

Letter of Comment No: 58 File Reference: 1082-200 Date Received: 09/03/02

August 29, 2002

Ms. Suzanne Bielstein
Director of Major Projects and Technical Activities
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Re: File Reference 1082-200

Exposure Draft on Consolidation of Certain Special-Purpose Entities,

a Proposed Interpretation of ARB No. 51

Dear Ms. Bielstein:

The Asset Managers Forum (the "AMF") appreciates this opportunity to comment on the exposure draft referenced above. The AMF, an independent affiliate organization of The Bond Market Association, represents the buyside with respect to major securities processing initiatives. The membership of the AMF includes over 35 major investment management firms with a combined NAV in excess of \$8 trillion of assets under management. A list of AMF members is attached for your reference, along with a roster of the AMF Accounting Policy Task Force.

The AMF is writing to comment on the Exposure Draft from the perspective of investment managers who invest in and serve as collateral managers for collateralized debt obligations (CDOs). While the AMF supports FASB's efforts to improve financial reporting by enterprises involved with SPEs, we have serious concerns related to the potential consequences of the proposed interpretation on the CDO market. Our comments on balance sheet implications and operational and compliance implications of the proposed guidance are detailed below.

Balance Sheet Implications

Consolidation of certain financial SPEs, where an investment manager holds a minority variable interest, would place on the investor's balance sheet assets to which the investor is not entitled and does not have access, and liabilities for which the investor is not liable. Investors will be less likely to buy sizable portions of subordinated or mezzanine tranches issued by an SPE if they risk having to

consolidate the entity even though the investments are still minority positions. Liquidity in the CDO market will therefore be reduced by an overly broad requirement to consolidate SPEs.

In the case of a CDO, the collateral manager has no access to the collateralized assets nor any recourse for the liabilities, yet the Exposure Draft likely leads the manager to the position of consolidating under the financial SPE provisions. Such consolidation could occur even where a collateral manager has no equity interest in the entity, no control by contract, and a market-based fee arrangement. This inappropriate "ballooning" of the collateral manager's balance sheet would lead to confusion among shareholders and other investors, and may also have a negative effect on the ratings assigned to the manager by the major credit rating agencies. These impacts would cause the manager to consider divestiture of existing investments and would greatly inhibit the manager from entering into any new deals if they involved potential consolidation of the CDO entity.

Operational and Compliance Burdens

Several provisions of the Exposure Draft would impose unrealistic operational and compliance burdens on investment managers due to their complexity and ambiguity. Included among those provisions are the "significant and significantly more" test detailed in Paragraph 13, the "market based fees" test detailed in Paragraph 19, the "variable interest" test detailed in Paragraphs 22 and 23, and the short transition period detailed in Paragraph 26.

Significant and Significantly More Test

The "significant and significantly more" test in Paragraph 13.c. would require a minority equity holder in an SPE to re-evaluate at each reporting period whether it provides a significant amount of financial support to the SPE, and, if it does, whether that amount is significantly more than that provided by any other party. While a narrow reading of the provisions of Paragraph 14 would seem to exonerate the manager from having to perform an "exhaustive search for information" to make such a determination, the provision remains overly burdensome in proportion to the anticipated benefit of the manager's involvement with the SPE. Also, the term "significant" is ambiguous and should be clarified. In the absence of more objective guidance on this point, the term will be left open to the interpretation of each firm, leading to inconsistent and potentially erroneous results, and the possibility of more than one firm consolidating a single SPE.

The "significant and significantly more" analysis is unlikely to lead to improved financial reporting by enterprises involved with SPEs due to the fact that in many cases, the information required for the analysis will be unavailable or restricted from dissemination, leading to a significant likelihood of false results. For example, a

false positive result could occur when an investment manager unnecessarily consolidates an SPE because they were unable to perform an exhaustive search for information, thereby failing to discover that they are no longer the primary beneficiary of the SPE. A false negative could just as easily result when a manager fails to discover that it has become the new primary beneficiary of an SPE by virtue of other investors in the SPE reducing their holdings below the "significantly more" threshold. These false results would lead to more than one party consolidating an SPE, or no parties consolidating an SPE where one would fit the Exposure Draft's definition of "primary beneficiary."

