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FSP140R46R

LETTER OF COMMENT NO. 16

File Reference: Proposed FSP FAS 140-e and FIN 46(R)-e

Dear Mr. Golden:

Deloitte & Touche LLP is pleased to comment on proposed FASB Staff Position No. FAS 140-e and FIN 46(R)-e, "Disclosures About Transfers of Financial Assets and Interests in Variable Interest Entities" (the "proposed FSP"), which amends the disclosure requirements in Statement 140[1] and Interpretation 46(R).[2]

We support the Board's efforts to increase transparency related to a transferor's continuing involvement with transferred assets and an enterprise's involvement with variable interest entities (VIEs) and believe that many of the proposed disclosures will help the Board achieve its objectives. However, we do have concerns about whether certain of the proposed disclosures are operational and whether the proposed effective date will allow calendar-year-end public companies enough time to compile the required information. Below are our comments on the disclosures, including a discussion of those disclosures that we believe should be eliminated or deferred.

The following is a summary of the disclosure requirements that we believe the Board should **eliminate** from the proposed FSP:

- Statement 140 disclosures (Appendix B).
  - Qualitative and quantitative information regarding implicit arrangements in a transfer (paragraph 17(i)(2)).

- Interpretation 46(R) disclosures (Appendix C).
  - Qualitative and quantitative information about an enterprise's implicit arrangements with a VIE (paragraph 22C(d)).

[1] FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* — a replacement of FASB Statement No. 125.
[2] FASB Interpretation No. 46(R), *Consolidation of Variable Interest Entities* — an interpretation of ARB No. 51.

  - A sponsor or an enterprise with a significant variable interest's estimated exposure to loss (paragraph 24(b)).
  - The disclosure requirements for sponsors with insignificant variable interests (paragraph 22C).
  - Alternative assumptions and judgments that could have reasonably been made in the determination of the primary beneficiary (paragraph 22C(a)(2)).

- Disclosures of nontransferor interests in qualifying special-purpose entities (QSPEs) (Appendix D).
  - The disclosures required for nontransferor's interests in QSPEs (paragraph D3).

The following are the disclosure requirements whose effective date we believe the Board should **delay** to allow preparers adequate time to compile the required information:

- Statement 140 disclosures (Appendix B).
  - Sensitivity analysis for all assets and liabilities related to the transferor's continuing involvement (paragraph 17(i)(5)).
  - Cash flows between the nonconsolidated special-purpose entity (SPE) and the transferor (paragraph 17(i)(6)).

In addition, we believe that the Board should consider including examples of the required disclosures to assist with financial statement preparation.

The following are our comments related to the operational issues that we have identified in the proposed FSP.

<u>Statement 140 Disclosures (Appendix B)</u>

Implicit Arrangements (Paragraph 17(i)(2))

We are concerned about an auditor's ability to obtain a reasonable level of assurance that the disclosures related to implicit arrangements in a transfer, as required in paragraph 17(i)(2), are complete and accurate. Implicit arrangements are generally based on management's intention and are tied to the occurrence or nonoccurrence of a contingent future event that is outside the enterprise's control. Therefore, we believe that auditors will be unable to obtain a reasonable level of assurance about management's intention.

We believe that the Board should eliminate the disclosure requirement for **implicit arrangements** or should at least defer its effective date to allow time to consider operational issues and to determine whether the disclosure's benefits outweigh its costs.

We believe that if the Board decides not to eliminate this disclosure, it needs to amend paragraph 17(i)(2) because none of the specific disclosures required in paragraph 17(i)(2) relate to implicit arrangements. It appears that the Board included the disclosure requirements in paragraph 17(i) (2)(c) to achieve this objective; however, a transferor currently would only be required to disclose explicit arrangements under this paragraph. Paragraph 17(i)(2)(c) currently requires the disclosure of "**the terms** of any arrangement that could require the transferor to provide financial support" (emphasis added). If the Board intends the disclosure in paragraph 17(i)(2)(c) to include implicit commitments, it should avoid using the phrase "terms of any arrangement" since this implies that the requirement is only for explicit contractual arrangements.

In addition, the Board should consider defining "implicit obligations." Under the current proposal, preparers may interpret implicit obligations as including only constructive obligations. We believe that this may be inconsistent with the Board's intention.

