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Comment Letter No. 153

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Gentlemen,

CAI International, Inc. (CAI) is one of the world's leading container leasing and management companies. Founded in 1989, CAI today operates a fleet of approximately 750,000 shipping containers, which are leased to shipping lines throughout the world. CAI is a public company with a market capitalization of approximately $500 million, and annual revenues of $174 million for the year ended December 31, 2012.

We have reviewed the FASB/IASB Lease Re-Exposure Draft ED/2013/6 *Leases* (RED) and have noted below a number of comments setting out why we believe the RED has been drafted without full consideration of the potential negative impact of the accounting changes to equipment lessors and lessees, and the readers of their financial statements. We believe that adoption of the proposed standard could and will result in like equipment with like lease terms being treated differently by different lessors and lessees, as opposed to the relatively unambiguous straight forward standards that are in use today.

Economics of the Lease

- The shipping containers in our fleet can remain in service for fifteen to twenty years, during which time they are usually leased to several different customers on leases with typical durations of between three and five years.

- Under current lease accounting, a lease is capitalized if it is, effectively, a financing transaction. In most cases, neither the lessor nor the lessee of shipping containers enters the leasing transaction with the intention of there being a transfer of title at the end of the lease. Lessees typically enter leasing transactions to improve their operational flexibility; treating these operating leases as financing transactions would create confusion among the users of financial statements as the containers are almost universally returned to the lessor, where the lessor re-leases them to a third party or based on the age of the equipment, may sell or scrap them.

- As an operating transaction, it is appropriate to reflect a straight-line pattern of income and expense recognition. This method more truly reflects the cash flow and economics of the lease as the benefits derived from the equipment by the lessee are constant over the lease term.

Subjectivity

- The RED requires a number of subjective judgments, particularly over estimates of residual values and fair values, as well as the determination of the 'significance' of lease terms compared to the economic life of an asset.

- For example, the phrase "insignificant in relation to the total economic life of the asset" is subject to interpretation. Would a three-year lease for a new piece of equipment that has an eighteen-year economic life be considered significant or insignificant?

- Since virtually every lessor operates with a high degree of leverage, cost of equipment is not the only factor that is important in evaluating a lease transaction; the lessor's cost of capital is critical in making a determination of the underlying economics of a transaction. For example, is a lease income stream that returns 50% of the original cost of the equipment in 5 years considered significant or insignificant (it might be significant if the lessor's cost of capital is low, but not significant if the lessor's cost of capital is high). Does it make sense that identical equipment will be valued differently by different lessors? Does this contribute to, or diminish the readability and transparency of financial statements? We believe it diminishes.

- Similarly, estimating residual values for leased shipping containers will lead to ambiguity and confusion. The fair value of a container at some point in the future is based on current container prices. Containers are effectively a commodity, with prices for new, and used, containers fluctuating significantly over relatively short periods of time. This is likely to lead to significant differences in treatment for what are essentially identical assets.

- These types of subjective decisions would need to be made individually for every piece of equipment in a lessor's portfolio and will be subject to an intense level of scrutiny by auditors, investors, lenders and others.

- Additional confusion is likely to arise due to the complexity of the proposed changes and the resulting reporting requirements, and due to the significantly expanded role and impact of management estimates of future residual values. Therefore, the objective of the proposed accounting changes (i.e., to achieve additional transparency) is unlikely to be realized.

Complexity

- It is unclear how the lease receivable and residual asset model would work for leases that involve multiple assets with different ages and values at lease inception and at lease expiration. The RED as currently drafted, would require us to account for each leased container as if it were a separate lease. Such treatment would be complex and burdensome.

- It is entirely possible that lessors and lessees will have to maintain multiple sets of books and records to satisfy GAAP, tax, legal and debt compliance requirements. This would result in significant additional cost being incurred by organizations, with little or no extra value provided to the users of the financial statements.

- These changes and the associated complexity will make it difficult for lenders to our industry to understand lessors' financial results, which, in turn, may make it difficult for such lessors to raise additional financing. This could potentially result in a reduction in the amount of capital provided to lessors, increased financing costs, increased compliance and regulation and a complete overhaul of current lending procedures.

Comparability

- Given the subjectivity and complexity of the proposed new accounting rules, it is likely that their adoption will be inconsistent among companies in similar industries. Not only will this lead to incomparability issues between companies in the same industry, but it is likely to also lead to disparate treatment of the same contract by lessors and lessees.

- Under the present accounting rules, the classification of leases in the financial statements is clear and easily understood by users, and the accounting for such leases is consistent among lessors. Disclosures in the notes to financial statements are comprehensive and provide all relevant data to financial statement users. There already exists a high degree of consistency between accounting requirements as set out by FASB and IASB, so accounting divergence and lack of financial statement comparability among lessors are not issues that exist today.

Financing

- The proposed accounting changes will have a significant effect on the financing of both lessors and lessees, leading to cost implications and compliance challenges for all parties involved with non-property leases.

- The proposed treatment of operating leases as financing transactions would require lessees to seek amendments, or waivers, to their own financing arrangements as many covenants are EBIT and leverage test based. The proposed accounting rules will change the classification of revenue and expense, as well as asset and debt classification on the balance sheet, creating a great deal of confusion as to what appropriate covenant standards should be – particularly in light of the fact that different companies may treat identical assets differently.

- For lessors, such as ourselves, the proposed changes would result in a significant change in the way we access capital. Currently, lenders provide debt capital based on a percentage of the net book value of the financed assets. By treating that asset as a receivable and a residual value will eviscerate the fundamental credit standards that underpin the extension of credit across the leasing industry and at a minimum will require changes to the entire funding structure, leading to complexity and cost.

Conclusion

- The rules proposed by the RED add complexity and create a compliance burden without improving the level of financial statement disclosure. Implementation of the proposed new rules will require considerable judgment and subjectivity, making the financial statements of lessors less meaningful to users. As a result of the complexity and subjectivity associated with adopting the new rules, financial statement audits will involve significant additional cost and will result in inevitable disagreement between financial statement issuers and their auditors.

- The changes proposed in the RED are significant and could have a profound impact on many industries. We consider the administrative burden resulting from these proposed changes to significantly outweigh any perceived benefit, and request that you reconsider your approach to lease accounting.

Please contact me if you require any clarification or have any questions.

Sincerely yours,

Timothy Page
Chief Financial Officer