We do not feel that the "significant and significantly more" test is consistent with the goal of determining whether in fact a party exercises a controlling financial interest over an SPE. We therefore recommend that the "significant and significantly more" test be replaced with a presumption that an enterprise will only consolidate an SPE if it has a majority voting interest or majority variable interest, or where the enterprise's minority variable interest can be shown to demonstrate a controlling financial interest in the entity. This scenario will reduce the operational burden on collateral managers, lead to more consistent results, and more accurately implement FASB's goal of requiring consolidation by a party with a controlling financial interest in an SPE.

Market Based Fees Test

The rebuttable presumption that a collateral manager's fee is not market based is unfair to the manager, as the necessary data for the market comparison required to defeat that presumption will be unavailable in many cases. Also, the Exposure Draft is ambiguous with respect to the determination of whether fees are "market based." Fees for the provision of services to an SPE are generally negotiated at arm's length with independent parties that represent the interests of the bond holders. Given the ambiguity of the guidance and the difficulty of obtaining evidence that a fee is "market based," we recommend that the "market based fees" test be divorced completely from the variable interest analysis.

Should FASB decide to retain the "market based fees" test, we feel that the presumption should be that the fee is market based, unless the particular facts and circumstances indicate that is not the case. Additionally, it should be clear that base fees and subordinated fees not related to profits should not be considered part of the variable interest. If the collateral manager has no risk of loss, then fees related to profits should also be excluded from the variable interest test.

The Variable Interest Test

Paragraph 23.b. lists the provision of "asset support that is subordinate to the interests of other parties" as one possible criteria for primary beneficiary status. It is

our understanding that an investment in subordinated or mezzanine tranches of a CDO would satisfy this requirement. According to prevailing market practices, however, a typical deal structure for a CDO is for the collateral manager to invest in subordinated tranches of the CDO in order to demonstrate that the collateral manager's interests are aligned with those of other investors, not to provide significant financial support to the SPE. This test should be refined to be determinative of whether the collateral manager's investment in subordinated tranches demonstrates the level of risk exposure that would indicate a controlling financial interest.

With respect to the provisions of Paragraph 18, recommend that FASB clarify the statement that variable interests generally subject the holder to risk of loss by explicitly recognizing that when the collateral manager has no risk of loss, they should not be considered to have any variable interest in the SPE. We also request that FASB clarify whether a variable interest is indicated by the ability of an enterprise to invest in non-passive derivatives or by the enterprise's actual positions in such securities. If variable interest arises from an enterprise's positions in derivatives, that variable interest can fluctuate from one reporting period to the next, potentially leading to alternating periods of consolidation and non-consolidation of the SPE. This accounting anomaly would only further confuse users of the consolidating enterprise's financial statements. Also, as "derivative instruments" can take an infinite variety of forms, we request further clarification on what particular types of derivatives indicate variable interest in an SPE.

With respect to the Paragraph 22 definition of "financial SPEs," we understand that such SPEs are subject to the same restrictions from holding derivatives as Qualifying SPEs under Statement 140. However, in the case of a CDO, it is very common for the SPE to hold derivatives while still providing for a significant dispersion of risk. We therefore see no direct correlation between an SPE's derivatives holdings and dispersion of risk. We recommend that FASB reduce the restrictions on the derivatives that a Paragraph 22 SPE may hold by allowing most types of active and passive derivatives.

Short Transition Period

The AMF feels that the short transition period proposed in Paragraphs 26 and 27 of the Exposure Draft would impose tremendous compliance and operational burdens on investment managers who are involved with SPEs. For SPEs created before the issuance date of the proposed interpretation, each manager would need to:

- identify all entities which are subject to the guidance;
- eliminate those that are consolidated by other entities based on voting interests according to the provisions of Paragraph 9:

- eliminate those that have no primary beneficiary according to a combination of the provisions of FAS 140 and the provisions of Paragraphs 22 and 23 of the Exposure Draft; and
- determine for the remaining entities whether the manager's variable interest is significant and significantly greater than any other party's.