Sensitivity Analysis (Paragraph 17(i)(5))
Currently, an enterprise is required to disclose a sensitivity analysis showing the hypothetical effect of unfavorable variations in key assumptions on the fair value of (1) servicing assets and liabilities and (2) any retained interests. Paragraph 17(i)(5) of the proposed FSP would expand the scope of the sensitivity analysis to include all assets and liabilities that relate to the transferor's continuing involvement. Thus, a sensitivity analysis would be required for (a) such items as derivative instruments related to transferred financial assets or (b) assets and liabilities recorded for a transaction accounted for as a secured borrowing.

We believe that given the expected timing for issuance of a final FSP, the Board should defer the effective date for this disclosure requirement. In addition, the Board should consider whether the benefits of providing a sensitivity analysis for all assets and liabilities related to the transferor's continuing involvement outweigh the costs.

Cash Flows Between the Nonconsolidated SPE and the Transferor (Paragraph 17(i)(6))
The Board should clarify whether the disclosures under paragraph 17(i)(6) would be required for all periods presented (three-year period) or only the current period. We believe that the most significant cash flows between a nonconsolidated SPE and the transferor would typically relate to servicing the assets transferred (although these cash flows are not specifically identified in paragraph 17(i)(6)). In light of the expected timing for issuance of a final FSP, it will be difficult for preparers to identify all such cash flows during the three-year period. In addition, auditors may not have enough time to audit these cash flows. We therefore believe that the Board should defer the effective date for this disclosure requirement and consider phasing it in. We believe that the Board should not require comparative disclosures for periods prior to the effective date.

Periods Presented (Paragraph 17(i))
It is currently unclear what periods the information in paragraph 17(i) should be provided for. The lead-in states that the disclosure requirement is for all financial assets in which the transferor has continuing involvement **at the end** of the most recent reporting period. However, a number of disclosures in paragraph 17(i) are related to transactions during the period, such as the provision of support in paragraph 17(i)(2)(d) and the cash flows between a nonconsolidated SPE and the transferor in paragraph 17(i)(6). It is unclear whether these disclosures would be necessary when the entity no longer has continuing involvement with

the financial assets as of the reporting date but transactions during the current and prior period were significant.

Definition of Continuing Involvement (Paragraph 16A(a))
Footnote 5 of the proposed FSP defines continuing involvement as "any involvement with the transferred financial assets . . . that **obligates** the transferor to provide additional cash flows or other assets to any party related to the transfer" (emphasis added). The footnote then identifies "implicit commitments to provide financial support" as an example of continuing involvement. This example is inconsistent with the footnote's definition of continuing involvement. An implicit commitment to provide financial support is typically not an obligation of the transferor; rather, it represents a noncontractual business decision to provide financial support. If the Board intends to include implicit commitments in the definition of continuing involvement, we suggest that this definition be amended as follows (changes are underlined):

> [A]ny involvement with the transferred financial assets . . . that obligates or could obligate the transferor to provide additional cash flows or other assets to any party related to the transfer.

Assets Restricted for a Specific Obligation (Paragraphs 16A(b) and 17(a))
The Board should consider revising the requirement in paragraphs 16A(b) and 17(a) to specify that it relates only to **transferred financial** assets that continue to be recognized by a transferor. As currently drafted, the disclosure requirement could be construed as applying to any assets that must be used to satisfy a specific obligation, irrespective of whether the obligation arose as a result of the transfer of a financial asset (i.e., secured borrowings). This is inconsistent with the other disclosure requirements in the proposed FSP, which focus only on transferred financial assets.

Gain/Loss Calculation (Paragraph 17(h)(2))
The level of detail required under paragraph 17(h)(2) for the calculation of the gain/loss on the sale of a financial asset is unclear (e.g., the calculation could be extremely complicated). The Board should consider providing examples for this disclosure requirement to help preparers determine the level of detail required.

Conforming Changes (Paragraphs 17(h) and 17(i))
A number of the disclosure requirements in paragraphs 17(h) and 17(i) are identical except that the disclosures in paragraph 17(h) relate to the initial measurement of fair value as of the date of the transfer while the disclosures in paragraph 17(i) relate to its subsequent measurement. To improve the consistency of these disclosure requirements, the Board should conform the language used in these paragraphs.

