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Mr. Russell G. Golden Technical Director Financial Accounting Standards Board 401 Merritt 7 PO Box 5116 Norwalk, CT 06856-5116

Re: <u>File Reference No. 1620-100</u> – Proposed Statement of Financial Accounting Standards – Amendments to FASB Interpretation No. 46R, *Consolidation of Variable Interest Entities* and <u>File Reference No. 1610-100</u> – FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets*

Dear Mr. Golden:

The American Council of Life Insurers (ACLI) appreciates the opportunity to respond to the proposed FASB Statement, *Amendments to FASB Interpretation No. 46(R)* (FIN 46(R)) and the Board's proposed amendment of FASB Statement No. 140. Our comments in the following letter are in response to both proposed amendments due to the related issues. The ACLI represents three hundred fifty-three (353) member companies operating in the United States, of which three hundred forty-five (345) are legal reserve life insurance companies, and eight (8) are fraternal benefit societies. These 353 member companies account for 93 percent of total assets, 93 percent of the life insurance premiums, and 94 percent of annuity considerations in the United States.

We generally agree with the Board's conclusions in the exposure documents and agree that the consolidation model provided by FIN 46(R) is difficult to apply and has resulted in inconsistency in practice. However, we believe that the guidance provided falls short of providing a comprehensive solution to consolidation guidance in U.S. GAAP. The IASB has undertaken a similar project to address consolidation accounting. It is our understanding that the two Boards intend to issue separate guidance and converge them in the future in conjunction with the Revised Memorandum of Understanding. We do not believe that this guidance provides the improvement necessary to require two changes, one with the implementation of the proposed guidance and another for the implementation of the converged guidance. As such, we recommend the FASB abandon the current project and strive to converge with the IASB without the interim proposed guidance. This path would provide a comprehensive solution for consolidation accounting.

Should the Board proceed with the proposed changes, we offer comments in the following areas of concern:

- 1. Elimination of the qualified special purpose entity (QSPE)
- 2. The proposed requirement to perform ongoing assessment;
- 3. The inconsistent use of kick-out rights;
- 4. The retention of the quantitative analysis in the two step approach; and
- 5. The application of the qualitative approach on asset managers.

Elimination of the QSPE

While we conceptually agree with the elimination of the QSPE, we are very concerned about the impact of its elimination and the consolidation consequences based on the proposed guidance. The extent of QSPEs that certain entities may be required to consolidate based on the qualitative approach provided by the proposed guidance could result in financial statements with significant gross ups of assets and liabilities for entities that are not significant to the operations of the company. While certain high profile entities that qualified as QSPEs have created financial liabilities for entities, we still believe that the vast majority of the QSPEs should not require consolidation. We are also concerned about the burden of ongoing assessment and applying that standard to a much larger population of securities by the elimination of the QSPE. Therefore, until a comprehensive standard can be developed by the Board, we believe that the scope-out of QSPEs in FIN 46(R) is appropriate.

Ongoing Assessment

We do not believe that a supportable need exists to require the burden for companies, in both cost and resources, for ongoing assessments of all relationships with consolidated and unconsolidated entities for current status of these entities as variable interest entities (VIE) and if so, whether the company is the primary beneficiary. We believe that reliance on reacting to trigger events, as current guidance already requires, is the more appropriate way to determine a reconsideration need for an entity. Reconsideration triggers meet the objectives of the standard while providing a cost effective means for implementation. Trigger events are used throughout U.S. GAAP as a means to provide a cost effective manner to apply complex standards. While guidance such as voting rights require ongoing assessment, voting rights change infrequently and are substantially less complex than the application of the proposed guidance. As such, the use of trigger events should be retained in the proposed standard. In the event that the Board does not believe that the current reconsideration events are adequate then a review and revision of the criteria should be pursued in lieu of requiring an ongoing assessment.

Absent a significant modification to the proposed revisions, the change in the financial statements resulting from ongoing assessment and the impact on consolidation does not provide meaningful information to financial statement users. Scenarios could exist where under ongoing assessments, an entity could frequently flip into and out of VIE status. One example of such a scenario would be a real estate entity that may qualify as a VIE pre-development due to insufficient equity to cover expected losses. Under the proposed guidance, the asset manager, with the power to direct, would be required to consolidate the entity while it was in VIE status. After the property is constructed, the value of the real estate may become sufficient so that equity then is adequate to absorb future variability and the entity may no longer meet the definition of a VIE. In that case, when the real estate entity no longer qualifies as a VIE, a significant equity holder, who is not the asset manager, may have to consolidate the entity under other consolidation guidance assuming there are substantial kick-out rights. Going forward, as property values fluctuate, this same real estate entity could change from being consolidated and being deconsolidated. With the recent changes in FASB Statement No. 160, Noncontrolling Interests in Consolidated Financial Statements, this will result in an earnings picture that is not logical, given the fact that no sale of interest has occurred. While we recognize that the change in the value of underlying assets represent an economic event, the accounting that the proposed guidance provides does not result in a proper reflection of that economic event. The consolidation and deconsolidation of the entity are more the result of the inconsistent application of different accounting standards.

