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August 23, 2002

Ms. Suzanne Q. Bielstein
Director of Research and Technical Activities
Financial Accounting Standards Board
401 Merritt 7
Norwalk, CT 06856-5116
Attn: File reference No. 1082-200

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RE: Exposure Draft: Proposed Interpretation: Consolidation of Certain Special-Purpose Entities, an Interpretation of ARB No. 51

Dear Ms. Bielstein:

America's Community Bankers (ACB)¹ is pleased to offer comments on the Financial Accounting Standards Board's (FASB) Proposed Interpretation: Consolidation of Certain Special-Purpose Entities, an Interpretation of ARB No. 51, dated June 26, 2002.

ACB Position

ACB agrees that FASB should provide Special Purpose Entity ("SPE") guidance for situations in which consolidation rules based on majority voting interests do not apply. The proposed variable interests methodology can offer a useful framework for determining the entity that should consolidate the SPE under such circumstances. ACB also strongly supports the position taken in the Exposure Draft that transferors of assets to Qualifying SPEs ("QSPEs"), as well as other SPEs that spread or disperse risk, should not be required to consolidate. While ACB finds merit in the basic framework presented, there should be clearer guidance in a number of areas for the Proposed Interpretation to be implemented and followed in a consistent manner that leads to greater transparency and benefits both preparers and users of financial statements.

The Exposure Draft Develops A Useful Framework for SPE Consolidation Guidance

It is both timely and proper for FASB to issue the Proposed Interpretation for Special-Purpose Entities ("SPEs"), an Interpretation of ARB No. 51 to guide SPE consolidation by business enterprises. As the Exposure Draft properly notes, there are certain SPE structures today in which the traditional consolidation approach of relying on majority voting does not apply. These situations have become increasingly common. They arise when the voting equity interests do not give the

¹ ACB represents the nation's community banks of all charter types and sizes. ACB members, whose aggregate assets exceed \$1 trillion, pursue progressive, entrepreneurial and service-oriented strategies in providing financial services to benefit their customers and communities.

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holders a controlling interest, because there are no voting interests or the entities are not subject to control through ownership of voting interests.

We also support the broad framework as described in the Exposure Draft for determining consolidation in these situations. To summarize, the framework generally calls for consolidation into the financial statements by the party, or Substantive Operating Entity, serving as the primary beneficiary of the SPE. The primary beneficiary would be determined by the variable interests method absent a resolution as provided in Paragraph 9.

QSPEs and Other Risk-Spreading SPEs Should Not Have to be Consolidated

ACB strongly supports the decision to preclude the transferor of assets to a QSPE as described in FASB Statement No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities from consolidating the QSPE. QSPEs provide the means for separating the pool of assets that are sold as part of a financing or securitization from the organization that generated or originated the assets. The QSPE limits the investor's risk exposure to the assets held in the QSPE. In so doing, it benefits the investor and facilitates a more active and liquid secondary market. In these transactions, there is no single primary beneficiary and, therefore, one entity should not be required to consolidate.

QSPEs serve the function of spreading rather than concentrating risk. In discussing the reason for precluding consolidation, the Exposure Draft indicates that SPEs that disperse or spread risks do not need to consolidate and "Qualifying SPEs ... and other SPEs with similar characteristics are examples of SPEs that disperse risks."

While the proposed treatment of QSPEs represents the economic intent of the QSPE structure, we are concerned about the impact of certain provisions of the Exposure Draft on SPEs that hold financial assets as part of a structured financing or asset-backed securitization transaction and that may not qualify for the treatment accorded to QSPEs. Nevertheless, they may have a similar intent and effect of dispersing risk. We refer specifically to Financial SPE ("FSPE") structures that come under Paragraphs 22 and 23. SPEs that hold multi-family mortgages may be an example of an asset class so affected.

Structured finance and securitization market participants have pointed out that, under the Exposure Draft, certain collateralized debt obligations and secured commercial paper transactions may have to be consolidated. They observe that the effect of required consolidation could be increased borrowing costs and perhaps even less participation by some conduits that have traditionally been active in these markets. Some have estimated that the impact on the commercial paper market could be in the order of 15 to 25 basis points rise in funding costs or even more. We note that equity analysts that follow large financial companies have also suggested that they may "back out" the impact of consolidated conduits to analyze the balance sheet and income statement positions of companies that sponsor conduits. Some of these analysts appear to prefer footnote disclosure.

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Additional Guidance and Clarification Sought

While the variable interests method sets a good broad framework, there is a need for additional guidance, including more examples of how the variable interests approach might work. The balance of this letter addresses these concerns, which relate to (i) difficulties in applying the variable interests methodology in determining who should consolidate the SPEs when there is a primary beneficiary and (ii) the conditions under which the FSPE must consolidate.

The Exposure Draft calls for consolidation when "an enterprise holds a majority of the variable interests in an SPE or a significant variable interest that also is significantly more than any other enterprise's variable interest is referred to as the primary beneficiary of the SPE" (Paragraph 6).

The Exposure Draft identifies a process for comparing competing variable interests to arrive at the primary beneficiary, or the enterprise required to consolidate the SPE. One can easily envision circumstances under which different conclusions can be reached with respect to the consolidation decision based on the Exposure Draft. Moreover, the primary beneficiary could easily change from reporting period to reporting period if two or more entities provide financial support to the SPE and have a similar level of variable interests.

