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October 30, 2008



Technical Director – File Reference No. 1620-100 Financial Accounting Standards Board 401 Merritt 7 PO Box 5116 Norwalk, Connecticut 06856-5116

RE: Proposed Statement, Amendments to FASB Interpretation No. 46(R) (File Reference No. 1620-100)

Dear Technical Director:

We appreciate the opportunity to respond to the proposed FASB Statement, Amendments to FASB Interpretation No. 46(R) (the "proposed Statement"). We support the Board's efforts to improve financial reporting by enterprises involved with a variable interest entity ("VIE"). We agree with the Board's stated objectives to improve financial reporting by enterprises involved with variable interest entities and to provide more relevant and reliable information to users of financial statements. We also agree that the application of FASB Interpretation No. 46 (revised December 2003), Consolidation of Variable Interest Entities ("FIN 46(R)") has created difficulties in practice, and consequences and financial results that are inconsistent with the Board's original intentions for the Standard. Overall, we believe the proposed Statement achieves the Board's stated objectives and is an improvement to the current accounting guidance under FIN 46(R).

While we support the issuance and overall objectives of the proposed Statement, we believe it is imperative that the Board clarify certain aspects of the guidance and reconsider other aspects prior to the issuance of a final Standard. Our general observations and specific comments on the proposed Statement are set forth below.

Qualitative Analysis - Primary Beneficiary

We support the Board's move to a qualitative approach ("Step 1" in the proposed Statement) for identifying the enterprise with a controlling financial interest in a VIE as the primary beneficiary ("PB"). We believe a qualitative approach will reduce complexity in implementation and meet the Board's objective of a more principles-based approach for determining the PB. The proposed Statement also requires the application of a quantitative analysis ("Step 2" in the proposed Statement) if an enterprise is unable to determine if it has a controlling financial interest through the qualitative analysis required in Step 1. Although we support the Board's attempt to provide guidance in situations

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where the conclusion is not clear under Step 1 of the qualitative analysis, we are not aware of circumstances that would warrant the completion of the quantitative assessment in Step 2 if the qualitative analysis in Step 1 is properly performed. This appears consistent with the Board's intent as paragraph B21 of FIN 46(R), as amended by the proposed Statement, states "The Board expects it to be uncommon for an enterprise to default to the quantitative analysis and has proposed a disclosure requirement for an enterprise to provide an explanation substantiating the use of the quantitative analysis." Given the expectation that it would rarely be appropriate to determine the PB under Step 2 of the guidance together with the fact that the Board has not provided any examples where a Step 2 analysis would be justified, we believe Step 2 of the revised PB analysis is unnecessary and may cause confusion or diversity in practice in applying the requirements of the proposed Statement.

We suggest that the Board either: (1) eliminate the quantitative analysis requirement in Step 2 in its entirety or, (2) clarify, such as through an additional example in Appendix A, the type of circumstances in which an enterprise would not be able to reach a conclusion about the PB in Step 1 and therefore would need to perform Step 2 of the PB analysis (please note, we are not suggesting that the Board illustrate the quantitative analysis itself, just a circumstance that would require use of Step 2 of the primary beneficiary assessment).

Substantive Kick-out Rights - Primary Beneficiary Analysis

Paragraph 14A(a) of FIN 46(R), as amended by the proposed Statement, states that an enterprise should not consider substantive kick-out rights in the determination of which enterprise has the power to direct matters that most significantly impact the activities of a VIE, with one exception. That exception relates to a situation where a single enterprise (including its related parties and de facto agents) has the unilateral ability to exercise such substantive kick-out rights. Paragraph B26 of FIN 46(R), as amended by the proposed Statement, acknowledges that the Board understands that excluding such substantive kick-out rights from this analysis is in conflict with other authoritative guidance, including other areas of FIN 46(R). However, the Board has indicated that if substantive kick-out rights are considered as part of the PB analysis then enterprises may have structuring opportunities to achieve a conclusion that no single variable interest holder has the power to control the VIE pursuant to paragraph 14A(a) of FIN 46(R), as amended by the proposed Statement. The Board also indicated that it believes substantive kick-out rights typically are not exercised and thus should not be considered until exercised in determining the PB for purposes of FIN 46(R). We do not agree with the Board's conclusion to ignore substantive kick-out rights in the assessment of power/control and we believe that excluding such substantive kick-outs rights is inconsistent with the power/control model of the proposed Statement and other consolidation literature. The

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Board's conclusion seems to be a reaction to perceived abuses and amounts to a rule that departs from the principles-based approach utilized in other aspects of the proposed Statement.