Once all of the SPEs in which an investment manager has an interest have been evaluated according to the above criteria, the manager would need to evaluate the implications of continuing to hold the interest in each SPE that requires consolidation. Considering the complexity of the analysis that market participants will be required to undertake, we request that FASB extend the transition period in a manner consistent with the recommendations of the American Securitization Forum as described in their comment letter.

Summary

In summary, the AMF believes that the proposed interpretation will have a material adverse impact on the CDO market, as institutional investors will be less likely to enter into transactions that will balloon their balance sheets and that carry huge operational and compliance burdens. It should be noted that due to these impacts, we understand that at least several investment management firms that serve as collateral managers for CDOs are considering divestiture of their current investments, and have indicated that they would not be willing to enter into any new deals as collateral manager if such activity involved consolidation of the CDO entity.

We recognize that FASB's mission is to serve the broad public interest by setting neutral standards that enhance transparency and comparability of financial statements. However, such transparency and comparability would not be enhanced by broad requirements to consolidate and de-consolidate SPEs, and we urge FASB to consider the consequences of the proposed interpretation on the investment management community, the CDO market, and investor confidence in reported financial information. The economic benefits of CDOs, including redistribution of risk by means of the tranching process, the availability of liquid, highly rated alternatives to the government bond market, and the availability of high yield exposure through lower rated tranches, will be lost to market participants if they are restricted from using SPEs.

We appreciate the opportunity to comment on the exposure draft and we look forward to participating in future discussions, including the "FASB Open Roundtable Discussion on Certain Special-Purpose Entities," scheduled for September 30, 2002. We would also be happy to provide detailed examples of the balance sheet and operational impacts discussed above. Should you have any

questions about this comment letter, please contact Kenneth Juster, Executive Director of the AMF, at 212.440.9471.

Sincerely,

Michael L. Wyne Fischer Francis Trees & Watts

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Chairman, The Asset Managers Forum

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Kenneth G. Juster Executive Director

The Asset Managers Forum

Attachments

Attachment A - AMF Member and Associate Member Firms

Full Members

ABP Investments U.S.

Alliance Capital Management. Ark Asset Management Barclays Global Investors BlackRock Financial Capital Group Companies Cascade Investments Colonial Management Conseco Capital Management Credit Suisse Asset Management Deutsche Asset Management Dresdner RCM Federated Investors Fischer Francis Trees & Watts General Motors Asset Management Goldman, Sachs Asset Management ING Investment Management J. & W. Seligman J.P. Morgan Asset Management Merrill Lynch Inv. Managers Metropolitan West Asset Management MFS Investment Management MKP Capital Management MSDW Investment Management New York Life Inv. Management Oppenheimer Capital Pacific Life Pacific Investment Management Company Prudential Asset Management Salomon Smith Barney Sanford C. Bernstein & Co. Standish, Ayer & Wood Strong Capital Management TIAA-CREF

Western Asset Management

Zurich Scudder Investments

The World Bank

Associate Members

Thomson Financial ESG

Advent Software
Chase Manhattan Bank
Fannie Mae
Interactive Data Corporation
Investors Bank & Trust
Market Axess
Mellon Financial Corp.
Merrill Lynch Securities Pricing Service
MBSCC
PricewaterhouseCoopers
Securities Quote Xchange
Standard & Poor's J.J. Kenny
State Street Corporation
The Capital Markets Co.

Attachment B - Roster of AMF Accounting Policy Task Force

John Adamczak
Federated Investors

Bruce Alberts

Western Asset Management Company

Mark Brubaker

Capital Group Companies

Jamie Dixon

Prudential Global Asset Management

Ron Ecoff

Federated Investors

Don Ellenberger Federated Investors

Cindi Finn

ING Investment Management, LLC

Sanjeev Handa TIAA-CREF

Ray Hanley Federated Investors

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Robert Kozlowski
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Lisa Ling

Federated Investors

Michael Locke

Capital Group Companies

Bibi Molini

Federated Investors

Brian Peterson

Investors Bank & Trust Co.

Mark Rath

Federated Investors

Jim Risbon

Federated Investors

Trisha Szto

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Timothy Trebilcock Federated Investors

Robert Waddell

Investors Bank & Trust Co.

John Widmer

Strong Capital Management, Inc.

Michael L. Wyne

Fischer Francis Trees & Watts