

October 30, 2008

Mr. Russell G. Golden  
Technical Director  
Financial Accounting Standards Board  
401 Merritt 7  
P.O. Box 5116  
Norwalk, CT 06856-5116



LETTER OF COMMENT NO. 16

**File Reference No.: 1620-100**

**Re: Proposed FASB Statement, *Amendments to FASB Interpretation No. 46(R)***

Dear Mr. Golden:

Deloitte & Touche LLP is pleased to comment on the Proposed Statement of Financial Accounting Standards, *Amendments to FASB Interpretation No. 46(R)* (the "proposed Statement").

We support the Board's efforts to improve financial reporting for consolidations and to increase the relevance and transparency of the related disclosures. We also agree that a consolidation model in which an enterprise consolidates an entity when the enterprise both has governance over the entity and significantly participates in the results of the entity is preferable to the current Interpretation 46(R)<sup>1</sup> model in which an enterprise consolidates an entity only when it absorbs a majority of the variability in risks or rewards. However, we do not support the issuance of the proposed Statement as currently drafted because it represents a significant change to the consolidation model for variable interest entities (VIEs) that will most likely require significant and costly changes to financial reporting systems and will only be effective for a short time. In addition, we have significant concerns about the amendments in the proposed Statement.

Rather than issuing this proposed Statement as a final standard, the FASB should work with the IASB to develop a common consolidation model that can be applied by all entities reporting under either U.S. GAAP or IFRSs. Currently, the two boards are expected to issue joint final standards by 2010. Therefore, if the FASB were to issue this proposed Statement as a final standard, U.S. registrants would have to apply three different consolidation models within a short time frame, resulting in operational challenges for preparers and introducing unnecessary complexity into financial reporting.

Because consolidation and derecognition are inextricably linked, we also strongly encourage the FASB and IASB to concurrently develop a common derecognition principle. The consolidation and derecognition principles should be conceptually consistent, based on the concept of control, and consistent with the definitions of an asset and a liability being developed in the joint conceptual framework. We believe that such consistent principles are fundamental to more faithfully representing the assets and liabilities of a reporting entity.

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<sup>1</sup> FASB Interpretation No. 46(R), *Consolidation of Variable Interest Entities* — an interpretation of ARB No. 51.

We acknowledge that if the FASB were to remove the project from its agenda and develop a joint standard with the IASB, the recent practice issues would not be addressed until such standard becomes effective. We therefore support requiring increased disclosures in the interim. (See our October 15, 2008, comment letter to the Board regarding proposed FSP FAS 140-e and FIN 46(R)-e.<sup>2</sup>)

If the Board determines that it must move forward with issuing the proposed Statement, it should consider revising it in accordance with our comments and suggestions below. The Appendix of this letter includes additional comments and recommendations that the Board should consider when finalizing the proposed Statement.

## **COMMENTS AND SUGGESTIONS REGARDING THE PROPOSED STATEMENT**

### ***Two Consolidation Models***

Currently, ARB 51<sup>3</sup> and Interpretation 46(R) contain considerably different models for determining whether an entity must be consolidated. ARB 51 prescribes a governance-based model that requires consolidation when an enterprise has a controlling financial interest in another entity, which is usually demonstrated through a majority voting interest. Interpretation 46(R) provides a risks-and-rewards-based model that requires consolidation when an enterprise absorbs a majority of the expected losses or receives a majority of the expected residual returns of a VIE.

Under the proposed Statement, the model used to determine consolidation incorporates aspects of control while participating in risks and rewards. We question whether retaining two separate consolidation models is necessary. We believe that creating one consolidation model that incorporates the control concepts in ARB 51 as well as participation in the activities of the entity could eliminate many of the inconsistencies between the definition of a VIE and the definition of a controlling financial interest in the proposed Statement (which are more fully discussed below). In addition, we understand that use of one consolidation model for all entities would be consistent with the approach that the IASB is considering in its consolidations project.

### ***Characteristics of a VIE***

The proposed Statement does not amend the definition of a VIE in paragraph 5 of Interpretation 46(R). However, the definition of a controlling financial interest in the proposed paragraph 14A appears to contradict the Interpretation's original intent of defining a VIE.