It appears that the Board may not have fully considered the existing FIN 46(R) kick-out rights substance tests during its deliberations regarding the proposed Statement. For example, at the joint FASB/IASB Board meeting on October 20, 2008, there was discussion about the potential difficulties in exercising kick-out rights. However, paragraph B20 of FIN 46(R) contains extensive requirements to determine whether kick-out rights to remove a VIE's decision maker are substantive. That paragraph states in part:

The determination of whether...kick-out rights are substantive should be based on a consideration of all relevant facts and circumstances. Substantive kick-out rights must have both of the following characteristics:

- a. The decision maker can be removed by the vote of a simple majority of the voting interests held by parties other than the decision maker and the decision maker's related parties.
- b. The parties holding the kick-out rights have the ability to exercise those rights if they choose to do so; that is, there are no significant barriers to the exercise of the rights. Barriers include, but are not limited to:
 - (1) Kick-out rights subject to conditions that make it unlikely they will be exercisable, for example, conditions that narrowly limit the timing of exercise
 - (2) Financial penalties or operational barriers associated with replacing the decision maker that would act as a significant disincentive for removal
 - (3) The absence of an adequate number of qualified replacement decision makers or inadequate compensation to attract a qualified replacement
 - (4) The absence of an explicit, reasonable mechanism in the contractual arrangement, or in the applicable laws or regulations, by which the parties holding the rights can call for and conduct a vote to exercise those rights
 - (5) The inability of parties holding the rights to obtain the information necessary to exercise them.

In practice, we have found that these substance requirements are rarely met for highly structured entities. It has been our experience that decision makers may not be willing to structure kick-out rights to meet these conditions because they view the ease and likelihood of exercise by the holders of the kick-out rights as too great when the

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conditions are met. 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" ("EITF 04-5"), contains substance tests for kick-out rights that are essentially the same as those in FIN 46(R). Similar to our experience with FIN 46(R), in preparation for the effective date of the guidance in EITF 04-5, we found many general partners unwilling to initiate modifications of limited partnership agreements to include substantive kick-out rights due to concerns that it would be too easy for the limited partners to exercise the kick-out rights. We believe it is unlikely that QSPEs that will become subject to the requirements of FIN 46(R) upon the effective date of the proposed Statement will meet the substantive kick-out rights requirements of paragraph B20 based on their existing governing documents. Likewise, we believe the existing kick-out rights over decision makers in other highly structured entities such as commercial paper conduits and SIVs typically don't meet these substance requirements. Accordingly, we believe the substance requirements in FIN 46(R) and EITF 04-5 have proven to be effective.

We believe current practice is generally consistent in assessing consolidation under both FIN 46(R) and EITF 04-5. That is, practitioners endeavor to reach consolidation conclusions under FIN 46(R) that are consistent with those that would be reached under the guidance in EITF 04-5 (for example, under the related party primary beneficiary guidance in paragraph 17 of FIN 46(R)) so that structuring an entity to be in either model, without significant differences in the economics, does not lead to a different consolidation outcome. Under the proposed Statement, we believe minor changes in the legal structure of an entity could result in different consolidation conclusions, due solely to the difference in how substantive kick-out rights are considered in the separate models.

Furthermore, we believe that if the guidance in this area is finalized as proposed investment funds that are VIEs in which investors hold substantive kick-out rights over the investment manager may be required to be consolidated by the sponsor (including, for example, money market mutual funds for which the sponsor has an implicit variable interest in the fund). We understand that certain Board members opposed such a conclusion specifically for money market funds when it was previously discussed under the existing guidance.

