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LETTER OF COMMENT NO. 30

20 October 2008

Mr. Robert Herz
Chair, Financial Accounting Standards Board
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06865-5116

Re: *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*

Dear Mr. Herz,

The CFA Institute Centre for Financial Market Integrity (CFA Institute Centre),¹ in consultation with its Corporate Disclosure Policy Council (CDPC)², appreciates the opportunity to comment on the FASB Staff Position (FSP) No. 140-e and FIN 46(R)-e, *Disclosures about Transfers of Financial Assets and Interests in Variable Interest Entities*.

CFA Institute represents the views of its investment professional members, including portfolio managers, investment analysts, and advisors, worldwide. Central tenets of the CFA Institute Centre mission are to promote fair and transparent global capital markets, and to advocate for investor protections. An integral part of our efforts toward meeting those goals is ensuring that the quality of corporate financial reporting and disclosures provided to investors and other end users is of high quality. The CFA Institute Centre also develops, promulgates, and maintains guidelines encouraging the highest ethical standards for the global investment community through standards such as the *CFA Institute Code of Ethics* and *Standards of Professional Conduct*.

¹ The CFA Institute Centre for Financial Market Integrity is part of CFA Institute. With offices in Charlottesville, VA, New York, Hong Kong, and London, CFA Institute is a global, not-for-profit professional association of more than 96,000 investment analysts, portfolio managers, investment advisors, and other investment professionals in 133 countries, of whom nearly 83,000 hold the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 136 member societies in 57 countries and territories.

² The objective of the CDPC is to foster the integrity of financial markets through its efforts to address issues affecting the quality of financial reporting and disclosure worldwide. The CDPC is comprised of investment professionals with extensive expertise and experience in the global capital markets, some of whom are also CFA Institute member volunteers. In this capacity, the CDPC provides the practitioners' perspective in the promotion of high-quality financial reporting and disclosures that meet the needs of investors.



General Comments

Recent market events signal the importance of full disclosure of an entity’s obligations, none more important than disclosure of off-balance-sheet obligations and continued involvement in transfers of financial assets and liabilities. While the FASB considers amending the accounting guidance for these transactions, it is essential that the disclosures surrounding these events be improved in the interim. These enhancements will enable the investor to identify risks not previously known or understood.

CFA Institute generally supports the FSP to amend FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities*, to require public entities to provide additional disclosures about transfers of financial assets and to amend FASB Interpretation No. 46 (R), *Consolidation of Variable Interest Entities*, to require enterprises to provide additional disclosures about their involvement with variable interest entities. While we are supportive of the disclosure proposals, the proposed disclosures should be presented in a manner that strengthens the clarity and understandability of the transactions. To that end, we suggest that the FSP consider showing example disclosures linking the requirements with the expected outcome, namely - enhanced qualitative and quantitative information for the investors. In this regard, we found that many of the selected disclosures found in the report of the Senior Supervisors Group, “Leading-Practice Disclosures for Selected Exposures,” (April 2008) are useful for investors in assessing the nature, purpose size, activities and risks related to consolidated or non-consolidated variable interest entities.

Further, CFA Institute surveyed members in 2007, 2003 and 1999 regarding importance and quality of information provided for off-balance-sheet assets and liabilities and risks and exposures to risks. As noted in the table below, respondents rated these disclosures as high in importance, yet showed low ratings for the quality of information provided. These results underscore that the expanded disclosures proposed in the FSP are critical to the investor’s understanding of an entity’s exposure to off-balance-sheet transactions and risks.

Importance ³	Survey Year		
	2007	2003	1999
Off-balance-sheet assets and liabilities (e.g., operating leases, securitized assets, etc.)	4.3	4.5	4.2
Risks and exposures to risks (e.g., business, financial and market risk factors)	4.1	4.1	3.9

³ Importance scale: 1= not important to 5=very important; Quality scale: 1=not useful and/or not provided to 5=very useful. The ratings shown represent the weighted average mean based on the total responses for each question and/or specific item set within a given question. If respondents selected “no opinion” or did not make a selection, this response or lack thereof is not included in the total responses used to calculate the mean rating.