The original intent of paragraph 5(a) of Interpretation 46(R) was that an entity would be identified as a VIE if its equity investment at risk was not considered substantive, in which case the voting or governance characteristics relating to the activities of the entity would not be particularly relevant to determining whether consolidation is appropriate. This is clarified in paragraph D20 of the Basis for Conclusions of Interpretation 46(R), which states that "an equity investment that is not sufficient to permit the entity to finance its own activities without additional subordinated financial support indicates that an analysis of voting rights is not an effective way to determine whether an enterprise has a controlling financial interest in that

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<sup>2</sup> Proposed FASB Staff Position No. FAS 140-e and FIN 46(R)-e, "Disclosures About Transfers of Financial Assets and Interests in Variable Interest Entities."

<sup>3</sup> Accounting Research Bulletin No. 51, *Consolidated Financial Statements*.

entity.” Because consideration of voting rights is not deemed effective in the determination of whether consolidation is appropriate if the conditions in paragraph 5(a) are met, Interpretation 46(R) requires that the consolidation conclusion be based on risks and rewards rather than voting rights. The proposed changes to Interpretation 46(R) conflict with the assertion that when the equity investment at risk is less than a certain calculated threshold, the voting rights are not relevant to determining whether a party has a controlling financial interest.

Furthermore, similar to paragraph 5(a), the intent of paragraph 5(c) of Interpretation 46(R) is to prevent an enterprise from avoiding consolidation by structuring an entity with nonsubstantive voting rights. More specifically, paragraph 5(c) of Interpretation 46(R) requires an enterprise to consider risks and rewards in determining consolidation when the voting arrangements of an entity have been skewed such that an enterprise with disproportionately few voting rights, relative to its economic interest, obtains substantively all of the benefits of the activities of the entity. Because the current consolidation model is based on risks and rewards, the conclusion about the primary beneficiary in this situation is biased toward the enterprise with a larger economic interest that obtains substantially all of the benefit of the entity’s activities.

However, in an analysis, under the proposed Statement, of which variable interest holder, if any, must consolidate an entity that is a VIE because of paragraph 5(c) of Interpretation 46(R), it is conceivable that the investor with disproportionately *more* voting rights relative to its economics will be the primary beneficiary, regardless of whether substantively all of the activities benefit a different variable interest holder. This conclusion is inconsistent with the intent of paragraph 5(c), discussed in the previous paragraph.

Thus, the scope of Interpretation 46(R) and the definition of a VIE appear to be inconsistent with the proposal to insert into the consolidation model a step that focuses on control. It would therefore make sense to eliminate such a delineation (i.e., eliminate the definition of a VIE in paragraph 5) and create one consolidation model for all entities. If the Board decides to keep the delineation, it should amend the Basis for Conclusions of the proposed Statement to explain the purpose of retaining the definition of a VIE.

#### ***Definition of a Controlling Financial Interest***

We do not believe that the description of a controlling financial interest in proposed paragraph 14A is operational or appropriate for several reasons as discussed in the following sections.

#### **Application of the Principle of Power**

The phrase “power to direct matters that most significantly impact the activities of the VIE” in proposed paragraph 14A(a) is ambiguous. The power to direct activities, which appears to have a lower threshold than unilateral control over governance, is applied inconsistently throughout the examples in Appendix A of the proposed Statement. For instance, the Board concluded that the collateralized debt obligation (CDO) manager (a service provider) in Example 2 has the power to direct activities but that the hotel manager (a service provider with responsibilities similar to those of the CDO manager) in Example 8 does not. (As more fully discussed in the Appendix of this letter, we do not agree that the fee received for managing the hotel is not a variable interest.) The proposed Statement is not clear on why this is the case. We believe that the Board needs to make the application guidance consistent to avoid confusion; otherwise enterprises with similar structures may reach inconsistent primary-beneficiary conclusions.