Kick-out Rights

We do not agree with the Board's conclusion to only include kick-out rights in the consideration of the primary beneficiary when the kick-out rights can be exercised unilaterally by a single variable interest.

The use of kick-out rights in the proposed amendments to FIN 46(R) is inconsistent with treatment in other consolidation guidance and will result in different consolidation results depending on the determination of an entity as a VIE. It is counter-intuitive that the existence of different structures of kick-out rights associated with an entity walking the line of being a variable interest entity or limited partnership could result in a different consolidation conclusion based on the inconsistent treatment of kick-out rights in the consolidation guidance. We believe that the definition of substantive kick-out rights that already exists within FIN46(R) ¹ and is consistent with EITF 04-5 is sufficient to prevent excessive structuring and should not be changed without due reconsideration of removal rights in the overall control context. The inconsistent use of kick-out rights in the consideration of consolidation combined with the elimination of the qualified special purpose entity and the ongoing assessment amendment will result in a significant gross up of corporate balance sheets. This is more likely to result in larger, more complex balance sheets and disclosures making it more difficult for investors to understand the true financial condition of the entity. As previously mentioned, until the Board addresses consolidation as a whole, including kick-out rights for all entities, we encourage the Board to retain the current decision maker removal right principles in FIN 46(R) as applicable to understanding control over a VIE.

Quantitative Approach

The Board has opted to retain the quantitative approach to accommodate the rare circumstances that the qualitative approach does not provide a clear answer on the determination of the primary beneficiary. We do not support the retention of the quantitative approach and request that the Board revisit the qualitative approach to provide clearer language to eliminate the risk that certain entities will need the quantitative approach. The existence of the quantitative approach in the standard will potentially retain a quantitative analysis as a validation even if the qualitative analysis is conclusive and could be viewed as something still necessary to provide auditors to support the company's conclusions. As such, we suggest the Board eliminate the quantitative approach and provide additional explanation of the qualitative approach to reduce uncertainty regarding its application.

Qualitative Approach - Asset Managers

Some of the examples in Appendix A indicate that if a manager has "power to direct" (via guidelines), consolidation should occur as long as the manager has the potential to receive benefits or absorb losses that could potentially be significant to the VIE. While we agree that the decisions the manager makes, within prescribed guidelines, can have a direct impact on the fees generated, it would seem that "power to direct" implies that a person(s) has more discretion than investment guidelines provide. In addition, we do not agree with the second test in determining the primary beneficiary based on the potential to receive significant benefit, including the implied financial responsibility.

We ask the Board to re-define "power to direct", especially in situations where the investment manager follows specified guidelines that are for the benefit of all investors. We also believe that the determination of significance should be based on whether a company has a significant variable interest currently, and not based on what could be a remote possibility. Having an investment manager consolidate a VIE where they have none, or a minimal amount, of the underlying risk of the consolidated assets and liabilities seems to go against the consolidation model. An example would be a 1% owner/manager of a VIE, who receives a fee of 20 basis points and a performance fee. This manager has a fiduciary responsibility to its investors, must follow established investment guidelines, and can be fired by its investors without cause. Using the quantitative approach, under current guidance, the manager could be deemed not to be the primary beneficiary because they do not receive the majority of the risks and rewards. However, using the qualitative approach under the proposed guidance, the manager would now be required to consolidate the investment vehicle because they would be deemed to have the power to direct and, through its fee arrangement, receives benefits that could potentially be

¹ FIN46R B20

significant to the VIE. Under the proposed qualitative approach, investment managers, who follow specified investment guidelines, would, more likely than not, be required to consolidate the VIE. This would result in a consolidating entity having increasingly irrelevant and inflated balance sheets where they don't bear much of the underlying risk of the consolidated assets and liabilities. This reporting would not benefit shareholders nor provide users of financial statements more meaningful information.

Conclusion

In conclusion, we offer these comments as suggestions for the Board in the event that they move forward with the implementation of these revisions. Our primary suggestion, however, is that these revisions should be postponed, and the Board should work with the IASB on a converged comprehensive analysis of consolidation. This approach will support the convergence objective of the Board, will eliminate the impact of multiple conversions for companies and will reduce the risk of creating additional confusion for financial statement users that would result by requiring multiple fundamental changes to an already complex area of guidance.

We appreciate the opportunity to respond. Please feel free to contact us with any questions.

Sincerely,

Michael Monahan

Director, Accounting Policy