The fact that the Board concluded in the proposed Statement that substantive kick-out rights should be considered in the PB test when those rights are held by a single party (including its related parties and de facto agents) suggests that the Board believes substantive kick-out rights are relevant but may not be satisfied with the existing substance tests in EITF 04-5 and FIN 46(R). We agree with the Board's apparent conclusion regarding substantive kick-out rights held by a single party that such rights, when substantive, are equivalent to voting shares in a corporation and provide their

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holder(s) with the ability to control the investee. We believe there is widespread agreement that for purposes of evaluating consolidation and control, voting shares in a corporation that is not a VIE are relevant even if the voting rights are frequently not exercised by the shareholders, for example, to replace existing Board members of the corporation. Therefore, we believe that substantive kick-out rights should be considered in identifying the PB of a VIE. If the Board is concerned that the existing substance tests in EITF 04-5 and FIN 46(R) are inadequate when kick-out rights are held by multiple unrelated parties, then the Board should amend those substance requirements rather than creating a rule that is inconsistent with the principle that applies to voting rights in a corporation or when substantive kick-out rights are held by a single party. (As indicated previously, we believe that the existing substance tests in EITF 04-5 and FIN 46(R) are appropriate and work well when applied as intended.) If the proposed guidance is not revised by the Board, we are concerned that inconsistencies in the consolidation literature will give rise to structuring opportunities that will likely cause unintended consequences.

Reconsideration Events - Variable Interests

Paragraph 5 of FIN 46(R), as amended by the proposed Statement, requires an ongoing reassessment of whether an entity is a VIE. We believe that continuous reassessment of an entity's VIE status should not be required for the following reasons:

- Impractical/Not Operational Continuous reassessment will require the holder of a
 variable interest to obtain updated fair value information regarding many entities in
 which it holds a variable interest on an ongoing basis to assess the sufficiency of the
 equity at risk. This information is likely not available in a timely manner or at a
 reasonable cost.
- Inconsistent with "by design" premise An entity's "design" is not changed solely by movements in market conditions or by operating results that are better or worse than expected. Specifically, a controlling financial interest is not created or changed solely as a result of excess operating income or losses. Rather, all potential outcomes should be considered in the original or most recent analysis of the entity's design on which the VIE evaluation is based. Changes in design may occur as a result of operating results that are better or worse than expected, but those changes would be evidenced in the circumstances that are already captured in paragraph 7 of FIN 46(R). In our experience, the circumstances provided in paragraph 7 are sufficient to capture events requiring reconsideration of an entity's status as a VIE.
- Not necessary to address primary concerns We believe the requirement for ongoing reassessment of an entity's status as a VIE is not necessary to addresses the primary concerns of the Board and its constituents. We believe the primary concern among practitioners relates to the timely reconsideration of which enterprise, if any, is the PB

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of a VIE. Paragraph 14 of FIN 46(R), as amended by the proposed Statement, requires continuous reassessment of an enterprise's status as a PB of a VIE and would address those concerns without any need for a change in the VIE reassessment requirements. Indeed, none of the circumstances resulting from the recent credit market deterioration, which prompted the Board to include this provision in the proposed Statement, pertained to entities that were not previously considered VIEs but would have been under more frequent reassessment requirements than those currently in paragraph 7 of FIN 46(R). Accordingly, we believe the PB reassessment provision should be the sole focus of the proposed Statement and, if properly applied, would satisfy the Board's objectives.

If the proposed VIE reassessment revision is finalized as proposed, we believe that banks may be required to assess each period whether obligors in commercial lending arrangements have become variable interest entities simply due to losses incurred during the period. A bank may not be able to avoid such an analysis simply by concluding that it would not be the borrower's PB even if the borrower is a VIE due to the extensive new disclosures required by the proposed Statement. While banks routinely perform reassessments of a borrower's financial condition, banks typically do not perform a sufficiently comprehensive assessment each reporting period or obtain updated information (e.g., fair value information regarding the borrower's assets and liabilities) to complete a FIN 46(R) VIE analysis and, therefore, we do not believe that it would be practical for variable interest holders to comply with the proposed guidance without incurring excessive cost and effort.

We suggest the Board remove the requirement for ongoing assessment of an entity's status as a VIE. We believe that including a requirement for continuous reassessment of the PB will address the Board's objectives and concerns without requiring constituents to incur undue costs and effort.

