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

Re: File Reference No. 1082-200  
Exposure Draft on Consolidation of Certain Special-Purpose Entities, a Proposed Interpretation of ARB No. 51

August 22, 2002

Dear Ms. Bielstein:

The American Securitization Forum thanks the Financial Accounting Standards Board for this opportunity to comment on the Exposure Draft on Consolidation of Certain Special-Purpose Entities, a Proposed Interpretation of ARB No. 51 (the “Exposure Draft” or the “Proposal”). We are writing to comment on the application of the Proposal to SPEs used in securitizations of financial assets. Two significant categories of these SPEs that could be adversely affected by the Proposal are issuers of collateralized debt obligations (“CDOs”) and multi-seller commercial paper vehicles (“MSVs”). In addition, a number of our comments (particularly relating to the treatment of derivatives in the Proposal) relate to SPEs used in the issuance of credit-linked notes (“CLNs”). Finally, we have included some comments relating to master trusts that are currently QSPEs but which face uncertainties created by EITF Issue 02-12, Permitted Activities of a Qualifying SPE in Issuing Beneficial Interests.

The ASF recognizes the importance of FASB’s efforts to clarify consolidation rules for SPEs. We support that goal, but we believe that the Proposal needs revisions to ensure it meets that goal. Most importantly:

- The Proposal would require some parties to consolidate SPEs used in many legitimate risk dispersing CDOs, CLNs and MSV transactions carried out in accordance with current market practices. Consolidation is not the most transparent accounting for these transactions, and we believe that the Proposal should be revised so that, except in unusual circumstances, no one will be required to consolidate them.

1 The American Securitization Forum (the “ASF”) is a broadly-based professional forum of participants in the U.S. securitization market. Among other roles, the ASF members act as issuers, underwriters, dealers, investors, servicers and professional advisors working on securitization transactions involving special-purpose entities. The views expressed in this letter are based upon input received from a broad range of ASF members including members of the ASF Accounting and Tax Subcommittee. More information about the ASF, its members and activities may be obtained from the ASF website at www.americancansecuritization.com.

2 Whenever we refer to securitizations below, we are referring only to securitizations of financial assets (other than equity securities).
• The special rules in paragraphs 22 and 23 for SPEs that hold financial assets ('paragraph 22 SPEs') do not seem to be oriented towards identifying and accommodating legitimate risk dispersing securitizations. In fact, in many cases it appears that an enterprise applying the tests under paragraph 23 to a paragraph 22 SPE would be required to consolidate, when no consolidation would have been required if the general variable interest approach had been applied to the same SPE. In their present form, paragraphs 22 and 23 would lead to the appropriate accounting result for investors who hold securities issued by a paragraph 22 SPE and who have no other relationship with the SPE (i.e., non-consolidation). However, we request revisions to these paragraphs to make them more precisely identify risk-dispersing securitization SPEs and give clear guidance that, except in unusual circumstances, no party should consolidate those SPEs.

• We do not see any link between risk dispersion and the portion of paragraph 22.b. that subjects all paragraph 22 SPEs to the same restrictions as QSPEs in relation to derivatives. This approach also does not seem to take account of measures that FASB has taken elsewhere to address its concerns relating to derivatives and SPEs.

• The Proposal would create a set of complex and subjective consolidation standards that will be difficult to apply in many circumstances and give rise to unrealistic compliance burdens, disproportionate to their reasonably expected benefits.

In crafting consolidation policy, FASB should be just as concerned about false positives, where consolidation is required in the absence of a controlling financial interest, as it is about false negatives, where no consolidation is required by a party that does hold a controlling financial interest. Either of these results is inconsistent with FASB's goal. While false negatives impair transparency by omitting assets and liabilities that are material to an enterprise's financial condition and results of operations, false positives diminish transparency by pulling assets and liabilities into consolidated statements in circumstances where they make those statements less meaningful, rather than more. Users of financial statements then have to devote resources to “unscrambling the omelet” in order to achieve comparability. False positives are also likely to impede economic activity, as parties may be unwilling to execute otherwise beneficial transactions that would inappropriately balloon their balance sheets and distort their income statements.