Disclosures When the Entity Has No Continuing Involvement (Paragraph 17)
The Board should consider identifying which disclosures, if any, are required when the entity does not have continuing involvement with the transferred assets. This would help preparers ensure that they have included all relevant disclosures.

Interpretation 46(R) Disclosures (Appendix C)

Implicit Arrangements (Paragraph 22C(d))
As with our above comment on paragraph 17(i)(2) of Appendix B, we have concerns about an auditor's ability to obtain a reasonable level of assurance for the disclosure requirements associated with implicit arrangements in paragraph 22C(d). As previously noted, implicit arrangements are based on management's intention and uncertain **future events.**

We believe that the Board should eliminate the disclosure requirement for **implicit arrangements** or at least defer the effective date to allow time to consider operational issues.

Estimated Exposure to Loss (Paragraph 24(b))
We are concerned about a preparer's ability to reliably estimate its estimated exposure to loss as required in paragraph 24(b). An exposure to loss is affected by a number of factors and future actions taken by an enterprise that are difficult to predict and estimate. We believe that the Board should eliminate this disclosure requirement or at least consider deferring the effective date to afford preparers sufficient time to accumulate the estimates.

Sponsors With Insignificant Variable Interests (Paragraph 22C)
The scope of the proposed FSP is inconsistent with Interpretation 46(R) regarding sponsors. In accordance with paragraph 6 of Interpretation 46(R), a sponsor that did not participate in the design of the entity and that does not hold a **significant** variable interest would not need to determine whether the entity is a VIE. However, the proposed FSP would require a sponsor that holds an insignificant variable interest in an entity (e.g., an investment management company that receives a fixed fee) to determine whether the entity is a VIE and thus whether it needs to provide the disclosures in the proposed FSP. We believe that the scope of the proposed FSP should be consistent with Interpretation 46(R) (i.e., only require the disclosures for entities in which a sponsor has a **significant** variable interest).

Determination of the Primary Beneficiary (Paragraph 22C(a)(2))
We believe that the disclosure requirement in paragraph 22C(a)(2) should be eliminated. Under the current proposal, an enterprise would be required to disclose "whether a different assumption or judgment could have reasonably been made that would result in a different [primary beneficiary] conclusion." Management determines which assumptions and judgments are most relevant on the basis of the best available information. We believe that requiring an enterprise to disclose alternative assumptions and judgments for its consolidation conclusion will confuse readers (i.e., cause them to wonder why the alternative reasonable assumptions were not used). In addition, it is unlikely that an enterprise will be able to provide this information for transactions consummated in prior years.

Exemption for Voting Interest Entities (Paragraph 23)
Footnote 11 of the proposed FSP would provide an exemption to the disclosures in paragraph 23 if, in addition to the enterprise's holding a majority of the voting interest in the VIE, the

VIE meets the definition of a business in Statement 141(R)[3] and the entity's assets are not restricted. We believe that the requirement for the VIE to meet the definition of a business should be removed. Corporations may be structured with a number of wholly owned subsidiaries that are holding companies of their operating entities. The holding companies may not meet the definition of a business under Statement 141(R) since their only activities are to receive dividends and interest from the operating entities. Although such corporations hold a majority of the voting interest in their wholly owned holding companies, to determine whether they need to comply with the disclosure requirements in paragraph 23, they would need to determine whether these entities meet the definition of a business and, if not, whether the entities are VIEs. We believe that the cost of determining if each of these holding companies meets the definition of a business, where an enterprise has numerous holding companies, outweigh the benefits of providing the information required in paragraph 23. The Board should consider including in the proposed FSP the scope exemption that is currently included in Interpretation 46(R).

Definition of a Sponsor (Paragraph 22C)
The Codification, when issued, will not include the Board's Basis for Conclusions. Therefore, to clarify which entities should be considered sponsors for disclosure purposes, the Board should consider including the information about the definition of a sponsor and reference to Issue 96-21[4] currently located in paragraph E14 of the proposed FSP in a footnote to paragraph 22C.