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Quality	Survey Year		
	2007	2003	1999
Off-balance-sheet assets and liabilities (e.g., operating leases, securitized assets, etc.)	2.9	2.6	2.9
Risks and exposures to risks (e.g., business, financial and market risk factors)	3.1	2.8	3.0

General Principles

Users consider transfers of financial assets under which the transferor retains some risk exposure fundamentally as a financing mechanism. Regardless of the financial reporting definition of a “true sale” or other attribute/mechanism that permits derecognition of securitized assets, most transfers of financial assets include some form of continuing involvement with consequences for the financial position, assessments of financial performance, and cash flows. Even when the continuing involvement is deemed immaterial (and/or does not call for accounting measurement, recognition, and/or disclosure) upon the proper application of management judgment with respect to financial reporting requirements, some degree of economic risk is retained in all transfers of financial assets. For example, banks did not recognize many structured investment vehicles (SIVs) and based their accounting on not being subject to FIN 46 (R). However, the current credit and liquidity crisis has made the bank-SIV relationship more transparent and showed us that recognition, measurement, and disclosure of the bank-SIV economic relationship would have been useful.

We recognize that determining whether an entity is the primary beneficiary of a variable interest entity requires significant judgment about many factors. Therefore, we strongly support the required disclosures in paragraph 22C.a. that request a discussion of the significant assumptions and judgements made and whether a different assumption or judgement could have reasonably been made that would result in a different conclusion.

From a user’s perspective, we need to understand how (amount, timing, and sources) the reporting entity will replace the existing funding mechanism provided by securitizations. In effect, when companies report little or no substantive continuing involvement in the current securitization vehicles (SPE, QSPE, VIE, SIV, or other form), users need to fully understand the range of likely financial statement consequences (the entity’s financial position, financial performance, and cash flows) of all transfers of financial assets and the alternative (replacement) financing mechanisms available to the entity. It is this principle that guides our response to the proposed FSP.

Disclosure Requirements of Statement 140 for Public Entities (Appendix B)

We generally agree with the principal disclosure objectives of the FSP as noted in paragraph B1 of Appendix B. The requirements provided in subsequent paragraphs are essential to the complete understanding of transfers and an entity’s continued involvement in financial assets



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transferred to an SPE. While overall we agree with these objectives, we urge the FASB to add that if an entity has any continuing relationship that may affect an entity's financial position, financial performance or cash flow that may currently be deemed to be less than significant, that the entity shall provide further information, as may be needed. We view this incremental information as the outcome of an internal sensitivity analysis of the critical factors used by management to determine disclosure levels. Management would not disclose this sensitivity analysis but would use it to determine whether additional disclosure would be useful. This reduces the likelihood that disclosures will be omitted if they do not necessarily meet the strict requirements for disclosure as provided by the FSP even though the information may be valuable to the investor.

Central to the disclosure requirements is the definition of *continuing involvement*, which is described in the FSP as:

Any involvement with the transferred financial assets that permits the transferor to receive cash flows or other benefits that arise from the transferred financial assets or that obligates the transferor to provide additional cash flows or other assets to any party related to the transfer.

As previously mentioned, determining an entity's continuing involvement in a transfer requires judgment especially as it relates to remaining de minimis risks and benefits. While it may seem that insignificant involvement would not warrant disclosure, it may be important for investors to understand (1) the reason for continuing involvement, and (2) the likelihood of the need to use alternative funding methods. In those situations, entities should follow a principles-based approach for disclosing information deemed useful to investors. For example, an entity should disclose the business purpose, risks, guarantees, liquidity needs, and other information (as it relates to the different classes of continuing involvement) considered beneficial to investors.

We believe that it would be useful for a sponsor of variable interest entities to identify alternative sources of funding that would be used if the market for such funding vehicles becomes illiquid or inactive. The entity may refer the user to other disclosures that identify those sources.

In general, we believe the definition of continuing involvement should include any transfer of assets or liabilities (to a related or unrelated entity) that:

- Constrains the resources of the transferor,
- Limits the benefits the transferor would normally receive from a sale or transfer,
- Adds to or does not reduce risks related to or stemming from operating, investing, or financing activities of the transferor,
- Exposes the transferor to incremental risks in the event the transferee is unable to provide services or discharge its contractual obligations, or
- Implies continuing involvement affecting risk or return (i.e., requires or may require



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additional collateral, cash or equity investment, repurchases of transferred assets or liabilities).

