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MP&T Director – File Reference 1082-200  
Financial Accounting Standards Board  
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**Re: Exposure Draft – Consolidation of Special-Purpose Entities**

We thank the Financial Accounting Standards Board for the opportunity to comment on the Proposed Interpretation. We believe that the current guidance on this topic is unclear and that even without events such as Enron, a new standard in this area is overdue.

**General Approach**

The securitization and structured finance markets have seen the development of many structuring techniques that disperse risks associated with certain assets among many participants. Some of these structures effectively and transparently transfer risk, and some unfortunately merely hide risk in circumstances where it needs to be clearly disclosed. We believe that the Proposed Interpretation could require a party to consolidate legitimate, transparent, risk-dispersing structures such as CDOs, CLOs and transactions involving Multi-Seller Conduit Vehicles (“MSC”).

Many of our comments are rooted in the long-standing accounting convention that an entity should only record in its records, assets that it controls. We recognize that in many transactions, a transferor or other party retains a significant portion of the risk of the transferred assets, however, this does not mean that the party controls the assets. We believe that full consolidation of transactions where a party does not control the assets is as confusing for the reader of the financial statements as non-consolidation of assets that should be recognized. We believe that a consolidation standard for SPEs should consider this carefully in its application.

We also recognize that even though an entity does not control certain assets, the retention of the risk associated with those assets does warrant some accounting result. Our comments on the various sections of the Proposed Interpretation are consistent with this view of a general approach.

**Controlling Financial Interest**

As we stated before, we strongly believe that assets that are not controlled by an entity should not be fully consolidated by that entity. We understand the presumption of the FASB is that any entity that holds an amount of variable interests that is significantly larger than any other entity effectively holds a

controlling interest in the SPE. The presumption is simply false. In market-standard transactions, the variable interest rarely gives the holder any of the variable interest any control over the assets or the transaction. For example, many MSC transactions involve at least senior noteholders, liquidity providers, transferors and often involve third party credit guarantors. In these types of transactions, the holder of the most significant amount of variable interests is often the transferor. Notwithstanding holding the largest variable interest, the transferor usually has the least control over the assets because:

- (i) the transferor has normally met the provisions of FASB 140 which requires that the transferor not control or effectively control the assets (in addition, how can one comply with the control standards of FASB 140 and then presume control because of the holding of a variable interest? The underlying conceptual frameworks of these two standards seem to be at odds),
- (ii) the nature of the documentation normally requires that all parties agree on any changes to the documentation that governs the transaction, and therefore, the assets,
- (iii) the transaction documentation usually provides that if the transferor does not adhere to the provisions of the documentation such as proper servicing and cash remittance, then the transferor can be replaced as servicer and have no further involvement in the assets.

We also take issue with the determination of the primary beneficiary as it relates to the types of interests that may be viewed as variable interests. Most interests often do not convey any actual controlling financial interest over the SPE or its assets. For example, a third-party investor may hold a significant portion of a subordinated tranche or multiple subordinated tranches in a single transaction. The problem is that these types of securities rarely give the holder any rights to make any decisions concerning the assets. We believe that the new controlling financial interest concept will cause reporting confusion because there is no bright line threshold for consolidation.

The significant or significantly larger concept in determining the primary beneficiary also presents problems in application. Under the Proposal, an enterprise considering consolidation of an SPE is required to assess not only information relating to its own holdings and other relationships with the SPE, but also non-public information about the holdings and other relationships of other unaffiliated parties. This is particularly important in future periods where public or private trading of subordinate tranches may lead to a different conclusion if all information is known to all parties. The necessary information will often simply not be available. Sometimes this fact may lead to a consolidation conclusion, sometimes it will lead to a non-consolidation conclusion. In either case however, making these kind of judgements in a vacuum will always lead to inferior financial reporting.

Notwithstanding the analytical issues with the approach, the concept that a passive investor who has an appetite for risk could be forced to consolidate assets and liabilities with which it has little involvement or control will very likely impair capital flows in this area. Pricing efficiencies gained over the past decade through better dispersion of risk are at peril of being reversed under this consolidations approach.

### **Multi Seller Conduit Vehicles (“MSC”)**

Because MSC transactions are often market standard and are usually negotiated by arms-length parties, we do not believe that they should be consolidated in the normal course. We believe that this was also the FASB’s intent through paragraphs 22 and 23. We believe that the intent of the new category of SPEs

that holds financial assets was to allow MSC transactions to avoid consolidation through the new QSPE classification.

