September 13, 2013

Mr. Russell Golden, Chairman
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856

Mr. Hans Hoogervorst, Chairman
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

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Dear Chairman Golden and Chairman Hoogervorst:

We, the Railcar Leasing Coalition ("the Coalition"), represent many of the largest railcar lessors doing business in North America, with some companies operating globally as well. According to the Association of American Railroads, more than fifty-seven percent of the 1.6 million railcars utilized in the US are lessor-owned[1]. We appreciate the opportunity to provide our comments, which represent the consensus views of the Coalition, on the Proposed Accounting Standards Update (Revised), *Leases (Topic 842)* ("the ED") to the FASB and IASB (collectively, "the Boards").

We do not support issuance of the ED as a final standard and respectfully recommend the Boards reconsider and revise the conclusions reached in the ED, particularly with respect to lessor accounting. In our opinion, the proposed changes do not represent an improvement over current GAAP since they would likely result in 1) reduced comparability, 2) accounting that does not reflect the economics of the underlying transactions, and 3) increased opportunities for structuring of lease contracts and uneconomic business decisions to achieve a desired accounting result. We support the Boards' objective to improve lease accounting and appreciate the Boards' outreach efforts. We commend the Boards for their past willingness to consider a diverse set of viewpoints and to modify the proposed approach in response to concerns in certain cases. In particular, we believe the revised ED represents an improvement from the initial ED with respect to estimating the lease term and lease payments. However, we believe the revised ED continues

[1] Numbers derived from data in Umler Database. 1 January 2013. Available for purchase from Railinc (www.railinc.com).

to present significant conceptual and operational issues and would not benefit users of financial statements.

By way of background, railcar lessors typically lease and manage extensive fleets of railcars over the assets' economic lives and retain risks of equipment ownership including maintenance and obsolescence. These railcar assets represent our stock-in-trade rather than financial investments. In addition to leasing railcars and locomotives, we often provide maintenance, repair, and administrative (e.g., regulatory and property tax compliance) services. While our customers may choose among any of the product offerings individually or combined as a full- service lease, our leases are typically full-service leases with lease terms ranging from three to ten years. We may also transact short-term, per diem, and net leases. Railcars may have economic lives of up to fifty (50) years, or even longer in some cases, so we may lease one railcar as many as fifteen times to one or more lessees. We generally depreciate all of our railcars on a straight line basis to an estimated salvage value. Thus, the depreciation policy is not impacted by whether the railcar is on lease. Rental rates are primarily based on supply and demand and the prevailing economic climate rather than the return the leasing activities should generate in reference to the value of the underlying asset, as indicated in paragraph BC41. In addition, most of our railcar lease contracts contain multiple assets. For the reasons stated above, our business primarily represents an "operating" lease model. Furthermore, we believe railcars share the characteristics of "investment property," such as land and buildings, which are typically leased multiple times over long economic lives for which the rental can cover both the use of the asset as well as related services.

In the remainder of this letter, we describe our concerns with the proposed lessor accounting model. Then, we offer recommendations for how the Boards should proceed with the project. While we have chosen to focus our comments on the proposed changes to lessor accounting, we believe the ED also imposes significant cost and complexity for lessees, particularly with respect to the following:

- Application of the classification approach that will likely result in many lessees having a mix of Type A and Type B leases requiring systems and processes to track two methods of accounting;
- The requirement to reassess the lease term and lease payments based on changes in the assessment of whether a significant economic incentive to exercise a renewal or purchase options exists; and
- The requirement for the lessee to allocate between lease and non-lease components based on information that may not be available.

Our Concerns

We believe the proposed lessor accounting model would result in reduced comparability.

We are concerned that the ED's proposed lease classification approach would reduce comparability across reporting entities due to the increase in management judgment associated with determining fair values and residual values for leased assets and allocating lease payments between lease and non-lease components (which are often not sold separately and for which the asset-service components can vary across cars under one lease contract).

