NEW YORK CLEARING HOUSE

100 BROAD STREET, NEW YORK, N. Y. 10004

Letter of Comment No: 147 File Reference: 1082-154 Date Received: 2/5/96

JILL M. CONSIDINE PRESIDENT

January 25, 1996

Mr. Timothy S. Lucas Director of Research and Technical Activities Financial Accounting Standards Board 401 Merritt 7 P.O. Box 5116 Norwalk, CT 06856-5116

Re: File Reference No. 154-D

Exposure Draft, Consolidated Financial Statements: Policy and Procedures

Dear Mr. Lucas:

The members of the New York Clearing House Association, an association of eleven commercial banks in New York City (the "Clearing House")*, are pleased to provide comments on the above mentioned Exposure Draft. This letter provides comments specific to certain key issues raised in the Exposure Draft.

Consolidation Policy—Control

In general, we do not believe that consolidation policy is an area that warrants new accounting standards or the significant use of the Board's resources that has been necessary to reach the views expressed in this Exposure Draft. The issuance of FASB Statement No. 94, Consolidation of all Majority-Owned Subsidiaries, in 1987 resolved most of the practice problems with respect to which entities should be consolidated, and we do not believe that users of financial statements perceive a significant need for the Board to develop a reporting entity concept for business enterprises. Instead, users' requests have focused more on disaggregated information; and, provided that entities consistently apply a consolidation standard, users seem to care little about which standard is applied. Accordingly, no compelling reasons exist to revisit the basic conclusion expressed in Accounting Research Bulletin No. 51, Consolidated Financial Statements, as amended by Statement 94.

The Clearing House has the following members: The Bank of New York, Chase Manhattan Bank, N.A., Citibank, N.A., Chemical Bank, Morgan Guaranty Trust Company of New York, Bankers Trust Company, Marine Midland Bank, United States Trust Company of New York, NatWest Bank, National Association, European American Bank, and Republic National Bank of New York.

January 25, 1996 Mr. Timothy S. Lucas Page 2

If the Board proceeds with a consolidation policy standard, the basic premise stated in the Exposure Draft on which that standard is based should be changed. Control alone, as contemplated by the Exposure Draft, is insufficient to require consolidation of one business enterprise by another. We would support continued use of the current consolidation criterion. This criterion, which was first espoused when ARB 51 was issued in 1959, has been accepted practice for many years and, as previously stated, we do not believe that users of financial statements perceive a need for change in this area. The existing "majority voting interest" criterion generally results in the consolidation of entities that are "controlled" by the parent.

If an entity owns less than 50 percent of the voting stock of another entity, the investor generally does not have the power to use or direct the use of the individual assets of the investee. In the rare circumstance that the investor has effective control without majority ownership, an approach like that in the SEC's Rule 3A-02 of Regulation S-X, which requires consolidation in some circumstances, notwithstanding the lack of majority ownership, could be adopted. While it would not be practical for the Board to establish an all-inclusive list of these circumstances and judgment obviously would continue to be necessary, this approach, which requires both control and majority ownership, has been workable in the past and would continue to be workable in practice because of the relative rarity of these situations.

In addition, the *potential* to obtain control in the future (paragraph 14(c)) does not give an investor current control. Accordingly, in that circumstance, including an investee in the consolidated financial statements would not present meaningful financial information. The ability to control should be legally enforceable through current ownership of the majority of the voting rights. It should not be based on an uncertain future event.

We share the views of the Board member who wrote the alternative view described in paragraphs 139-144 of the Exposure Draft. Specifically, we agree with paragraph 139 which states in part, "consolidated financial statements for a business enterprise are intended to serve primarily the needs of the shareholders of the parent. He believes that assets and liabilities of a controlled entity should be consolidated only in situations where the ultimate net cash inflow or outflow from those assets and liabilities inure substantially for the benefit of, or detriment to, investors in the parent."