We also believe that the Board should modify the proposed paragraph 14A(a) to include indicators of power to direct activities. These indicators should reflect various characteristics that suggest that an enterprise has the power to direct the matters that most significantly impact the activities of the VIE. We recommend that these characteristics be similar to those discussed at the April 9, 2008, Board meeting and to the characteristics of control included in the IASB's consolidations Exposure Draft discussed at the October 20, 2008, joint FASB and IASB meeting. Most importantly, the concept of power to direct activities must be sufficiently clear to stand on its own without reliance on the examples in Appendix A of the proposed Statement.

Further, we suggest that the Board clarify how to analyze voting rights under the proposed paragraph 14A(a). We believe that nonsubstantive voting rights should be ignored in the determination of which enterprise, if any, has the power to direct matters that most significantly impact the activities of the VIE. We do not believe that an enterprise with nonsubstantive voting rights should be the primary beneficiary of a VIE. The Board should consider whether it needs to provide guidelines on determining whether voting rights are nonsubstantive under the proposed paragraph 14A(a).

### **Fiduciary or Agency Activities**

The proposed Statement is unclear on how fiduciary or agency (e.g., a service provider, a collateral manager) activities would be analyzed under the proposed amendment to paragraph 14A of Interpretation 46(R) when a service provider does not retain a residual interest in the VIE. Each example in Appendix A, that includes a service provider, assumes that the service provider is a variable interest holder because it retains a residual interest in the VIE. Regarding the determination of whether the service provider has a controlling financial interest, each example concludes that the residual interest retained (as opposed to the fee received for performing the service) is an obligation to absorb losses that could be potentially significant to the VIE (as contemplated in the proposed paragraph 14A(b)). However, it is unclear whether receiving a fee (whether fixed or incentive-based) for performing a service when a residual interest is not retained would represent a right to receive benefits that could be potentially significant to the VIE. We suggest that the Board clarify whether it intends fiduciary -type service contracts to represent a controlling financial interest when such a contract is not coupled with other variable interests.

As part of this suggestion, we ask the Board to consider that the controlling interest holder must have the ability to direct the activities of another entity *for its own benefit* (since this is a fundamental component of any control principle). In other words, the ability to make decisions about the activities of another entity must directly affect the magnitude of the benefits (whether positive or negative) that the controlling interest holder obtains from those activities. We believe that a fiduciary that does not have the ability to direct the activities of another entity *for its own benefit* is acting more as an agent on behalf of investors rather than as a controlling financial interest holder. The Board should consider clarifying that a fiduciary that is deemed an agent<sup>4</sup> of other investors cannot be a controlling financial interest holder under the proposed paragraph 14A.<sup>5</sup>

### **Substantive Kickout Rights**

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<sup>4</sup> For this purpose, the Board should consider the characteristics of an agent in EITF Issue No. 99-19, "Reporting Revenue Gross as a Principal Versus Net as an Agent."

<sup>5</sup> The concept that an agency relationship does not represent a controlling financial interest is consistent with the IASB's consolidations Exposure Draft.

We disagree with the requirement in the proposed paragraph 14A(a) that substantive kickout rights should be ignored in the determination of whether an enterprise has the power to direct matters that most significantly impact the activities of a VIE. While we agree that kickout rights associated with certain structured vehicles often are not substantive, we disagree with an approach that ignores the effect of kickout rights on the basis of an arbitrary rule of how many parties are involved. Such an approach is inconsistent with the definition of a VIE in paragraph 5(b)(1) of Interpretation 46(R), the definition of a variable interest in paragraphs B18–B21, and the concept of substantive kickout rights in Issue 04-5.<sup>6</sup> Until the Board fully addresses whether consolidation should be based on the current power to direct activities or the potential to lose or unilaterally attain such power (e.g., option on voting stock, kickout rights), we encourage the Board to retain a model that is consistent with Issue 04-5.

### **Shared Power**

While we agree with the Board's intent regarding treatment of an entity in which *shared power* exists (e.g., a joint venture), we do not believe that the proposed paragraph 14B is effective in excluding the enterprises sharing power in a joint venture from consolidation.