I. Executive Summary.

The ASF has numerous comments relating to the Proposal. The body of this letter is devoted to our key comments, which are presented as follows:
Our principal comments on the variable interests approach (each of which is discussed in more detail in Part II below) are:

1. There should be a presumption that an SPE will be consolidated only by an enterprise that holds a majority of the variable interests in the SPE. As with non-SPEs, consolidation should also be required if a party holds a controlling financial interest through other means, but the presumption should parallel the majority holding presumption for non-SPEs.

2. In most cases, a counterparty to a derivative with an SPE should not be considered the primary beneficiary of the SPE. We offer in this letter proposed indicators of situations that would support a conclusion that a derivative counterparty should not be considered a variable interest holder that could be the primary beneficiary.

3. Paragraph 19 proposes criteria relating to “market-based” fees that could contribute to the risk of false positives under the Proposal and also could have unintended anti-competitive effects.

4. The silo approach under paragraph 17 should be extended to additional parties (particularly administrators of MSVs) and to master trusts, and FASB should also provide guidance on how to apply the variable interest approach to multi-step transactions involving multiple SPEs.

Our comments in paragraphs 3 and 4 above also apply to paragraph 22 SPEs.

Our principal comments on paragraphs 22 and 23 (each of which is discussed in more detail in Part III below) are:

5. Paragraph 22.b. should be revised to more directly focus on the risk-dispersing function of an SPE holding financial assets, rather than starting from the qualifying SPE criteria in Statement 140.
6. Paragraph 23 should only require an enterprise to consolidate a paragraph 22 SPE if two conditions are met: (a) the enterprise holds a majority of variable interests in the SPE; and (b) the enterprise meets at least two of the three conditions currently specified in paragraph 23 (subject to our further comments below). If FASB does not accept our proposal to adopt a majority approach, then paragraph 23 should at least incorporate the general requirement that the enterprise hold a significant portion of the variable interests that is significantly larger than the portions held by others.

7. We request additional changes to make paragraph 23 better identify situations in which an enterprise holds a variable interest that truly provides significant financial support to an SPE or has purchase and sale discretion that is consistent with a controlling financial interest.

Our other principal comments (each of which is discussed in more detail in Part IV below) are:

8. When consolidation of an SPE holding financial assets is required under the final interpretation, the consolidating enterprise should display its interest in the SPE using the “matched presentation,” as described in Appendix C to this letter.

9. Paragraphs 9, 11 and 12 of the Proposal (relating to consolidation based on voting interests) include rules that could contribute to the risk of false positives under the Proposal, to the extent that securitization SPEs are ever analyzed based on voting interests.

10. Several aspects of the Proposal impose compliance burdens that are either impracticable or in excess of the reasonably expected benefits.

11. The category of preparers of financial statements to whom the disclosures contemplated by paragraph 25 apply should be narrowed, and we recommend alternative disclosures relating to non-consolidated SPEs.

12. We request a modest lengthening of the transition period and request additional guidance from FASB relating to the transition period.

II. Comments on General Variable Interest Approach.

Paragraphs 22 and 23 seem to have been intended as the primary framework for the consolidation analysis of securitization SPEs, which is the focus of our comments. However, FASB has indicated that those paragraphs are meant as “additional, more specific guidance,” which is intended to be consistent with the general variable interest approach. As a result, our comments on the general variable interest approach provide some helpful background for our comments on paragraphs 22 and 23, and we have begun with our comments on the general variable interest approach.
A. Majority of Variable Interests as the Presumptive Consolidation Criterion.

ARB No. 51 requires one enterprise to consolidate another if the first enterprise holds a controlling financial interest in the other. The controlling financial interest standard could theoretically require a detailed facts and circumstances analysis for each consolidation decision. However, for non-SPEs it is usually reasonable to assume that one enterprise has a controlling financial interest in another only if the first enterprise holds a majority of the voting interests in the other. Consequently, when one enterprise considers whether or not to consolidate a non-SPE, the great majority of holdings can be analyzed in terms of a simple, operational majority of voting rights rule.3 A preparer of financial statements also has to consolidate where a controlling financial interest exists without holding a majority of voting interests, but that is the exception and is a subjective judgment.

