

February 15, 2012

Via Email: director@fasb.org

Attention: Technical Director File Reference No. 2011-220 Financial Accounting Standards Board 401 Merritt 7 P.O. Box 5116 Norwalk, CT 06856-5116

Re: Exposure Draft of a Proposed Accounting Standards Update – "Consolidation (Topic 810): Principal versus Agent Analysis"

Ladies and Gentlemen:

The American Securitization Forum ("ASF")¹ appreciates the opportunity to submit this letter in response to the request for comment by the Financial Accounting Standards Board ("Board") regarding the Exposure Draft of a Proposed Accounting Standards Update – "Consolidation (Topic 810): Principal versus Agent Analysis" (Exposure Draft). We applied the Board's efforts to develop an accounting standard in a manner that takes into account the concerns expressed by commentators.

As a brief background, over the past decade, ASF has become the preeminent forum for securitization market participants to express their views and ideas. ASF was founded as a means to provide industry consensus on market and regulatory issues, and we have established an extensive track record of providing meaningful comment to policy makers, standard setters and federal regulatory agencies on issues affecting our market.

We generally support the proposal to develop greater converged consolidation guidance with that of the International Accounting Standards Board as outlined in this Exposure Draft. We further support the proposed guidance to eliminate the inconsistency when evaluating kick-out and participating rights under the voting interest and variable interest models. However, we would

¹ The American Securitization Forum is a broad-based professional forum through which participants in the U.S. securitization market advocate their common interests on important legal, regulatory and market practice issues. ASF members include over 330 firms, including issuers, investors, servicers, financial intermediaries, rating agencies, financial guarantors, legal and accounting firms, and other professional organizations involved in securitization transactions. ASF also provides information, education and training on a range of securitization market issues and topics through industry conferences, seminars and similar initiatives. For more information about ASF, its members and activities, please go to www.americansecuritization.com.

ASF Letter re "Consolidation (Topic 810): Principal versus Agent Analysis" February 15, 2012 Page 2

like to share the following observations regarding inconsistencies and areas that would benefit from further clarity.

Basis for conclusions on illustrative examples – Assessing a Decision Maker's Capacity

We appreciate the Board's effort to provide various illustrative examples to assist in the evaluation of the proposed principal versus agent analysis. However, without further clarification on how the conclusions were reached, particularly with respect to how an entity's purpose and design were considered, we are concerned that some of the examples may cause the preparers to draw bright lines from the facts presented. For example, one may conclude from Case C² that a pro rata equity investment of 20 percent or more with a 2 percent fixed fee of the assets under management and a performance fee of 20 percent of the fund's profit is indicative of a principal relationship in the absence of substantive kick-out rights. While this may be an appropriate assessment for one type of entity, this may not always be true for another type of entity with a different set of facts and circumstances (i.e., different purpose and design).

For example, in certain circumstances, a pro rata equity investment of 20 percent may represent a seed capital investment in an entity by a manager. Typically, the purpose of keeping this seed capital investment in the entity is to align the manager's interest with and to attract other investors, and the seed capital is invested only temporarily. Once the entity has sufficient equity investments made by other investors, the manager will pull out the seed capital investment. Considering the purpose and design of this specific scenario, one may conclude that the manager is an agent and not a principal under the exact same terms as Case C.

To avoid such generalization in the application of the proposed guidance and to ensure exercise of appropriate judgment as intended by the Board, we encourage the Board to provide further transparency into the thought-process behind the principal versus agent analysis in the illustrative examples presented. For example, we believe a more robust discussion on how the purpose and design of the entity were considered in the overall assessment and what changes to this fact pattern could result in different conclusions would be helpful. Furthermore, we find the discussion of alternative facts included at the end of Case D³ that could alter the overall principal versus agent assessment also to be helpful (however, it still does not clarify the consideration of purpose and design). We believe inclusion of such discussion in other illustrative examples will encourage readers to apply appropriate judgment in weighting various factors in arriving at the overall principal versus agent conclusion. Lastly, to further clarify that the illustrative examples are not intended to provide any bright lines, the Board may want to consider adding similar language to that included in ASC 810-10-55-94⁴ (illustrative examples on identifying a primary beneficiary).

² Case C: Investment Fund – Performance-Based Fees and Additional Interests (Exposure Draft - page 67)

³ Case D: *Investment Fund – Board of Director* (Exposure Draft - page 69)

⁴ ASC 810-10-55-94: "...These cases are hypothetical and are not meant to represent actual transactions in the marketplace. Although certain aspects of the Cases may be present in actual fact patterns, all relevant facts and circumstances of a specific fact pattern or structure would need to be evaluated to reach an accounting conclusion..."