The venturers in a joint venture often may be considered related parties under paragraph 16(d)(1) of Interpretation 46(R) because each venturer contractually does not have the ability to transfer its interest without the prior approval of the other venturers. On a combined basis, the owners of a joint venture have the ability to direct matters that impact the activities of the joint venture, but each individual venturer does not have such power. In accordance with paragraphs 16 and 17 of Interpretation 46(R), the variable interest holders in the de facto related-party group will need to determine which interest holder is considered most closely associated with the VIE. We believe that because paragraph 17 *requires* that this interest holder be consolidated as the primary beneficiary, many joint ventures will ultimately have to be consolidated by one of the venturers even when no one party has a controlling financial interest under the proposed paragraph 14A. To resolve this issue, the Board should consider excluding joint ventures from the scope of the de facto related-party provisions in paragraph 16(d)(1).

We believe that in addition to affecting the analysis of joint ventures, the concept of shared power may have a significant impact on the analysis of certain structured finance entities. For example, many structured finance vehicles hold assets that are transferred by various transferors and serviced by multiple servicers. Similarly, with certain actively managed revolving structures, one party is responsible for managing the structure's assets and another party is responsible for managing the structure's funding. On the basis of the concept of shared power in the proposed paragraph 14B, it appears that such structured finance vehicles may not be consolidated by any one party because the power to direct matters that most significantly impact the activities of the entity is shared by multiple parties (i.e., the multiple servicers or the asset manager and the funding manager). We suggest that the Board clarify whether it intended the concept of shared power in paragraph 14B to apply to structured finance vehicles such as those described above. If not, the Board should consider clarifying whether it is necessary to perform a quantitative analysis to determine the primary beneficiary in such cases.

### **Benefits or Losses That Are Potentially Significant to the Entity**

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<sup>6</sup> EITF Issue No. 04-5, "Determining Whether a General Partner, or the General Partners as a Group, Controls a Limited Partnership or Similar Entity When the Limited Partners Have Certain Rights."

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We do not believe that paragraph 14A(b), which requires that the controlling financial interest's right to receive benefits from the VIE or obligation to absorb losses of the VIE be *potentially significant to the VIE*, is operational in its current form. "Potentially" implies that worst- and best-case scenarios are assumed, even if there is only a remote possibility that either of these scenarios will ever occur. Further, although the proposed Statement does not define "significant to the VIE," it appears that "significant" is intended to be an extremely low threshold; therefore, most variable interest holders would meet the criteria in paragraph 14A(b).

### ***Reconsideration***

We agree with the Board's proposal to require an enterprise to continually reconsider whether it is the primary beneficiary of a VIE. However, we do not support the proposed Statement's requirement that such reconsideration include operating losses that are in excess of the entity's expected losses. We do not believe that an entity's VIE status should change solely because losses incurred in excess of a VIE's expected losses result in an insufficient equity investment. We think that because the definition of a VIE in paragraph 5 is based on the *design* of the entity (including how the entity is structured), an entity's status as a VIE should be reconsidered when the design of an entity has substantively changed. Thus, while we do not believe it is appropriate for an entity to become a VIE *solely* because of the occurrence of losses that reduce the entity's equity investment at risk, a restructuring of an entity's debt arrangements in response to significant losses, for example, may indicate that a substantive change in the *design* of the entity has occurred; in such cases, reconsideration of VIE status should be required.

### ***Transition***

The transition guidance in paragraph 6 of the proposed Statement only addresses the initial recognition of the assets, liabilities, and noncontrolling interests of a VIE as a result of consolidation upon initial adoption of the proposed Statement. However, the deconsolidation of a VIE could result upon initial adoption of the proposed Statement. We suggest that the proposed Statement clarify whether an enterprise should apply Statement 160<sup>7</sup> when accounting for a deconsolidation of the VIE upon initial adoption of the proposed Statement.

### ***Disclosures***

We support the objectives of the proposed Statement's disclosure requirements. Because the disclosure requirements in the proposed Statement are the same as those in proposed FSP FAS 140-e and FIN 46(R)-e, we recommend that the Board review our October 15, 2008, letter on the FSP.

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If you have any questions concerning our comments, please contact Robin Kramer at (203) 761-3079 or Randall Sogoloff at (203) 761-3777.