We believe that comparability across entities would suffer due to different interpretations of the new thresholds provided in paragraphs 842-10-25-6 and 842-10-25-7, specifically, "insignificant," "major part," and "substantially all." We note that the term "significant" is used numerous times in the accounting and financial reporting literature with quantitative values between 3% and 20%. The limited guidance in the ED indicating what is meant by "insignificant" is found in Example 11 of the ED (16.67% is "more than an insignificant part of the total economic life" and 27.8% is "more than insignificant relative to the fair value" of the leased asset)[2]. In the absence of clear objectives or qualitative factors, we believe that bright-line rules of thumb would evolve in practice, as practitioners would have no basis on which to support a conclusion that, for example, a particular lease term is insignificant to the economic life of the leased asset. We do not think this result would represent an improvement over current practice, which is well understood by users and preparers.

It is also unclear to us if "insignificant" implies the same quantitative threshold for the lease term criterion (842-10-25-6(a)) and the lease payment criterion (842-10-25-6(b)) or whether a high "significance" level on one criterion would overcome a determination that the other criterion was insignificant. Regardless, we believe that the likely variations in interpretation and application of these new subjective concepts would result in reported financial information being significantly less comparable across entities.

We also believe that comparability within an entity would suffer as many lessors of long-lived equipment would likely be required to report a mix of Type A and Type B leases in their portfolios. Generally, in the railcar leasing industry both lease rates and lease terms are primarily driven by market factors, with car types in high demand typically requiring higher rates and longer lease terms than car types with lower demand. As a result, and given the fact that railcar leases typically have terms ranging from 5% to 25% of the economic life of the leased asset, we expect that Type A leases would comprise many car types in elevated markets while Type B leases would comprise many car types in depressed markets. Further, given the cyclicality of these market factors, application of the ED's lessor model would result in railcars moving between Type A and Type B leases throughout their economic lives depending on the term of the particular lease. We believe this mix of leases would create an unintelligible and overly complex mix of finance revenue and rent revenue, which would not be comparable across periods within a single entity.

We also question whether this switching between accounting models based on "consumption" of an arbitrary portion of the asset's economic life or fair value provides useful information to investors if the lessors themselves do not consider such a notion when pricing leases or operating the business.

We believe the proposed lessor accounting for Type A leases does not appropriately reflect the underlying economics of many leases involving long-lived equipment.

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[2] In addition, paragraph BC125(b) provides additional (non-authoritative) guidance: a 4 year lease of a rail car that has a 50-year economic life (8%) is considered insignificant and a 4-year lease of a truck that has a 10-year economic life (40%) is more than insignificant.

As stated in our previous letter dated September 28, 2012, we believe the business model of most railcar lessors closely resembles the business model of a real estate lessor, consistent with the model described in paragraph BC73(b)(2). We are generally focused on managing our assets to generate cash flows over their economic lives rather than simply providing finance to lessees. Accordingly, we do not believe the "partial sale" model required for Type A leases faithfully presents the economics of the railcar leasing business or other businesses involved in leasing long-lived assets.

We believe the application of the classification principle largely based on whether the leased asset is property or non-property is conceptually flawed[3]. We acknowledge the Boards' intent to simplify application of the classification criteria; however, we believe an arbitrary distinction based on the nature of the leased asset does not represent an improvement over current GAAP.

Furthermore, under the Type A approach, lessors may recognize large gains (losses) upon lease commencement that would not necessarily indicate the current value of the underlying asset. We also observe that depreciation expense would be presented for only the portion of the rental fleet on Type B leases and, potentially, for railcars that are idled between assignments on Type A leases. We do not believe these results faithfully represent the economics of equipment leasing businesses such as railcar leasing, which generally focus on leasing and managing the assets over their entire economic lives.

Finally, we observe that the dual model approach and classification criteria would fundamentally change the financial reporting by lessors Lessor lease classification would determine whether the lessor continues to recognize the asset or applies the "partial sale" accounting of the Type A lease approach and derecognizes the leased asset. This approach would result in lessors accounting for economically similar transactions under very different methods, which does not provide decision-useful information to investors. We observe that this change is being proposed despite the lack of significant concern or evidence indicating that the lessor accounting model under existing guidance is inadequate or deficient.

We believe that the proposed guidance creates unusual accounting results that may lead to uneconomic business decisions and increased structuring of lease contracts.