The Proposal would impose a very different paradigm for SPEs, which would be much more likely to require consolidation without a majority of the relevant measured interests than is the case for non-SPEs. Under the Proposal, no special circumstances or demonstrable de facto controlling financial interest is necessary to require consolidation without a majority of variable interests. The absolute rule (not even a rebuttable presumption) is that if no party holds a majority of an SPE’s variable interests, then any party that has a significant variable interest that is significantly larger than any other party’s is required to consolidate. We believe this new paradigm will result in numerous false positives, requiring consolidation by enterprises that in fact do not exercise a controlling financial interest. We strongly oppose this result and, consequently, also oppose the new paradigm.

The potential for false positives under this paradigm is exacerbated by the types of interests that may be viewed as variable interests. These interests often do not convey any actual controlling financial interest over the SPE or its assets. To illustrate, contrast the holder of a significant (but non-majority) portion of a subordinated or mezzanine tranche issued in a securitization with the rights of the holder of a significant non-majority portion of an operating company’s voting stock. Unlike voting stock, the securitization interests often do not convey any control rights in the ordinary course. As a result, it is far less likely that holding a significant non-majority of securitization interests will result in a true controlling financial interest than it is that holding a significant non-majority of voting stock will. The voting rights of a significant non-majority holder could well motivate the board of directors and managers of an operating company to observe the preferences of the holder. This is much less likely to be the case with non-voting variable interests in an SPE. We believe that the new paradigm moves in the wrong direction, by lowering the bright line threshold for consolidation in these circumstances.

Besides the analytical problems with this approach, it is likely to have an adverse economic impact. Investors will be less willing to buy sizable portions of subordinated or mezzanine tranches if they risk having to consolidate an SPE in which they would be a

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3 See also SOP 78-9, paragraph 7: “the usual condition for control of a corporation is ownership of a majority (over 50 percent) of the outstanding voting stock”. Paragraph 7 also suggests a majority of financial interests in profits and losses test in deciding whether or not to consolidate a partnership in which voting interests are not clear.
passive investor. This is likely to increase the cost of capital in the affected transactions, as arrangers and underwriters have to seek out additional investors. If widespread, this phenomenon is likely to drive up costs of credit in the lines of business in which the securitized assets are originated.

We urge FASB to place the consolidation analysis for SPEs on a more even footing with the analysis for non-SPEs by establishing a presumption that consolidation is only required for a party that holds a majority of variable interests. This presumption should be limited by two important qualifications:

- In order to determine the extent of its variable interests in an SPE, an enterprise should be required to make a qualitative assessment of all of its relationships with the SPE, as currently required by the Proposal.

- If an enterprise has a significant non-majority share of an SPE’s variable interests, the enterprise should be required to consider whether it nevertheless has a de facto controlling financial interest through other means. This requirement should closely parallel the guidance for non-SPEs. This would retain the concept that consolidation may be required without a majority of the variable interests, while avoiding the frequent false positives that are likely to result from setting a bright line test at too low of a threshold.

B. Excluding Some Derivatives from the Variable Interests Analysis.

Paragraph 18.j. of the Proposal identifies derivative instruments as one way that a variable interest can arise. We think this is inappropriate for arm’s length market derivatives, since derivatives are already accounted for under Statement 133. In fact, for a derivative counterparty to consolidate an SPE solely because of the derivative would often amount to the counterparty showing the notional amount of the derivative on its balance sheet, a result which FASB specifically rejected in developing Statement 133. Also, given the mark to market requirements under Statement 133, the expected future losses associated with a derivative could fluctuate significantly over the life of an SPE, as market values for the underlying change. This could result in serial instances of consolidation and de-consolidation of the same SPE, which cannot be the most representationally faithful accounting for these transactions.

We recognize, however, that derivatives can take on virtually infinite forms, and some of those forms could be used to concentrate risks in a manner that justifies consolidation. As a result, we do not recommend a blanket exclusion of derivative counterparties from the universe of possible primary beneficiaries. Instead, we suggest that FASB incorporate into the final interpretation the following indicators of situations that support a conclusion that a derivative counterparty should not be considered a variable interest holder that could be the primary beneficiary:

- There are investors in the SPE that have cash at risk that is subordinated to the claims of the counterparty, i.e., they have made a meaningful investment in the SPE that is at
risk based on the performance of the SPE's assets and contracts entered into by the SPE.

