



Investors Technical Advisory Committee

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January 21, 2009

LETTER OF COMMENT NO. 71

Russell G. Golden
FASB Technical Director
Financial Accounting Standards Board
P.O. Box 5116
Norwalk, Connecticut 06856-5116

Re: File Reference Numbers: 1610-100 and 1620-100 - Proposed FASB Statement, Amendment to FASB Interpretation No. 46(R), Consolidation of Variable Interest Entities, and Proposed FASB Statement, Accounting for Transfers of Financial Assets - an Amendment of FASB Statement No. 140

Dear Mr. Golden:

This letter is written on behalf of the Investors Technical Advisory Committee ("ITAC"). The purpose of the ITAC is to provide independent technical advice, from the investors' perspective, to the Financial Accounting Standards Board ("FASB") and its staff. The ITAC is comprised of individuals from the investment profession possessing strong technical accounting knowledge.¹

We note that over the course of the past three decades, the FASB has repeatedly adopted financial reporting standards, without success, to provide transparency to the economics of asset sales, securitizations and the related financings. It is important to the creditability of the Board, that this time the issue be properly addressed, without compromises that have had a negative impact on earlier standards. We also note that the AICPA over three decades ago established a standard^{2 3} that required transactions structured as a sale, but which were in substance financings, to be reported as financings. We believe such transparency is sorely needed once again in a timely manner.

We believe that to achieve a successful standard, the Board should set forth its objectives at the forefront of the standard. Those objectives should be clear, and enforceable, and

¹ This letter represents the views of the Investors Technical Advisory Committee ("ITAC") and does not necessarily represent the views of its individual members, or the organizations in which they are employed, or the views of the Financial Accounting Standards Board or its staff. For more information about the ITAC, including a list of current members and the organizations in which they are employed, see http://www.fasb.org/investors_technical_advisory_committee/itac_members.shtml.

² Statement of Position 74-6 – Recognition of Profit on Sales of Receivables With Recourse, June 14, 1974.

³ Issues Paper "Accounting for Transfers of Receivables With Recourse," March 20, 1980.

should explicitly state that transactions that are in substance financings of assets, should be reported as such.

ITAC appreciates the opportunity to express its views to the FASB and staff on the issues of accounting for transfers of assets and consolidation of variable interest entities (VIEs). Overall, we are encouraged that the FASB is addressing long-lasting shortcomings in these critical accounting and reporting standards. As noted in our February 15, 2008 letter to FASB:

The general consensus of the ITAC: the reporting of securitization transactions currently provided to investors has significant deficiencies, and has contributed to uncertainty and volatility in the capital markets. Accordingly, we applaud and support efforts of the FASB to improve financial transparency that will allow investors to make fully informed and timely decisions.

...

...Short-term repairs to Statement 140 will do nothing to address the issue of structured investment vehicles (SIVs) and other similar asset-backed securitization transactions that are not effected through a QSPE (e.g., many ABCP transactions), most of which did not exist on the balance sheets of companies that have originated them and have benefited from their borrowing activities. We believe investors have not been provided with meaningful information about potential risks associated with such activities – partly attributable to the insufficient balance sheet accounting for them despite the application of Interpretation 46R, and partly attributable to the lack of full-throated disclosures. Such vehicles have been the cause of much market tumult over the last six months, and there appears to be a substantial lack of transparency surrounding them. In retrospect, the sponsors have retained substantial risks in many of these transactions, while providing only limited disclosures to investors regarding their off-balance sheet activities. ITAC believes that the consolidation provisions of Interpretation 46R may be applicable to such entities, but the principles-based aspects of that standard have not been applied particularly well in practice. These vehicles escaped consolidation and as consequence, important investor information was deficient... The ITAC strongly urges the FASB to also take up the issue of SIV and similar non-QSPE securitization accounting as it develops a replacement for Statement 140.⁴

We strongly encourage FASB to change, without further delay, the accounting so as to eliminate opportunities for structuring financial arrangements and transactions in order to avoid recognition of financings on the face of financial statements while at the same time retaining risk exposures and involvement in the structured entities. In revising Statement

