Interpretation's guidance.

Information Requirements

The consolidation guidance of the Proposed Interpretation is too dependent on the preparer's knowledge of the identity, investments, agreements, and actions of independent third parties and presumes a level of information that often does not exist in the market. The voting interest information required to apply ARB No. 51 and FASB Statement No. 94, *Consolidation of All Majority-Owned Subsidiaries* is usually available, but the information required to apply the variable interest model of the Proposed Interpretation is very often restricted in transactions. Investors are not aware of the identity of other investors (for example, whether the investors are substantive operating entities, individuals, or SPEs), the amount of investments those investors have made, or any related agreements or subsequent actions of those investors.

The Proposed Interpretation also is too dependent on an individual preparer's judgment regarding expected losses of its own investments and the investments of independent third parties. Paragraph 16 states that an SPE may have only one Primary Beneficiary, but then requires that a tie between variable interest holders be broken by the party with the largest variable interest. The relative size of a variable interest is determined by comparing expected future losses. The Proposed Interpretation presumes that all parties will reach the same judgment about future losses of the SPE and will each identify the same

¹ Accounting Principles Board Opinion No. 18: The Equity Method of Accounting for Investments in Common Stock, paragraph 17.

Primary Beneficiary. In reality, different enterprises may reach very different conclusions about expected future losses, and the Proposed Interpretation may lead to no consolidation or double-consolidation simply due to the judgment involved in the consolidation guidance.

We encourage the Board to revisit the operational aspects of the Proposed Interpretation and reduce an enterprise's reliance on the identity, investments, and actions of unrelated third parties when making its own consolidation conclusion.

Silo Approach for Administrators of Multi-seller SPEs

We support the silo approach discussed in paragraph 17 of the Proposed Interpretation, and agree that approach captures the substance of the transactions described in that paragraph. We believe the silo approach is also the most appropriate accounting for other enterprises involved in those transactions (for example, the administrator of a multi-seller SPE). Administrators do not usually fall within the current terms of paragraph 17, but a substantial portion of their rights and obligations relating to the SPE are directly linked to individual silos.

We recommend that the Board expand the silo approach to apply to all entities involved in the transactions described in paragraph 17, rather than limit the applicability to transferors. Without this change, the Proposed Interpretation may require an administrator to consolidate an entire conduit, even if one or more individual sellers to the conduit consolidate their own silo, causing the consolidation of one vehicle by multiple parties.

Periodic Reassessment

The Proposed Interpretation requires reassessment at each reporting date for the reporting entity to determine if consolidation of the SPE is appropriate. While we agree that the consolidation conclusion should not be a one-time evaluation, we are concerned that the primary beneficiary concept in the Proposed Interpretation could result in changes in the primary beneficiary of an SPE based solely on market events (such as deterioration in asset credit quality) or third-party actions (dispersion or consolidation of beneficial interest holders). We are concerned that these changes will lead to illogical consolidation decisions at subsequent dates – consolidation decisions that will make little sense to financial statement users, and have little connection to the underlying economics of a transaction involving an SPE.

Consider, for example, an enterprise that holds 30% of the variable interests in an SPE, and another party holds 40% and the remaining 30% is widely dispersed. Assume the 40% subsequently disposes of its variable interest to four unrelated parties, who buy 10% each. We disagree with the Proposed Interpretation's conclusion that the 30% holder has suddenly acquired a controlling financial interest through these transactions when it has taken no action itself and may not even be aware that the 40% holder has made these sales. We believe that an enterprise's consolidation conclusion – and the primary beneficiary designation – should change only based on actions by that enterprise, its related parties or its agents.

Transition

We recognize that the implementation of a new consolidation standard for SPEs is perceived as a matter of some urgency. We believe, however, that satisfying a deadline of April 1, 2003 (for calendar year-end enterprises) may be impossible for many SPEs in light of the work that must be done to evaluate an SPE under the new rules. In addition, changes in the underlying documentation for a multi-seller SPE might require disclosure to its commercial paper investors and sufficient time for commercial paper outstanding prior to such disclosure to rollover to investors who have been given appropriate disclosure.

We request that the implementation deadline be extended to SPEs still existing as of the beginning of the first quarterly period beginning after September 15, 2003. This would allow enterprises involved with SPEs additional time to evaluate their involvement and would still require the new consolidation guidance to be applied in the 2003 financial statements for calendar year-end enterprises.

In addition, we request that consideration be given to not consolidating SPEs that are being liquidated, where that liquidation decision has been made, and the necessary corporate mechanics have been implemented, prior to the effective date of the Proposed Interpretation, and where the liquidation will be completed prior to December 31, 2003. We believe that this is a practical accommodation to facilitate an orderly transition to the new consolidation standards, and avoids situations where a liquidating SPE is consolidated by the primary beneficiary for one or two quarters during the liquidation period.

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We appreciate your consideration of our comments on the Proposed Interpretation and hope our suggestions assist the Board in its decision with this matter. Should you have any questions or comments, please contact me at (312) 904-1221 or Bret Dooley at (312) 904-8276.

Very truly yours,



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