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Director of Major Projects and Technical Activities
Financial Accounting Standards Board
File Reference No. 1082-200
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Gentlemen:

CIGNA Corporation is pleased to comment on the FASB Exposure Draft (ED), *Consolidation of Special-Purpose Entities - an interpretation of ARB No. 51*.

We commend the FASB for quickly compiling understandable and generally sound and practical guidance in a complex area. We believe that much of the proposed guidance will improve financial reporting, and is clear enough for companies to interpret and implement. However, with respect to certain facets of the ED discussed below, we believe further clarification is needed to enhance the operability of the guidance and achieve appropriate consolidation results.

We disagree with the ED's conclusion in paragraph 19 that market-based management fees should be included in the calculation of variable interests whenever the holder has another interest in a special purpose entity (SPE). We offer the example of holding servicing rights along with an interest in securitized financial assets such as mortgages. The fees associated with servicing retained may be standard, arm's length compensation, independent of the return of the underlying mortgage portfolio. We believe that when fees are competitive (market-based), unsubordinated, and essentially represent fixed compensation for services, the amount of such fees does not represent a variable interest in the securitization and should not be included in the calculation of variable interests made to determine the primary beneficiary (PB). To be considered unsubordinated for this purpose, fees should have priority over other interests in the SPE and have no associated contingent liabilities or obligations other than management or servicing. Such arm's length fees could be excluded from the calculation of variable interests if they are not subordinated to other variable interests and are based on a fixed rate or on a fixed dollar amount. This stipulation

would distinguish them from fees that would be more appropriately considered variable interests because of their potential to vary significantly due to their subordinated nature and/or dependence on the market performance of a portfolio under management. We therefore recommend that the phrase "has an investment at risk" be deleted from the first sentence of paragraph 19, and that the Interpretation separately address the types of fees that would appropriately be considered variable interests. Also, we would like to point out that the market may contain sufficient comparable SPE management arrangements to determine that a fee was negotiated at arm's length, even though the negotiation did not take place "under competitive conditions." We therefore believe that this phrase, too, should be deleted from the first sentence of paragraph 19.

With regard to risk-sharing SPEs, we suggest that the provisions of paragraph 23a be more specific with respect to the criterion covering an enterprise's "authority to purchase and sell assets." We presume that this refers to the ongoing ability to manage the assets of the SPE, rather than the initial role of transferring assets to an SPE. Under SFAS 140 and, by analogy, for risk-sharing SPEs similar to QSPEs, the transferor should not be required to consolidate the SPE. The application of paragraph 23a to ongoing activities rather than to the initial transfer of assets to an SPE should be clarified.

Further clarification is also needed in paragraph 23a as to what constitutes "sufficient discretion" to "significantly affect the revenues, expenses, gains and losses of the SPE." Typically, the manager of a financial SPE operates within tight restrictions defined by the legally structured constraints on an SPE's activities. For example, a manager may have limited authority to buy and sell a specifically defined selection of debt securities within a securitization vehicle. In such an arrangement, the manager would not have sufficient discretion to "significantly affect" the SPE's results, and should not be considered to have control over the SPE or be required to consolidate it. However, paragraph 23a does not clearly point to this conclusion. We believe additional definition is needed to improve the operability of this criterion so that entities can consistently identify asset management arrangements permitted under paragraph 23a. Otherwise, the risk-sharing SPE exemption could apply only to investors who provide no services to an SPE and would establish a double standard - exempting investors from consolidation, but not investor/managers, regardless of limitations on the latter's discretion in making decisions and regardless of the relative sizes of their investments. As a result, an investor with a majority interest in an SPE might not consolidate the SPE under paragraphs 22-23, whereas the investor/manager with little discretion might. Paragraph 23a (and, as discussed above, paragraph 19) should be modified so that consolidation of a financial SPE covered in paragraph 22 is not required by a manager who earns market-based fees and has little decision-making authority beyond the constraints of the SPE investment vehicle.

The ED states in paragraph 14 that, for the purposes of initially measuring variable interests, fair value should be used, but does not clarify whether this measure would be applied to measure variable interests on an ongoing basis. To create a level playing field, the ongoing basis of measurement should be specified. Since different entities might pay different amounts at different times for the same percentage of an interest in an SPE, fair value rather than cost should be the ongoing basis of measuring variable interests in an SPE.

Finally, with respect to the liabilities of a consolidated SPE, we disagree with the ED's characterization of the relationship of its conclusions to the conceptual framework (discussed in the fourth section of the ED Summary). We do not believe that the liabilities of a consolidated SPE are the obligations of the PB - we believe they are the liabilities of the consolidated SPE, and nothing more. The ED states that, "because the liabilities of the SPE will require sacrificing the assets of the SPE, those liabilities are obligations of the primary beneficiary even though the creditors of the SPE may have no recourse to the general credit of the primary beneficiary." We disagree with this logic and do not think it provides theoretical justification for recording the liabilities on the PB's balance sheet. The SPE's liabilities require the PB to make "probable future sacrifices of economic benefits" only to the extent of the assets of the SPE and are therefore not obligations of the PB but of the SPE. We believe the liabilities of an SPE should be consolidated when and because the SPE's assets are deemed to require consolidation, but not because they are the PB's liabilities. Although our suggested change in characterization of SPE liabilities will not affect the dollar amount of recorded liabilities, we offer this theoretical clarification because it could potentially affect a PB's balance sheet presentation or associated disclosures.

If we can provide further information or clarification of our comments, please call me or Nancy Ruffino (860-226-4632).

Sincerely,

Jim Sears