⁴ Letter from Jack Ciesielski, Member, Investors Technical Advisory Committee, to Mr. Robert Herz, Chairman, FASB (Feb. 15, 2008), http://www.fasb.org/investors_technical_advisory_committee/ITAC_Stmnt140.pdf

140 and Interpretation 46(R), we believe the following objectives should be incorporated therein:

1. To the extent a sponsor implicitly or explicitly controls, has the power to control or has the most exposure to the risks and rewards of an entity, then the sponsor should consolidate it.
2. Companies should be able to report to investors that an asset has been sold only if it really has been sold, and not merely financed in one form or another such as a structured financing. When a company retains economic benefits or risks of the asset, such as through structured finance or through continuing involvement, we do not believe that an asset should be treated as a sale and qualify for de-recognition of an asset. Otherwise the transactions are simply financings and should be reflected as such on the balance sheet.
3. Consolidation should occur when a transferor continues to control or has the power to control the assets or retains benefits or risk of loss. For instance, presence of these factors may be indicated through such arrangements as:
 - a. Asset substitution agreements.
 - b. Servicing agreements, especially if the sponsor has the rights to a portion of the cash flows from the assets through such agreements
 - c. Contractual terms that include “triggers” which stipulate when cash flows can be redirected
 - d. Other credit enhancements
 - e. Loan modifications
 - f. Exercisable rights or options to control
 - g. Put or call rights.
4. Consolidation should be required if a transferor retains the benefits or risk of loss associated with an asset or entity. For instance, a transferor may take on the “first dollar of loss” risks through over collateralization, holding the lower tranches and residuals, or through “puts” or other rights or may retain exposures via derivatives. Some of these agreements in essence, put the seller in the position of being the equity holder in the deal, or holding substantially similar risks. When the money used to acquire assets in transactions leaves those who provide the money in the position of a debtor, rather than exposed to loss that an equity investor would be expected to incur, then those funds should be reported to investors as financings.
5. If the seller of an asset or sponsor of a structured entity has historically or is likely to have reputational risks that would cause them to make investors whole on losses, or share in the benefits above and beyond some rate of return to the investors, then the transactions should be reported as liabilities or benefits respectively.

We would like to offer comments on specific issues related to the proposals.

International Convergence

It is not clear whether the consolidating conclusions with regards to structured entities would be the same under Exposure Draft 10 Consolidated Financial Statements that was issued by the International Accounting Standards Board, as they would under the proposed Amendment to Interpretation 46(R). In our view, the implementation guidance in ED 10 appears insufficient to achieve a financial reporting outcome as high quality and transparent as we expect would be achieved under the FASB proposal to amend Interpretation 46(R). Accordingly, and consistent with our view of the urgency of moving forward, we urge the FASB to finalize the proposals without delay notwithstanding non-convergence with International Financial Reporting Standards (IFRS). FASB should stay the course and resist calls to delay implementation in the interest of convergence with IFRS.

Quantitative Test

We believe that the aforementioned overriding objectives should drive guidance. As we discussed at our June 2008 meeting with FASB, we are concerned with retaining the quantitative test, which is currently required in Interpretation 46(R) and has provided significant structuring opportunities to determine which party is the primary beneficiary of the entity. Even though the proposed amendment would require an entity to use the quantitative test only when a determination of the primary beneficiary could not be made using the qualitative assessment, we are concerned with including the quantitative test at all, despite the proposed requirement to disclose why a qualitative assessment could not be utilized to determine the primary beneficiary. At the Congressional hearing on Transparency in Accounting: Proposed Changes to Accounting for Off-Balance-Sheet Entities on September 18, 2008, Chairman Jack Reed appropriately pointed to the salient issue when he asked:

I understand the [FIN 46(R) Amendment] Proposal has a default position of a quantitative measure. If the qualitative approach does not work, what is to prevent someone from doing sort of a paper drill, you know, a qualitative analysis to satisfy Mr. White and Mr. Kroeker and their colleagues and then essentially just say, well, here is the number, and [achieve deconsolidation or derecognition]?⁵

We share the concern that companies may not identify primary beneficiaries under the qualitative test and therefore default to the quantitative test resulting in accounting practice for variable interest entities similar to how it is today.