Unfortunately, we do not believe that these intentions have been captured in the Proposed Interpretation. Our issue is that entities such as MSCs often carry out activities that would not be allowed under the FASB 140 definition of a QSPE, but do seem to fit the intention of paragraphs 22 and 23. For example, we believe that a QSPE is restricted from purchasing multiple tranches of assets (because this requires subsequent decision-making ability on the part of the SPE), or from purchasing assets from different transferors (again, decision making ability). Notwithstanding our understanding of the QSPE rules, we believe that the QSPE defined in paragraph 22 of the Proposed Interpretation intended to include SPEs such as a MSC. In order to be clear, we feel that the Proposed Interpretation discussion of SPEs that hold financial assets needs to be more detailed to demonstrate precisely what kind of vehicles it is intended to capture.

### **Other Comments on Paragraphs 22 and 23**

Based on our understanding of the deliberations prior to the release of the interpretation, we were surprised to find that the overall analytical framework of the interpretation prescribes consolidation for many standard market securitizations of financial assets. We expected these types of transactions would not be subject to consolidation in the normal course. At this point we can only assume that paragraphs 22 and 23 were intended to capture and eliminate many of these transactions from consolidation, however, we do not believe this is accomplished by the current draft. We suggest that paragraph 23 be modified to preclude consolidation on legitimate risk-dispersing securitizations, as we had believed was the intended approach. Paragraph 23 clauses (b) and (c) should be eliminated and the paragraph should be modified to reflect that consolidation is only required when the following two conditions are met: (a) the potential consolidator has discretion of the type described in paragraph 23.a.; and (b) the potential consolidator has a majority of variable interests.

Many SPEs also directly originate assets through an origination agent. We believe it is possible to carry out these activities under a "limited powers" framework and comply with the current intent of 22 and 23. We feel the Proposed Interpretation needs to further clarify the channels through which a QSPE can acquire assets, and how often.

### **Multiple SPE Structures**

We realize that board deliberations on this topic addressed at length, the issue of multiple SPE transactions where one of the SPEs might be a QSPE. We notice that the FASB chose not to specifically prescribe consolidation in a situation where an originator sells asset to a QSPE and the QSPE funds the purchase of the assets by issuing a note to a MSC. We applaud the current approach. Any other approach might negate the QSPE approach that has been the focus of so much effort to date. Many securitizers have developed QSPE securitization structures in reliance on these established concepts and their good faith should not be rewarded with a complete reversal of accounting guidance.

## Presentation Issues

Without control over the assets, we do not support full consolidation. If the final Proposed Interpretation retains the presumption of a controlling financial interest (and the standard results in widespread proportionate consolidation of MSC transactions, CDOs, CLOs etc.), then we would propose a tiered presentation standard that would address the presentation goals of the FASB.

Our proposed presentation would involve a linked presentation that is similar to that used under UK GAAP. The Assets section of the balance sheet would have a separate section that presents the assets and liabilities of SPEs in which the entity has a "controlling financial interest" as determined by the primary beneficiary approach in the Proposed Interpretation. For example, a controlling financial interest in a SPE might be presented as follows:

Assets of ABC SPE	10,000,000
Related debt of ABC SPE	(9,000,000)
Subordinated interest of third parties	<u>(500,000)</u>
Net retained interest in SPE	500,000

The advantages of the linked presentation are as follows:

- (i) it would highlight the exposure of the entity to the assets;
- (ii) it would provide a better understanding that the assets have been pledged against a specific source of debt and that only the retained interest in the assets is available to general creditors of the entity (a critical point when considering the confusion that could ensue if readers assume that these assets are generally unsecured);
- (iii) many entities that use asset sales as a normal source of funding have covenants that measure balance sheet risk based on assets and liabilities. Full consolidation of assets and liabilities where the risk is actually limited may cause entities to breach such covenants when there has been no actual increase in risk.

The second tier of our proposed presentation involves full consolidation when an entity has a true controlling financial interest in the SPE. If, based on the transaction documentation and the provisions of the transaction, an entity has de facto control over the SPE, then full consolidation is appropriate.

## Transition Comments

We recognize that the implementation of new consolidation standards is urgent given recent developments in financial markets. However, the immediacy of the proposed transition timelines is not adequate for market participants to deal with its implications, especially for those issuers that entered current transactions in good faith in relying on the then-current guidance. The final interpretation should be effective for new transactions beginning in the first fiscal period beginning at least four months after the final interpretation is released. The transition period for pre-existing SPEs should be extended so that the provisions of the interpretation must be applied as of the beginning of the first interim or fiscal period at least nine months after the final release. Given the complexities of these transactions and the usual

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actual lack of control of any one party to unilaterally make the necessary changes, the timeline proposed above is in fact, aggressive.

We thank the FASB for the opportunity to participate in the comment process for this new standard. The structured finance market has become an integral part of North American capital markets and the effects of this new standard on those markets is likely to be significant.

Sincerely,

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