Yours truly,

Deloitte & Touche LLP

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<sup>7</sup> FASB Statement No. 160, *Noncontrolling Interests in Consolidated Financial Statements* — an amendment of ARB No. 51.

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cc: Robert Uhl

**APPENDIX**  
**Deloitte & Touche LLP**

*Definition of a Variable Interest*

The Board should clarify when an enterprise must determine whether its interest in a VIE is a variable interest. Currently, service and supply contracts would most likely be considered variable interests under Interpretation 46(R) if there is off-market pricing on the date of the initial Interpretation 46(R) assessment. While many service and supply contracts are **not** priced off-market on the date of the initial assessment, they may become off-market subsequently as a result of changes in current market rates for the service or product. Because the proposed Statement requires continual reconsideration of whether an entity is a VIE and of which enterprise, if any, is a VIE's primary beneficiary, service and supply contracts could meet the definition of a variable interest after inception even if such a contract was originally structured at market pricing. We suggest that the Board consider clarifying whether service or supply contracts can become a variable interest solely because of movements in market rates for the service or the product.

*Interperiod Consolidation/Deconsolidation*

The proposed Statement's amendment to paragraph 5 of Interpretation 46(R) would require that a VIE be consolidated when an enterprise becomes the VIE's primary beneficiary, which may be during a reporting period. Because consolidation may occur when unilateral control over the VIE does not exist, it may be difficult for the primary beneficiary to obtain the necessary information to perform the consolidation between reporting periods. We suggest that the Board consider, as a practical expedient, modifying its proposed amendment to paragraph 5 to require consolidation of a VIE only on a reporting date.

*De Facto Agency Relationships Between Venturers in a Joint Venture*

The Board should reconsider whether *mutual* transfer restrictions that are designed to preserve the strategic intent of an entity should result in a de facto related-party relationship pursuant to paragraph 16(d)(1) of Interpretation 46(R). Paragraph E38 of Interpretation 46(R) clarifies that the intent of the related-party concepts in paragraph 16 is to prevent a variable interest holder from avoiding consolidation of a VIE "by arranging to protect its interest or indirectly expand its holding through other parties." Because mutual transfer restrictions often have a substantive business purpose and are not used by one interest holder to circumvent consolidation under Interpretation 46(R), we recommend that the Board modify the definition of de facto related parties in paragraph 16(d)(1) to exclude such restrictions.

We believe eliminating mutual transfer restrictions from the definition of de facto related parties in paragraph 16(d)(1) will most significantly impact joint venture arrangements in which power is shared among joint venturers. Currently, the proposed paragraph 14B stipulates that an enterprise is not the primary beneficiary of a VIE if the power to direct matters that most significantly impact the activities of the VIE is shared among multiple parties. It appears that the Board intended this concept to apply to joint ventures. However, because many joint ventures would be considered related parties as a result of mutual transfer restrictions, we question whether the concept of shared power achieves the Board's intended result. If the venturers to a joint venture are related parties, the related-party group would most likely meet the conditions in the proposed paragraph 14A and an analysis under paragraph 17 of Interpretation 46(R) would need to be performed to determine which party in the related-party group has to consolidate the VIE. This

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conclusion seems inconsistent with the intent of the proposed paragraph 14B (i.e., that no primary beneficiary exists if power is shared by multiple parties).

#### *Shared Power and Related Parties*

We recommend that the Board clarify in the proposed paragraphs 1A and 14B that if power is shared among parties within a related-party group, one interest holder in the related party will be required to consolidate the VIE pursuant to paragraph 17 of Interpretation 46(R), irrespective of the fact that power is shared. As currently drafted, paragraphs 1A and 14B state that an enterprise will not be the primary beneficiary of a VIE if “power is, in fact, shared among multiple parties such that *no one party* meets the criteria in paragraph 14A” (emphasis added).