- The derivatives are marked-to-market by the derivative counterparty.

- The derivatives do not concentrate substantially all of the risk and rewards of the assets in the derivative counterparty, as could happen for instance with some total return swaps.

Note also that any derivative counterparty would be subject to the general requirements to make a broad qualitative assessment of any other relationships it has with the SPE and consider whether, taken together, it has a de facto controlling financial interest in the SPE.

If FASB does not add the requested indicators, we request that FASB provide examples on how to compare the variable interests of a counterparty under a senior, market-making derivative to those of subordinated debt or equity investors. To illustrate the current lack of guidance, in a plain-vanilla interest rate swap, does it matter which leg of the swap a party has, or whether the swap is an asset or a liability, in determining the significance of the variable interests in relation to other types of variable interests?

If our requested indicators are added, then the final example in paragraph A3 on page 12 of the Exposure Draft as it relates to derivatives should be deleted. If not, we request that FASB clarify that example.

C. Market-Based Fees.

Paragraph 19 proposes standards relating to fees that could contribute to the risk of false positives under the Proposal. First, the final sentence of the paragraph establishes a presumption that a fee is not market-based unless the fee can be demonstrated to be comparable to fees in similar observable arm's length transactions. We object to this presumption and to the demonstration required to overcome it. Ideally, we do not think that there should be any presumption. We ask FASB to better articulate the relationship between the question of whether fees for services can be demonstrated to be market-based and the determination of whether the service provider is a primary beneficiary.

If a presumption is retained, then FASB should provide some appropriate guidance as to how the presumption may be overcome. For instance:

1. Consistent with the definition of "market-based fee" in the first sentence (i.e., "a fee negotiated at arm's length under competitive conditions"), a fee should be considered to be market based if it can be demonstrated that the fee was in fact set through bargaining between independent substantive entities with an interest in the outcome or where there is competition for a particular transaction or other engagement.

2. Similarly, in many transactions a fee is set by one party based on what that party believes to be a market level and then accepted by other interested
and independent substantive entities (for instance, through their purchase of securities issued by an SPE after disclosure of the level of the fee). This common market practice also provides an adequate market test of the level of a fee, and the final version of the Proposal should accept this kind of test.

3. Evidence that a fee is comparable to fees in similar observable arm's length transactions or arrangements (as contemplated by the Proposal) should also be acceptable, but should not be the only acceptable basis for overcoming any presumption.

4. Evidence that a service provider can be terminated without cause should also be acceptable, but again, should not be the only acceptable basis for overcoming any presumption.

A separate point relating to paragraph 19 is that the second sentence states that any significant incremental investment made in order to earn a variable fee should be considered in determining if the enterprise has a variable interest. Businesses commonly have to make investments in personnel and facilities in order to earn fees. We fail to see why doing so should make the investment an element of a service provider's variable return. This test could also function as an anti-competitive barrier to entry for new service providers, since they are more likely to need significant incremental investments that are traceable to a particular engagement than are established providers.

Another potential anti-competitive effect is that requiring fees to effectively be consistent with past market practice is likely to reduce the willingness of market participants to agree to different fee structures that are potentially more attractive from the third party equity/note holders' perspective. For example, many investors prefer management fees to be more highly subordinated or performance-based. Managers will be less likely to agree to this type of fee if the fee is likely to be viewed as a variable interest and increase the possibility that the manager will be required to consolidate the SPE.

Finally, the determination of whether or not a fee is market-based should be made only at the inception of a transaction. The fact that market rates may change during the term of a transaction should not matter.

D. The Silo Approach and Multiple SPE Transactions.

We support the silo approach established by paragraph 17 of the Exposure Draft. We also believe that the silo approach is just as appropriate under a paragraph 23 analysis as it is under the general variable interests analysis.
other enterprises involved in transactions that are already described in paragraph 17, particularly administrators of MSVs; and

master trusts, in which separate series of securities share a single pool of assets but generally function like separate SPEs with respect to their allocable shares of the assets.