Continuous Reassessment - Primary Beneficiary

Paragraph 14 of FIN 46(R), as amended by the proposed Statement, primarily focuses on the requirement to continuously reassess whether a variable interest holder should consolidate a VIE based on the provisions of paragraphs 14A-14C of the proposed Statement. We believe that this paragraph should be clarified to indicate that the result of the continuous reassessment may also be that an enterprise that currently is the PB of a VIE should deconsolidate the VIE based on the provisions of paragraphs 14A-14C of the proposed Statement.

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Assessment of Power

The proposed Statement should consistently describe how decision-making power should be identified in both the assessment of whether the entity is a VIE and of whether the enterprise is the PB of a VIE. Paragraph 5(b)(1) of FIN 46(R) states that an entity may be considered a VIE and subject to consolidation if as a group the holders of the equity investment at risk lack "the direct or indirect ability through voting rights or similar rights to make decisions about an entity's activities that have a significant effect on the success of the entity" (emphasis added). This is different than the description of decision-making power that is required under paragraph 14A(a) of FIN 46R, as amended by the proposed Statement, which states that an enterprise has a controlling financial interest in a VIE if it has "the power to direct matters that most significantly impact the activities of a VIE, including, but not limited to, activities that impact the entity's economic performance" (emphasis added). We believe the language in paragraph 5b(1) should be amended to be consistent with the language regarding decision-making power in paragraph 14A(a). If the language is not amended, that suggests that the concept for evaluating whether an entity's equity-at-risk investors control the entity is different than the concept for evaluating whether a variable interest holder controls a VIE. We cannot think of any reason why this should be the case; however, if the concepts are intended to be different, as currently evidenced by the different wording, the Board should explain why.

Implementation Guidance

We agree with the Board's decision to include numerous examples in Appendix A to provide application guidance and give constituents a better understanding of the Board's intentions for application of the new principles in the proposed Statement. However, we believe that the examples are overly simplistic and "assume away" many of the critical decisions and judgments that will be required in practice. This is because the examples are written in a way where there is obviously only one possible result of the judgments, particularly with respect to the assessment of decision-making power. While we understand that the Board cannot provide an example to cover every scenario in practice, we believe that the examples in the proposed Statement should be improved to provide more realistic assumptions to illustrate the principles and objectives of the Board.

We also believe there is a risk that constituents will interpret the examples too narrowly as identifying the *only* fact patterns or scenarios that should result in the PB (control) determinations reached. We are not suggesting that the Board consider removing the implementation guidance, but we believe that the examples can be improved to provide guidance for more complex situations that require considerably more judgment in applying the guidance. For instance, Example 8 in Appendix A of the proposed Statement could be adjusted to reflect a master/special servicer relationship where both parties are

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variable interest holders in the VIE and have the power to direct matters that impact the activities of the VIE, therefore requiring an analysis of which enterprise has the power to significantly impact the VIE's activities when power is not shared equally. As currently constructed, the examples depict opposite ends of the judgment spectrum where decision-making power is either obviously present or obviously not present. To be more effective at communicating the Board's objectives, at least some of the examples need to address points in the judgment spectrum where the presence or absence of decision-making power is not as obvious.

Primary Beneficiary - Related Parties

Given the fundamental change in the criteria for assessing the PB as outlined in paragraphs 14A-14C of FIN 46(R), as amended by the proposed Statement, we believe that the Board should also change the related party PB tiebreaker guidance provided in paragraph 17 of FIN 46(R). If the Board removes the quantitative analysis altogether for determining the PB as suggested in our earlier comments, the Board should also remove paragraph 17(c), which requires consideration of "A party's exposure to the expected losses of the VIE." If the Board retains the quantitative assessment in Step 2 (paragraph 14C), paragraph 17(c) should be retained, but we suggest that the Board clarify that it is not relevant for determining the PB when the related party group has been determined to be the PB based on the qualitative test in Step 1 (paragraph 14A). Additionally, we believe the guidance in paragraph 17(e) as added by the proposed Statement should "trump" the criteria in paragraphs 17(a)-(d). That is, if one party in a related party group meets the criteria in paragraph 14A as having a controlling financial interest in the VIE, that party should always be determined to be "most closely associated with the variable interest entity." If the Board concludes otherwise, we believe it should explain the reason for its conclusion in the final Standard.