ASF Letter re "Consolidation (Topic 810): Principal versus Agent Analysis" February 15, 2012 Page 3

Evaluation of substantive kick-out rights and participating rights

We believe it was the Board's intention to align the evaluation of kick-out rights with that of participating rights. If more than one unrelated party holds such rights, neither kick-out rights nor participating rights, in isolation, are conclusive in determining that a decision maker is not a principal. We understand that the substance of both such rights should be studied and analyzed. However, while the Exposure Draft clearly states that the likelihood of exercise by the interest holder should not be considered in assessing whether a participating right is substantive, it does not afford the same consideration to a kick-out right.

Due to the inconsistency in the drafting of the language around kick-out rights and participating rights as discussed herein, we are concerned that uniform evaluation of substantive kick-out rights versus substantive participating rights may not occur. We urge the Board to clarify that the likelihood of (or intention to) exercise is also not a consideration in evaluating the substance of kick-out rights.

In addition, it would be helpful to clarify the word "likelihood." We believe what the Board expects is for one to ignore the 'intention" held by the holders of the participating rights to exercise their rights but not the "practicability." If so, we suggest replacing the word "likelihood" with "intention" to clarify the Board's expectation. For example, "The <u>intention</u> of the participating rights holders to exercise their rights shall not be considered when assessing whether a participating right is substantive. However, the "practicability" of exercise should be considered when evaluating the substance of such rights."

Furthermore, we ask that the Board clarify that kick-out rights can be deemed substantive even if certain restrictions apply. For example, some kick-out rights may have restrictions which stipulate that they cannot be exercised for a cause unrelated to the entity (e.g., the holder of the kick-out right cannot use it as a leverage to threaten to kick-out a servicer as a means to get unrelated business opportunities). We believe it is not the Board's intention that such restriction will prevent the kick-out rights from being deemed substantive.

Reconsideration: Primary beneficiary versus Principal/Agent

We would like to highlight our concern with respect to the inconsistency in the reconsideration requirement of a primary beneficiary versus that of a principal/agent. While the primary beneficiary status is reconsidered continuously as facts and circumstances change, the proposal, as drafted, requires the reconsideration of a principal versus agent relationship only upon changes in the purpose and design of the entity (ASC 810-10-35-6 and ASC 810-10-35-7 in the Exposure Draft). We strongly believe a reconsideration of a principal versus agent determination upon changes in facts and circumstances and not only upon changes in the purpose and design of an entity is critical. This would allow for a reconsideration of principal or agent upon a change in circumstance as well as a reconsideration of determining whether the entity is a variable interest entity ("VIE").

ASF Letter re "Consolidation (Topic 810): Principal versus Agent Analysis" February 15, 2012 Page 4

We believe it is the Board's intention and expectation that an agent (or its related parties / de facto agents) who acquires additional interests in an entity should reconsider its relationship as a principal or agent. Similarly, if a principal (or its related parties / de facto agents) disposes of its interests in part or in whole, we believe the Board also expects that the principal reconsider whether it is using its power in the capacity of a principal or an agent.

Furthermore, to illustrate our concern, we would like to draw the attention of the Board to Case C of the illustrative examples – *Assessing a Decision Maker's Capacity* where the investment manager is considered to be a principal. If the investment manager subsequently sells its 20 percent pro rata investment in the entity in its entirety, the facts will now be reflective of Case B⁵ of the illustrative examples – *Assessing a Decision Maker's Capacity* where the investment manager is considered to be an agent. While a decision maker's economic interest in an entity is one of the criteria in evaluating whether it is a principal or an agent at initial assessment, a change in such economics is not considered a change in the purpose and design of the entity. Accordingly, despite having sold all of its equity investment in the entity and despite the fact it would be considered an agent under the initial principal versus agent evaluation, the investment manager in the scenario above would continue to be deemed a principal. Such an assessment has multiple implications in the overall consolidation analysis. Continuing to consider the investment manager to be a principal would result in the entity remaining a VIE and the investment manager a primary beneficiary even though it only receives a fixed fee of 2 percent of the assets under management and a performance fee of 20 percent of the fund's profit.

Given the peculiar outcome that would result from not being able to reconsider a principal versus agent relationship upon changes in facts and circumstances as discussed above and given what we believe the Board's expectation is on changes in one's economic interest(s) in an entity, we urge the Board to align the reconsideration requirements for principal versus agent status with that of the primary beneficiary status.

⁵ Case B: *Investment Fund – Performance-Based Fees* (Exposure Draft – page 65)

ASF Letter re "Consolidation (Topic 810): Principal versus Agent Analysis" February 15, 2012 Page 5

ASF very much appreciates the opportunity to provide the foregoing comments in response to the Board's request for comment. Should you have any questions or desire any clarification concerning the matters addressed in this letter, please do not hesitate to contact me via telephone at 212.412.7107 or via email at tdeutsch@americansecuritization.com, or Jim Johnson, ASF Managing Director, Public Policy, via telephone at 202.339.8607 or via email at jjohnson@americansecuritization.com.

Sincerely,

Tom Deutsch

Executive Director

Jow Deutsch

American Securitization Forum