#### *Current Power to Direct Matters*

The Board should clarify whether the proposed paragraph 14A(a) applies to the *current* ability to direct matters that most significantly impact the activities of a VIE. The proposed Statement appears to be inconsistent on this issue. For instance, paragraph 14A(a) states that kickout rights should be ignored in the determination of whether an enterprise has the power to direct matters, unless they can be exercised unilaterally by a single interest holder (including related parties). By ignoring kick-out rights, paragraph 14A(a) appears to focus on the *current* ability to direct matters. However, several examples in Appendix A of the proposed Statement conclude that an enterprise has power to direct matters even though certain contingent events must occur before that power can be exercised. For example, the Board concludes that the special servicer in Example 1 has the power to direct matters even though such a power is only exercisable if an underlying loan defaults. We suggest that the Board clarify how contingent rights should be analyzed (e.g., in the above example, the Board should clarify whether it believes power exists even though a default is likely to occur and power is imminent).

In addition, the Board should clarify whether participating significantly in the creation or design of an entity represents power to direct matters, as contemplated in paragraph 14A(a). In many structured finance entities, the activities that significantly impact the entity’s success are determined when the entity is created. For example, in many commercial mortgage-backed securities transactions, whether the securitization is successful depends heavily on the underwriting procedures of the transferor and the selection of the assets that are transferred. However, it is unclear whether involvement in the creation of an entity (especially entities whose decision-making abilities are limited or whose activities are predetermined) is important to determining whether the condition in paragraph 14A(a) is met. In paragraph A34 (Example 3) of the proposed Statement, the Board acknowledged that a sponsor’s significant involvement in the creation of the entity affects the determination of whether the sponsor has the power to direct matters that impact the activities of the VIE, but only provided that the involvement “does not in isolation result in the [s]ponsor being the primary beneficiary.” While this consideration seems important for all securitization transactions, Example 3 is the only example that discusses an entity’s involvement in the creation of the VIE. We suggest clarifying how an enterprise’s involvement in the creation and design of a VIE should be analyzed and whether this consideration is important to determining whether power to direct matters exists.

#### *Significant Variable Interests*

The proposed paragraph 14A requires that a primary beneficiary have power to direct activities. Therefore, the Board should consider whether the definition of a significant variable interest in

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the proposed amendment to paragraph 6 of Interpretation 46(R) is consistent with the original intent of that definition to allow an enterprise not to apply the provisions of Interpretation 46(R) if it was highly unlikely that the variable interest holder would be deemed the primary beneficiary of the VIE.

More specifically, we believe certain passive interest holders (e.g., a debt holder or a guarantor) with a significant economic exposure to a VIE may be deemed to have a significant variable interest pursuant to paragraph 6 even though it is highly unlikely that the interest holder would be considered the primary beneficiary. Because a passive interest holder would most likely not have the ability to direct matters that most significantly impact the activities of the VIE, the Board should consider clarifying whether the significance noted in paragraph 6 should be driven by economic exposure or the potential to be the primary beneficiary of a VIE.

#### *Characteristics of a Controlling Financial Interest*

The proposed Statement amends paragraph 5(b) of Interpretation 46(R) by removing the reference to “characteristics of a controlling financial interest.” We believe the Board made this amendment because it described the characteristics of a controlling financial interest in paragraph 14A differently than in paragraph 5(b). We recommend that rather than eliminate the reference in paragraph 5(b), the Board should make it consistent with that in paragraph 14A. The Board should also consider the discussion in paragraphs D21 and D22 of the Basis for Conclusions of Interpretation 46(R).

#### *Example 1 — Commercial Mortgage-Backed Securitization*

There appears to be a subtle, but important, difference between the descriptions of a primary servicer in paragraph A5 (Example 1) and paragraph A71 (Example 6) of the proposed Statement. Paragraph A5 describes primary servicing activities as those that are “administrative in nature and include remittance of payments on loans, administration of escrow accounts, and collections of insurance claims.” However, primary servicing activities in Example 1 do not include default management. Rather, default management is administered by a special servicer. In contrast, paragraph A71 describes primary servicing activities as “collecting and remitting principal and interest payments, administering escrow accounts, monitoring overdue payments, and overall default management.” This distinction between the primary servicing role in Example 1 and that in Example 6 (i.e., which party performs default management) is the determining factor for which enterprise is the primary beneficiary. Because default management is the determining factor for which enterprise has the ability to direct matters that impact the activities of the VIE, we suggest that the Board clearly emphasize this point in its proposed Statement so that constituents understand when a servicing activity results in power to direct activities.