We believe that the lessor model introduces a level of complexity that may lead to uneconomic decisions and a greater focus on structuring lease contracts to arrive at a desired accounting result than what is currently believed to occur under existing guidance.

For lessors of long-lived assets, the accounting results under the Type A approach would be driven largely by an estimate of residual value. In fact, for some lessors the residual asset may represent the single most significant asset on the balance sheet and the resulting accretion revenue would likely represent the largest source of revenue. This introduces a high level of

[3] In the American Accounting Association's Financial Accounting Standards Committee's article, *Evaluation of the Lease Accounting Proposed in G4+1 Special Report*, the committee states that the "nature of the property under lease should not affect the accounting, nor should the length of the lease."

subjectivity into lessor accounting and provides the potential for abuse or structuring. Additionally, this approach essentially requires lessors to remeasure long-lived, income-generating assets to fair value upon each new lease, which is a significant operational burden and a drastic departure from the historical accounting treatment for long-lived assets (particularly since the Boards do not contend that the lessor has "sold" or lost control of the underlying asset). We believe the Type A approach would generally incline lessors to use the low end of the range of estimates for residual value in order to reduce the potential for subsequent write-downs and, for a given asset fair value, increase the gains to be recognized upon current and subsequent leases.

In addition, the Type A remeasurement requirement could impact a company's decisions regarding what actions to take when an asset comes off lease. For example, we believe lessors could avoid or delay recognizing a loss when the fair value of the asset at the end of a lease is less than the carrying amount of the residual asset[4] by either not re-leasing the asset or leasing only on a lease that qualifies for Type B treatment (or under the short-term lease scope exception).

Lessors would also be inclined to assign assets to particular leases based on the net book value of the asset at the commencement of the new lease. This is because the asset carrying value for two identical assets would be different depending on whether the asset was previously placed on a Type A or Type B lease. Under this approach, lease gains can be "manufactured" by placing assets on Type B leases in between longer Type A leases.

Consider an example. Lessor Co leases two identical assets to Lessee Co. The assets have economic lives of 20 years. Asset 1 has been leased for a single 10-year lease term accounted for as a Type A lease. Asset 2 was leased on five consecutive 2 year leases (no renewal options), all of which were treated as Type B leases. In year 11, Lessee Co again wishes to lease one asset for 10 years and one asset for 2 years. At that point in time, assume the carrying amount of Asset 1 is $75,000 (accreted residual value – assume no gain/loss upon the initial lease) and the carrying amount of Asset 2 is $55,000 (10 years of depreciation assuming salvage value of $10,000). If Lessor Co again places Asset 1 on the 10 year Type A lease (assume fair value also equal to $75,000), no gain is recognized at lease commencement. However, if Lessor Co. assigns Asset 1 to the 2 year lease and Asset 2 to the 10 year lease, a gain of almost $20,000 would be recognized at lease commencement. We fail to see the benefit to users of an accounting approach that results in disparate accounting treatment for economically identical transactions and incentivizes companies to structure transactions to achieve a particular accounting result.

Our Recommendations

As lessors of long-lived assets that are often leased to multiple lessees over time, our principal concerns are rooted in the fact that significant changes have been imposed on lessor accounting as a consequence of what was initially perceived as a conceptual weakness in lessee accounting.

[4] We note that a residual asset's carrying value may often exceed its fair value without triggering an impairment under Topic 360 due to the long economic life of the asset, which would often result in the carrying amount being "recoverable" on an undiscounted cash flow basis.

We are unaware of significant deficiencies in the existing lessor accounting model and do not believe that model should be upended simply to appear consistent with the proposed lessee accounting model. To do so only complicates the preparation and analysis of lessor financial statements and, for reasons previously stated, reduces the decision usefulness of lessor financial information.

