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LETTER OF COMMENT NO. 47

14 November 2008

Reconsideration of Interpretation 46R, Consolidation of Variable Interest Entities

Dear Mr. Roberge:

We appreciate the opportunity to provide comments on the Exposure Draft (the ED) of a Proposed Statement of Financial Accounting Standards, *Amendments to FASB Interpretation No. 46(R)*. We support the FASB in its efforts to deal with the very complex issues of consolidation and transfers of financial assets. As a global financial services firm, we deal with those issues regularly.

Our financial reports are prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (the IASB). We also have regulated subsidiaries that are required to prepare stand-alone financial statements under US GAAP. Thus, we are keenly aware of differences between IFRS and US GAAP. Our key message for the Board is to reach a converged solution on accounting for consolidations of variable interest entities and voting interest entities.

The credit crisis and its consequent market upheaval have highlighted that differences between IFRS and US GAAP are not supportable in global capital markets. They have proven again that accounting standards must provide a level playing field in which reporting entities' key objective is to provide information that faithfully represents their respective financial position and performance. Unlevel playing fields impair the credibility of standard setters, weaken confidence in the accounting standards themselves and damage the trust that users of financial statements place in financial reporting to faithfully represent an entity's economic condition.

At the recent joint meeting, the FASB and IASB discussed the ED and the IASB's staff draft of a consolidation standard expected to be issued as an exposure draft in this last quarter of 2008. In that meeting, it was noted in the discussion that the staff draft (and its underlying principles in SIC 12, *Consolidation—Special Purpose Entities*) would produce similar consolidation outcomes to those in the examples of the ED. Some FASB Board members questioned that assertion. We have extensive practice experience with SIC 12 and its principles, and we do not agree with the assertion that one would come to the same consolidation outcomes in the ED's examples using SIC 12. In practice under SIC 12, a quantitative analysis of risks and rewards has been a heavily weighted factor in reaching consolidation decisions. In our experience, it is unusual for an entity to consolidate an SPE if it does not have a majority of risks or rewards. Paragraphs 10(c) and 10(d) and the appendix of SIC 12 explain that an analysis of risks and rewards is necessary to consider in assessing whether a particular entity controls the SPE. We do not

believe that the IASB staff draft discussed at the joint meeting would in practice change the emphasis placed upon the quantitative analysis. Therefore, we believe that the ED and the anticipated IASB standard will result in significantly different consolidation outcomes with respect to SPEs.

As noted above, we urge the FASB and the IASB to work jointly to produce a single standard on consolidation that uses the same wording. We believe the Boards should cease work on some other projects to dedicate additional resources for the development of a joint consolidation standard. Global capital market participants do not understand why accounting standards continue to give different outcomes to the same transactions. We believe that the time for stop-gap standards is over. Genuine convergence is needed.

We have the following other concerns with the ED:

- The ED's qualitative analysis in paragraph 14A will result in the consolidation of most (if not all) investment funds in which the fund manager does not have a substantive equity investment and cannot be kicked-out. The power of investment fund managers is often limited by the investment guidelines and other agreements that cannot be changed by the fund manager. In general, the fund manager acts in an agency capacity with investors redeeming their equity shares if dissatisfied with the agent's services. Redemptive rights can force the sale of fund assets and therefore one can argue that such rights mean that the investors as a class have the power to direct matters that most significantly impact the activities of an investment fund.
- Paragraph 14A(a) of the ED limits the consideration of substantive kick-out rights to those held by a single entity. We do not understand the basis for that decision (although we understand that the Board was concerned about potential abuse) and believe that this represents an exception to the principle being articulated. If substantive kick-out rights exist, then the manager is acting in an agency capacity; that fact should be recognized as the right holders have the power to direct matters that most significantly impact the entity.
- The ED will result in a significant amount of VIEs being consolidated. Those consolidated entities will gross up balance sheets and have the potential to mislead financial statement users about the nature of assets and liabilities that reporting entity is deemed to control. We believe that linked presentation offers a substantive mechanism for dealing with that issue. It would improve transparency and understandability. Additionally, it is a topic that the IASB is developing in relation to transfers of financial assets. Again, the Board needs to work hand-in-hand with the IASB to develop a single standard.

We recognize that the Board is under significant pressure to issue a revised standard for VIEs. We believe that a stop-gap standard has the potential to cause more harm than good; what is needed is a single converged standard established through a process that thoroughly considers all the issues. We thank the Board for this opportunity to participate in its due process. If you have any questions regarding our comments, please contact John Gallagher at (203) 719-4212 or Mike Tovey at (203) 719-8164.

Kind regards

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