In addition, we are concerned that the presumptions of control indicated in the Exposure Draft could create inconsistencies from period to period among the entities comprising consolidated financial statements. As discussed in paragraph 14 (b) of the Exposure Draft, an owner of a large minority interest could "control" an entity simply because not all shareholders exercise their rights to vote. Depending on how many shareholders vote each year, control—and, therefore, consolidation—could change from year to year thereby resulting in inconsistent and incomparable financial statements. This

January 25, 1996 Mr. Timothy S. Lucas Page 3

type of "control" without legal authority should not result in consolidation. Users of financial statements would be ill-served by such a concept. Consolidation or deconsolidation should result only upon the occurrence of a significant economic event.

In the proposed Statement, the Board asserts that consolidated financial statements are always more meaningful than the separate statements of affiliated entities and relies on control alone as the condition for consolidation. That narrow view fails to adequately consider certain situations for which consolidation clearly does not present more meaningful financial statements. In our view, control should result in consolidation only when it exists today and is expected to continue for the foreseeable future. For example, when the appropriate level of management commits to a plan to dispose of a subsidiary, the most useful portrayal to investors would be to deconsolidate the subsidiary (with appropriate disclosure, if material). Similarly, venture capital-type investments for which economic realization is intended to come from disposal rather than operations should not be subject to consolidation.

Special Purpose Entities

If the Board proceeds with this consolidation standard, its definitive views about consolidation of special purpose entities created in connection with asset securitizations should be addressed. We believe that the control standards expressed in paragraphs 9 and 10 generally will not require the sponsor of a securitization to consolidate special purpose entities created in connection with the securitization. However, it is important that the FASB specifically confirm this intent in any final Statement because the proposed Statement, as currently written, is unclear about the Board's intent. Many parties participate in the design of a securitization, and all those parties seek to accomplish their own objectives in selecting a particular structure. However, once the transaction commences, no one may change the treatment of assets and their proceeds in ways that will materially affect other parties to the transaction without the consent of all parties. This structure, including the significant restrictions on servicing and use of the assets. makes it clear that the sponsor cannot use the assets transferred to a special purpose entity created in connection with a securitization as if they were the sponsor's own. We believe that the FASB agrees with this analysis and does not intend to negate the important work accomplished in its project on asset transfers. Accordingly, the Board should clearly state its intent with respect to special purpose entities created in connection with asset securitizations in any final Statement.

If the Board disagrees with this assessment and believes that the sponsor of a special purpose entity created in connection with an asset securitization should consolidate it, the Board should reconsider its conclusion in light of the significant impact that such a standard would have on financial institutions, other corporations, and the economy as a whole. For example, the growing use of securitization structures for credit card receivables and mortgage loans has permitted financial institutions to reduce the geographic concentration risk of their assets, which, in turn, has provided liquidity for

January 25, 1996 Mr. Timothy S. Lucas Page 4

consumers by increasing the availability of funds for revolving credit and mortgages. These important considerations should be weighed by the Board in its deliberations on a final Statement.

Conforming Accounting Policies

The FASB requirement to conform all accounting principles in consolidated financial statements is inappropriate. We agree that a company whose business units have similar business activities should be consistent in its choice of accounting methods. However, it would be illogical to require industry-specific accounting practices to be reversed in consolidation because those industry-specific accounting principles, developed by AcSEC and others, respond to needs of financial statement users. The Board has not justified why those same accounting principles no longer would be appropriate in the consolidated financial statements.

If it is not the Board's intent to reverse industry-specific accounting policies in consolidation, that intent should be clarified in any final Statement.

In summary, current consolidation practice is one area of accounting that has withstood the test of time, produced reasonable and understandable results and has not been subject to widespread abuse. As a result, we strongly urge the Board to abandon this move toward a fundamental change of the current consolidation standards.

We would be pleased to discuss our views on these matters with the Board or staff at your convenience.

Yours very truly,

Jell M Considere