As a result, we recommend the Boards adopt an approach consistent with the alternative views of Mr. Linsmeier as it relates to the lessor classification and accounting model. Lease contracts that transfer substantially all of the benefits of the underlying asset to the lessee should be accounted for as constructive sales by the lessor, consistent with a point-in-time sale as defined in the proposed revenue recognition guidance. Lease contracts that transfer less than substantially all of the benefits of the underlying asset should be accounted for under the proposed revenue recognition guidance as a performance obligation satisfied over time (likely more aligned with the proposed accounting for Type B leases). Not only would this result in greater conceptual synergy between lease accounting rules and revenue recognition rules, it would also reduce the complexity of financial information by allowing lessors to account for all leases that are not constructive sales under one accounting method. This singular model would greatly limit the magnitude of changes imposed on the time-tested and widely accepted lessor accounting model.

Alternatively, if the Boards continue to pursue the dual-model lessor approach, we recommend that classification be based on the lessor's underlying business model (defined similar to the approach described in paragraph BC73) such that "operating" lessors would apply Type B accounting and "financial" lessors would apply Type A accounting. "Operating lessors," like many represented in our coalition, generally retain significant asset residual risk and often provide full-service leases to ensure that their assets are well-maintained while on lease. They may purchase assets on a speculative basis with no committed lessee in order to secure "inventory" that can be leased to new or existing customers and their expenses are typically heavily weighted towards maintenance and property taxes. In contrast, most "financial lessors," purchase assets only when they have lease commitments for a significant portion of the assets' lives, and each lease is priced as a discrete financial transaction with the assumption that the lessor will dispose of the asset at lease expiry rather than re-lease it. Generally, the lessee is responsible for operating costs of the leased asset and, as a result, the primary risk to the lessor is the risk of default by the lessee. We believe that financial statement users would find a business-model approach more in line with how they view the economics of the lessor's underlying lease portfolio and more useful in performing evaluations and analyses on the expected performance of the lessor entity.

Finally, we believe a thorough analysis of the anticipated costs and projected benefits of the proposed lessor accounting model should be performed prior to issuance of a final standard. We understand the Boards plan to engage in field testing and other outreach during the comment period, but we are concerned that much of the dialogue would be focused on lessee accounting. As part of that outreach, we suggest that the Boards consider engaging with users of lessor financial statements, specifically, lessors of long-lived assets. As lessors, it is difficult to see how the proposed changes would benefit the users of our financial statements given the dramatic increase in complexity highlighted by the use of significant and highly judgmental assumptions. On the other hand, we believe the costs lessors would incur to implement the proposed standard are likely to be substantial given the changes to systems and processes that would be required. Lessors would be required to dedicate significant resources to (a) estimate asset fair values and residual values upon commencement of every lease, (b) split rental payments between the lease and service components for which observable market data is typically not available, (c) track accounting for individual cars that may, over their economic lives, qualify as assets under either Type A and Type B lease classification depending on length of lease term and then-current-market rental rates, and (d) acquire and maintain systems to track thousands of railcars under a mix of Type A and Type B leases although this does not reflect the manner in which the lessor manages the business. This would impose a significant burden for companies that may enter into thousands of multiple-car leases every year and manage their business on an overall asset return basis rather than a lease-by-lease basis. As a result, we strongly urge that the Boards specifically consider the cost and benefits from a lessor perspective.

Conclusion

We respectfully recommend the Boards reconsider and revise the conclusions reached in the ED, particularly with respect to lessor accounting. In our opinion, the proposed changes do not represent an improvement over current GAAP since they would likely result in 1) reduced comparability and transparency, 2) accounting that does not reflect the economics of the underlying transactions, and 3) increased opportunities for structuring of lease contracts and uneconomic business decisions to achieve a desired accounting result.

We are available to assist the Boards and staff and provide any additional information as may be necessary to clarify our stated positions.

Sincerely,

The Railcar Leasing Coalition consisting of the following organizations:

American Railcar Industries, Inc.
American Railcar Leasing, LLC
Chicago Freight Car Leasing Co.
CIT Rail
Equipment Leasing and Finance Association (ELFA)
First Union Rail Corporation, A Wells Fargo Company
Flagship Rail Services, LLC
GATX Corporation
GE Capital, Rail Services
Helm Financial Corporation
Midwest Railcar Corporation
Railway Supply Institute
The Andersons, Inc.
The Greenbrier Companies, Inc.
Trinity Industries, Inc.
VTG Rail, Inc.