Fair Value Disclosures for Consolidated VIEs (Paragraph 23(d))
The disclosure requirement in paragraph 23(d), under which an entity must disclose the fair value of a consolidated VIE's financial assets and liabilities, should include the scope exceptions in paragraph 8 of Statement 107.[5]

Disclosure Objectives (Paragraph 22A))
The Board should amend the disclosure objective in paragraph 22A(d) to remove the word "current." Because the objective relates to the **potential future** financial effects of an entity's involvement with a VIE, including the word "current" could be confusing.

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[3] FASB Statement No. 141(R), *Business Combinations.*
[4] EITF Issue No. 96-21, "Implementation Issues in Accounting for Leasing Transactions Involving Special-Purpose Entities."
[5] FASB Statement No. 107, *Disclosures About Fair Value of Financial Instruments.*

Scope (Paragraph 22B)
Paragraph 22B requires that when similar entities are aggregated for disclosure purposes, an enterprise distinguishes between VIEs that are (1) not consolidated "because the enterprise is not the primary beneficiary but is either the sponsor or has a significant variable interest" and (2) consolidated. We believe that to be consistent with the other disclosure requirements in the proposed FSP, paragraph 22B(a) should be revised as follows (changes are underlined):

a. Variable interest entities that are not consolidated because the enterprise is not the primary beneficiary but is either the sponsor <u>that holds a variable interest</u> or has a significant variable interest

<u>Disclosures of Nontransferor Interests in QSPEs (Appendix D)</u>

Disclosures Required for Passive Investments in QSPEs (Paragraph D3)
The disclosure requirements for nontransferor investments in QSPEs are onerous and would not represent a substantial improvement over the disclosure requirements in Statement 115,[6] SOP 94-6,[7] and Issue 99-20.[8] Companies with a large portfolio of investments in QSPEs, each with different risk-and-reward characteristics (e.g., various credit ratings and different maturities), would now have to disclose the information required in paragraph D3 for all assets included in their portfolio. For example, an insurance company with a large portfolio of investments for which it is not the sponsor, each of which is considered significant, would now be required to disclose additional information about its investments that it may not have access to.

We believe that the Board should eliminate this disclosure or at least should consider deferring its effective date to afford preparers enough time to accumulate the required information.

<u>Other Items</u>

Definition of a Public Entity (Paragraph 1)
The definition of a nonpublic entity (enterprise) in footnote 1 of the proposed FSP should be consistent with the definition in Statement 132(R).[9] Currently, the definition in the proposed FSP does not carry forward the definition of "conduit debt securities" from the definition in Statement 132(R).

In addition, the proposed FSP should use the terms "entity" and "enterprise" consistently to avoid confusion. Currently, the proposed FSP uses "entity" to refer to all public companies that must provide the disclosures under Statement 140. However, the proposed FSP

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[6] FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities.*
[7] AICPA Statement of Position 94-6, *Disclosure of Certain Significant Risks and Uncertainties.*
[8] EITF Issue No. 99-20, "Recognition of Interest Income and Impairment on Purchased Beneficial Interests and Beneficial Interests That Continue to Be Held by a Transferor in Securitized Financial Assets."
[9] FASB Statement No. 132(R), *Employers' Disclosures About Pensions and Other Postretirement Benefits* — an amendment of FASB Statements No. 87, 88, and 106.

sometimes uses "enterprise" and sometimes "entity" to refer to public companies that must provide the disclosures under Interpretation 46(R). These terms are also used inconsistently in the appendixes. For example, paragraph C1 states, "This appendix provides the following enhanced disclosure requirements of Interpretation 46(R) for public **entities** . . . ." (emphasis added), which is inconsistent with the remainder of Appendix C.

Quarterly Reporting
The proposed FSP will require a significant amount of additional disclosures in both annual and quarterly financial statements. The Board should discuss with preparers and users whether the benefits of providing extensive quarterly disclosures outweigh the costs. In addition, the Board should consider deferring the effective date for quarterly financial statements to allow time to consider the ramifications of such disclosures.

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Deloitte & Touche LLP appreciates the opportunity to comment on the proposed FSP. For questions about our comments, please contact Robin Kramer at (203) 761-3079 or Trevor Farber at (203) 563-2547.

Yours truly,

Deloitte & Touche LLP

cc: Bob Uhl