#### *Example 2 — Collateralized Debt Obligation*

Paragraph A23 of the proposed Statement concludes, “Through the equity interest **and** [the] performance-based fee, the [m]anager has the right to receive benefits that could potentially be significant to the variable interest entity . . .” (emphasis added). This statement appears to imply that the performance-based fee **alone** gives the manager the right to receive benefits that could be potentially significant. Therefore, regardless of whether the manager holds an equity interest in the CDO, it would most likely consolidate the CDO as its primary beneficiary. Because the facts section of the example does not describe the characteristics of the performance-based fee (e.g., how the fee is determined and its place in the cash waterfall), it is unclear whether the Board meant that **any** incentive-based fee represents a right to receive benefits that could be potentially

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significant. We suggest that the Board clarify what it considers to be a right to receive benefit that could be potentially significant. Please see the discussion of fiduciary (agency) activities in the body of this letter.

*Example 6 — Mortgage-Backed Securitization*

Paragraph A74 of the proposed Statement concludes that the transferor, as the servicer, is the primary beneficiary of a mortgage securitization trust because it “has the ability to manage the entity’s assets that become delinquent (or are reasonably foreseeable of becoming delinquent) to improve the economic performance of the entity.” We suggest that the Board clarify how much discretion a primary servicer that manages delinquent assets needs to have in order to have the power to direct matters that impact the activities of the VIE. The polling and servicing agreement that establishes a mortgage securitization generally prescribes the activities of a servicer and what it can do if an asset of the trust becomes delinquent. Furthermore, the Board should clarify whether a servicer that has a limited number of options for managing a delinquent asset truly has the power to direct matters that impact the activities of the VIE.

*Example 8 — Joint Venture*

In paragraph A94 of the proposed Statement, “[t]he fee paid to Company A under the service agreement and contract does not represent a variable interest based on a consideration of the conditions in paragraph B22 of Interpretation 46(R).” We disagree that the fee received by Company A is not a variable interest for several reasons.

First, Company A would most likely be considered a decision maker rather than a service provider. In this example, the entity is designed such that Company A (with its hotel expertise) will direct the day-to-day activities of the entity. Paragraph A91 of the proposed Statement states that because “Company A has expertise in hotel management, it performs the day-to-day operating activities of the hotel under a service contract.” While “decision maker” is not defined in Interpretation 46(R), an interest holder has typically been viewed as a decision maker if a management or service contract gives it the ability to make significant decisions about the day-to-day activities of a VIE. In addition to its right to manage the day-to-day activities of a the VIE, Company A holds an equity interest in the entity that exposes it to more than a trivial amount of the entity’s expected losses. Therefore, the fee received by Company A for managing the activities of the VIE would seem to be a variable interest under paragraph B19(c) of Interpretation 46(R).

Second, regardless of whether Company A is considered a decision maker, the fee received by Company A for performing its servicers typically would be a variable interest under paragraph B22(c) of Interpretation 46(R). While the facts in the example are not entirely clear, it appears that removal of a service provider requires the consent of both venturers in the joint venture. Because Company A is a venturer, it seems unlikely that Company A would vote to remove itself as the service provider for the VIE. Therefore, the service contract does not appear to include *substantive* customary cancellation provisions, which are necessary for the service fee not to be considered a variable interest under paragraph B22(c).

*Example 9 — Furniture Manufacture*

In paragraph A106 of the proposed Statement, “[t]he furniture manufacturer has the right to receive benefits that could potentially be significant [to the VIE] through its equity interest . . . .” In this example, the furniture manufacturer’s equity interest in the VIE represents 0.00003% of

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the total capital structure of the entity (i.e., \$100 in equity compared with \$3 million in debt). We question how such a de minimis amount of equity could provide the equity holder with a right to a benefit that could be potentially significant to the VIE. If the Board intends the threshold in paragraph 14A(b) to be this low, it should indicate this. We also recommend that the Board consider whether a right to such a small benefit is consistent with the definition of a controlling financial interest. Please see the discussion of fiduciary (agency) activities in the body of this letter.