Implicit Variable Interests

The Board has included additional references to implicit variable interests, for example, in paragraph 14A and Appendix A (Example 3) of FIN 46(R), as amended by the proposed Statement, in addition to new disclosure requirements with respect to implicit variable interests. While the Board's explicit acknowledgment of such interests is both helpful and necessary to achieve consistent application, the Board should also address (1) the identification of an implicit variable interest, (2) the implication of such interests on the assessment of whether an entity is a VIE and determination of the PB, and (3) how, or whether, an implicit variable interest could ever be disposed of.

Also, we recommend that the Board include an example specifically addressing whether sponsors will be required to consolidate money market funds for which the sponsor has

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an implicit variable interest in the fund under the requirements of FIN 46(R) as amended by the proposed Statement.

Disclosures by Primary Beneficiaries

Consolidated Variable Interest Entities - Paragraph 23 of FIN 46(R), as amended by the proposed Statement, requires primary beneficiary disclosures in certain circumstances even if the primary beneficiary also holds a majority voting interest in the VIE. We do not believe this change to FIN 46(R) is necessary. Rather, we believe the existing disclosure requirements in GAAP other than FIN 46(R) should apply in those circumstances. The proposed changes to paragraph 23 would require enterprises to analyze entities that are consolidated to determine whether those entities are VIEs and then further determine what subset of those entities meet the Statement 141(R) definition of a business and for those entities whether their assets can be used for purposes other than satisfying their liabilities. We believe the Board needs to provide a discussion of how the benefits of the FIN 46(R) disclosure requirements in these circumstances justify the incremental costs should it choose to retain the proposed changes to paragraph 23.

<u>Fair Value Information for Consolidated Assets</u> - Paragraph 23(d) of FIN 46(R), as amended by the proposed Statement, requires separate disclosure of the fair value of a consolidated VIE's financial assets and financial liabilities from the fair value disclosure requirements of Statement 107. We do not believe fair value disclosures for assets and liabilities of a consolidated VIE should be any different than for similar assets or liabilities of subsidiaries that are consolidated under other authoritative literature.

Other Disclosure Requirements

Definition of Sponsor

We believe that the Board should define the term *sponsor*. Although the term *sponsor* is used in other accounting literature without definition, we believe the scope of the other literature that references the term *sponsor* is very narrow while the scope of FIN 46(R) is very broad. Although determining whether an enterprise is a sponsor will necessarily require professional judgment, the application of judgment when neither a definition nor a framework is provided will naturally lead to inconsistent interpretation and application. Therefore, we believe that the importance of defining the term has increased based on the disclosure requirements of the proposed Statement and is essential for a consistent application of those requirements.

Significant Assumptions and Judgment

Paragraph 22C(a)(2) of FIN 46(R), as added by the proposed Statement, would require enterprises to disclose their methodology for determining whether the enterprise is (or is not) the PB, including the enterprise's significant assumptions and judgments made and

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whether a different assumption or judgment could have reasonably been made that would result in a different conclusion. We agree that it is important for a reporting enterprise to disclose its significant judgments and assumptions made in applying FIN 46(R). However, we believe that requiring an entity to second guess its own assumptions or judgments and disclose opposing assumptions or judgments does not provide useful information to financial statement users and could also create unintended difficulties from an audit and legal perspective. Accordingly, we recommend that the proposed requirement to disclose whether a different assumption or judgment could have reasonably been made that would result in a different conclusion be eliminated from the final Standard.

Continuing Applicability of the Proposed FSP's Requirements

To avoid confusion about the ongoing applicability of the disclosure requirements under 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" (the "proposed FSP"), we recommend that the Board clarify that upon an enterprise's adoption of the final Standard to amend FIN 46(R) the requirements of the proposed FSP cease to be applicable.

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We would be happy to further discuss the specifics of these issues in more detail at the request of the Board or the staff. If you have any questions about our comments or wish to discuss any of the matters addressed herein, please contact Mark Bielstein at (212) 909-5419, Kimber Bascom at (212) 909-5664, or Jason Jacobs at (212) 909-5565.

Sincerely,