It recognizes correctly that there may be situations in which information about other substantive operating enterprises may not be readily available or easily accessible, especially in complex structures. Yet, Paragraph 14 requires consideration of "all factors influencing consolidation decisions at each reporting date using all evidence that the enterprise possesses or would be reasonably be expected to possess". That strikes us as a high standard and one difficult to implement, even taking into account the footnote in the Exposure Draft that "an entity is not required to conduct an exhaustive search for information about the actions of other unrelated parties that might cause the entity to become the primary beneficiary or cease to be the primary beneficiary". Specific guidance would be helpful.

A related issue in the Exposure Draft is the requirement of recalculating variable interests at each reporting period. While we understand the desire to base the determination of principal beneficiary on current information, it does raise a couple of concerns. First, we note the compliance burden of recalculation at each reporting period. The second concern is the impact of changes on the consolidated financial statements should the primary beneficiary change from one reporting period to the next. One can envision the circumstance under which the enterprise may have to consolidate or no longer have to consolidate based on the changes in variable interests in other parties. For instance, an entity may have a 40% interest and another party's interest declines from 45% to 35%, requiring consolidation due to the actions of other parties. The situation can reverse the following reporting period. The effect is financial statement volatility. This raises the question of whether such a reporting environment enhances the quality of investor information.

Some have offered a solution of requiring consolidation only when one enterprise holds the majority of variable interests. In response to requiring a majority of variable interests in order to consolidate, the FASB commented that "an entity's variable interest takes on decreased significance as its

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absolute size diminishes. However, a parent has never been required to have a majority of risks and benefits from its subsidiary in order to consolidate that subsidiary. The interpretation does not change that" (Paragraph B17).

Given that position, FASB may wish to consider providing some basic benchmark indication of the level of variable interests that rises to the point of "significant" variable interest. There is precedent for such guidance in this Exposure Draft. It would be analogous to the presumption of at least a 10% equity investment in order for the SPE to be able to finance itself (Paragraph 12). Similarly, a certain threshold measure of significant variable interest ownership may be developed for situations in which no party has a majority of variable interests. Such a threshold measurement could carry with it similar qualifications as Paragraph 12 provides in its discussion of the 10% equity threshold.

If no single enterprise holds a variable interest that reaches the minimum threshold level, the FASB guidance may decide that consolidation is not warranted. An alternative approach (though one we find less appealing) is that each entity may report its pro rata component interest in an SPE along the lines described in Paragraph 17 relating to SPE "silos". Paragraph 17 states that, "if contractual or other legal obligations substantially restrict an enterprise's right 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, that enterprise shall treat those assets and the portions of the SPE's liabilities to those assets attributable to those assets as a separate SPE." Similar guidance may help to clarify the uncertainty that is bound to arise in comparing variable interests.

FSPEs and Risk Spreading

The intent of Paragraphs 22 and 23 is to identify certain risk-dispersing structures that hold financial assets and preclude them from consolidation comparable to the treatment accorded transferors of assets to QSPEs. Referring to Paragraph 22, the Proposed Interpretation states, "The appropriate application of the provisions of this Interpretation would not result in consolidation of SPEs that effectively disperse risks." It goes on to state, "That class of SPEs holds 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" (Paragraph B20).

One can debate whether the Paragraph 23 criteria for determining whether the FSPEs would be subject to the consolidation rules in the Exposure Draft are the right ones. Nevertheless, the stated criteria should be clarified. We refer especially to the first criterion and the phrase "sufficient discretion to significantly affect revenues, expenses, gains and losses", but also to the third criterion of market-based fee pricing and how that may be determined.

We also note an apparent inconsistency between Paragraph 23 and Paragraph 17. Paragraph 17 describes the "silo" approach in which a multi-party SPE conduit may consolidate its pro rata share of assets. Yet Paragraph 23 does not explicitly incorporate similar language. It may be helpful to state that, with respect to Paragraph 23, the silo treatment may be available.

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Other Issues: Timing and Disclosure Requirements

Finally, we would like to draw attention to the disclosure requirements, as well as the suggested pro forma statements. We would recommend that FASB carefully consider the extent to which such information will actually be used by readers of financial statements. Perhaps the roundtable scheduled for late September will help to this end. Requiring such disclosures may prove to be burdensome to financial statement preparers, especially considering the aggressive schedule for implementation. The Interpretation is to be applied to fiscal years and interim periods beginning after March 15, 2003. As the final rule is expected to be released at the end of the year, financial statement preparers effectively have only a one-quarter transition period.

Summarizing, ACB commends the FASB for responding to the need for guidance on SPE consolidation. While we believe that the conceptual framework is sound, we encourage FASB to take a closer look at the issues related to implementation. Specifically, we wish to ensure that consolidation is not applied to structures that spread and disperse risk.

We appreciate having this opportunity to present our views to FASB. Please contact Steve Davidson at 202-857-3158 or sdavidson@acbankers.org regarding questions or clarification of our views.

Sincerely,

Robert R. Davis Managing Director, Government Relations