Given the general lack of transparency in the disclosures existing today, we feel that while the level of disclosure proposed by the FSP may appear excessive, and will certainly draw cries of information overload as well as adverse cost-benefit arguments, it is essential to understanding the nature of the transaction and the associated risks. Preparers may object to providing the expanded disclosure, but given the potential losses from off-balance-sheet transactions we feel that the added transparency is essential to fully understanding the economic impact and risk exposure. Additionally, preparers of financial statements argue frequently that additional disclosures cannot be assimilated or are not used. We believe that more accurate and useful information does not result in overload. Moreover, key attributes of any disclosures should be parsimony and transparency. Entities with sound risk management and financial reporting practices should have much of the required information readily available as a part of their routine risk assessment for these investments. Not regularly analyzing risks could prove more costly in the long run as unforeseen developments adversely impact the financial fundamentals for these investments.

Comments on Specific Proposals in Appendix B

Paragraph 17 b (3) Add a requirement to disclose how the fair value was determined.

Paragraph 17 e (3) Add a requirement to disclose how changes in circumstances (e.g., interest rate changes, contractual arrangements, etc.) could affect each of these.

Paragraph 17 f (2) Require not encourage an entity to disclose the valuation techniques, as well as quantitative and qualitative information about assumptions used to estimate the fair value of those instruments.

Paragraph 17 g (3) Require not encourage an entity to disclose the valuation techniques, as well as quantitative and qualitative information about assumptions used to estimate the fair value of those instruments.

Disclosure Requirements of Interpretation 46(R) For Public Enterprises (Appendix C)

While our remarks above relating to the seemingly dense display of the requirements also apply to variable interest entity disclosures, we nonetheless strongly support the expanded disclosures proposed in Appendix C when an entity is (a) the primary beneficiary of a variable interest entity, (b) holds a significant variable interest in a variable interest entity but is not the primary beneficiary, or (c) is a sponsor that holds a variable interest in a variable interest entity (irrespective of the significance of the variable interest). The proposed disclosures enhance the transparency of these transactions and will close existing gaps in information critical to investors. Paragraph C1 describes the principal objectives of the disclosures required by subsequent paragraphs. We suggest that the sentence below be more prominently displayed in the objectives in order to further emphasize its importance.



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... if the enterprise's economic relationship with the variable interest entity or exposure to risk is not addressed by any of the disclosures provided in paragraphs 22B-26, the enterprise shall provide further information, as needed.

This requirement is in keeping with a principles-based approach to disclosure and would capture those situations which may otherwise be obscured by not meeting the strict definitions of the proposed requirements.

Furthermore, we suggest the following specific disclosures:

1. Require entities to disclose how they determine if their variable interest is significant and under what situations it may be reassessed.
2. If an entity is a primary beneficiary, significant variable interest holder or sponsor, report any transactions with the VIE (e.g., purchases of commercial paper from an ABCP conduit, etc.)
3. Disclose how an entity assesses whether it is a primary beneficiary, significant variable interest holder and how and when these may be reassessed.
4. Disclose any transfers or derivatives entered into with any third party with the underlying representing interest or assets of the VIE. These transactions alter the nature of the risk with the VIE and the entity, but unless these are with the trust, under current practice these are not generally assessed or disclosed.

Disclosures for a Public Enterprise that is a Nontransferor Enterprise that Holds a Significant Variable Interest in a Qualifying SPE (Appendix D)

For reasons as noted above, we strongly support the expanded disclosures for nontransferors holding significant variable interests in qualifying SPEs. This information will enable investors to better assess the nature of the qualifying SPE and associated risks.

Closing Remarks

We commend the FASB for undertaking the initiative to improve the disclosures for transfers and variable interest entities. The enhanced disclosures provide key information to investors. As previously stated, we believe that the FSP could be greatly strengthened by providing disclosure examples and discussion related to how the enhancements contribute to decision usefulness.



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If you, other board members or your staff have questions or seek further elaboration of our views, please contact either Matthew Waldron, CPA , by phone at +1.434-951-5321, or by e-mail at matthew.waldron@cfainstitute.org , or Patrick Finnegan, CFA, by phone at +1.212.754.8350, or by e-mail at patrick.finnegan@cfainstitute.org.

Sincerely,

/s/Kurt N. Schacht

Kurt N. Schacht, CFA
Managing Director

/s/ Gerald I. White

Gerald I. White, CFA
Chair, Corporate Disclosure Policy Council

cc: Corporate Disclosure Policy Council