⁵ Opening statement by Senator Reed, at Hearing on “Transparency in Accounting: Proposed Changes to Accounting for Off-Balance-Sheet Entities,” September 18, 2008, United States Senate, Subcommittee on Securities, Insurance and Investment, Committee on Banking, Housing and Urban Affairs, <http://banking.senate.gov/public/index.cfm?Fuseaction=Hearings.Detail&HearingID=be81458c-abc1-49aa-ac6d-0ab5f8d9fea2>.

Qualitative Test

While we support the requirement that companies consider reputational risk in the control assessment, we would prefer that this requirement be framed as a rebuttable presumption. That is, there should be an inherent presumption that consolidation occur for entities structured by or assets transferred by the reporting entity if failure of the structures or loss in value of transferred assets could diminish the reporting entity's reputation.

Shared Powers

We are concerned that the shared-power requirement for achieving deconsolidation is confusing. Such arrangements entered into to get a derived accounting result, such as sales treatment when the substance of the transaction is a financing, should be prohibited. We encourage FASB to revisit this requirement so it does not provide structuring opportunities or where a controlling party solely may relinquish or share powers to achieve a desired accounting outcome. We welcome the opportunity to review potential new guidance in this area and help clarify and make it more robust to prevent abuse.

Kick-out Rights

We agree with the FASB's conclusion that the qualitative analysis should not consider substantive kick-out rights unless the enterprise has the unilateral and sole ability to exercise such kick-out rights. It is our understanding that kick-out rights are typically not exercised. Therefore, we believe they should not be considered exercised until they are exercised. However, we recommend strengthening paragraph B20 to read as follows:

The ability of an investor or another party to remove the decision maker (that is, kick-out rights) does not affect the status of a decision maker's fees in the application of paragraphs B18 and B19 unless the rights are substantive. The determination of whether the kick-out rights are substantive should be based on a consideration of all relevant facts and circumstances. Kick-out rights must be substantive, and must include the following characteristics and other characteristics if relevant to their substance:

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 explicit or implicit 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 the 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.*

Reconsideration of a VIE

We concur with the FASB's decision to improve the requirement for reconsidering whether an entity is a VIE. Since economics surrounding a VIE and related risks change with time, as well as who might be the likely beneficiary and/or has the exposure to risk, an on-going evaluation will provide the only meaningful accounting.

Participating Interest Exception and Definition of Control in Amendment to Statement 140

We disagree with the FASB's decision to have the transfer of a portion of a financial asset accounted for as a sale and be eligible for derecognition for a pro rata portion that meets the definition of a participating interest. We are concerned that the accounting is inconsistent for economically similar transactions and would present structuring opportunities, and contributes to overall complexity in accounting. Specifically, we read the proposed amendment to Statement 140 to allow derecognition when a loan or loan portfolio is transferred to a trust and a portion retained. However, at the same time, the ED requires that if only part of the same loan or loan portfolio is sold outright and a portion is retained, that the transaction does not qualify for derecognition and must be booked as a secured borrowing. We recommend simplifying implementation and adhering to our aforementioned objectives under the general spirit of no continuing involvement for derecognition.

In conclusion, we encourage the FASB to achieve timely issuance of the proposed amendments to Statement 140 and Interpretation 46(R). Investors have been waiting for decades for more representational accounting and reporting of structured entities and asset transfers. As is evidenced during the current financial crisis, improving financial reporting in this area is of utmost importance to investors. We believe that the proposals will serve to improve confidence in the country's capital markets.

If you have any questions, please feel free to contact the undersigned or any ITAC member.

Sincerely,

Investors Technical Advisory Committee By:

A handwritten signature in black ink that reads "Elizabeth J. Mooney". The signature is written in a cursive style with a long, sweeping underline that extends to the right.

Elizabeth Mooney
Member
Investors Technical Advisory Committee

CC Chris Roberge, Project Manager, FASB
Alan Teixeira, Director of Technical Activities, IASB