Administrators of MSVs do not usually fall within the current terms of paragraph 17, but a substantial portion of their rights and obligations relating to an MSV are directly linked to particular silos. Those rights and obligations that are not specifically allocable to particular silos could generally be allocated among all silos on a reasonable basis. Besides making this extension, FASB should provide additional guidance as to how an MSV administrator should apply the silo analysis. Specifically, an administrator should (1) allocate the assets held by an MSV into silos, (2) determine whether each silo is a paragraph 22 SPE or not (using the guidance we have suggested in our revisions to paragraph 17 in Appendix B) and (3) analyze each silo separately, using the paragraph 23 conditions for silos that are paragraph 22 SPEs and the general variable interests approach for any silos that are not paragraph 22 SPEs.

We suggest the expansion of the variable interests silo approach to master trusts out of concern that the outcome of EITF Issue 02-12 may render the QSPE category unworkable for master trusts. This would happen if the ultimate consensus imposes material restrictions on the range of tenor of securities that can be issued by a single master trust if the master trust is to function as a QSPE.

Just as paragraph 17 requires some parties to treat a single asset pool within an SPE as a separate SPE, we believe that it is also appropriate for some parties to negotiated MSV transactions to look collectively at interests held in more than one SPE in a single asset pool in making a consolidation assessment. Frequently, MSV transactions – like other securitizations – use a two-step transfer in order to achieve isolation. From the point of view of an MSV and its administrator and liquidity and program credit enhancement providers, the number of SPEs involved in creating the senior interest in receivables that the SPE purchases is largely irrelevant, so long as legal isolation is achieved.

Equally irrelevant to the MSV and its service and facility providers is whether one or more of the SPEs used in structuring the MSV’s investment is a QSPE. We believe that the use of a QSPE should isolate the transferor from any requirement to consolidate a silo that holds a beneficial interest issued by the QSPE. The rights and obligations of the transferor relating to the QSPE are identical whether beneficial interests in the QSPE have been sold to another SPE or to a substantive investor. However, that does not mean that subordinated retained interests issued by the QSPE should be ignored when a party other than the transferor analyzes the transaction.

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5 See paragraph 83 of Statement 140.
For example, suppose that a finance company transfers a pool of amortizing installment receivables to a QSPE, and an MSV purchases a senior beneficial interest issued by the QSPE, while the transferor (or an affiliate) retains a 5% subordinated interest issued by the QSPE. From the point of view of the MSV and its administrator and other service providers, the transferor could equally well have transferred the receivables to the QSPE for 95% cash and a 5% deferred purchase price obligation, so long as isolation could be achieved in either structure. In either case, from the point of view of the MSV and its service and facility providers, the important point is that the MSV’s interest in the receivables has the benefit of a 5% subordinated interest held by the transferor or its affiliates.

This should only be the case, however, where an ABS is structured specifically to be placed in the MSV to provide a transferor access to the ABCP market. In this case, the transferor is an intended beneficiary of the MSV and makes a conscious choice to access the ABCP market through the MSV. Because of that relationship, it is appropriate for parties other than the transferor to consider the transferor as a potential primary beneficiary of a silo within the MSV.

In contrast, in a transaction where an SPE purchases beneficial interests issued by another SPE without the knowledge or other involvement of the transferor, it does not seem appropriate to consider the transferor as a potential primary beneficiary. Although the retained interests of the transferor might be virtually identical as between these two situations, the nature of the transferor’s relationship with the investing SPE distinguishes the two situations. If this relationship were not taken into consideration, a transferor that did not use a QSPE in its transaction could be required to consolidate SPEs that it did not even know existed.

To avoid arbitrary accounting differences between economically identical transactions, we recommend that, for non-transferor parties, in analyzing any silo for consolidation, the variable interests in that silo (and relevant paragraph 23 attributes, in the case of a paragraph 22 SPE) should be construed broadly to include subordinated interests in, and other relationships with, the other SPEs involved in negotiated MSV transactions intended to provide a transferor access to the ABCP market. For instance, in the example above, the transferor’s 5% retained subordinated interest in the QSPE should be viewed by any non-transferor party to the transaction as a variable interest in the silo. We have suggested language to accomplish this in our mark-up of paragraph 17 in Appendix B.

III. Comments on Paragraphs 22 and 23.

The introductory portion of the Exposure Draft indicates that the Proposal is meant to require consolidation of SPEs that do not effectively disperse risks and acknowledges that securitizations often do disperse risks. Also, statements by various FASB members leading up to the publication of the Exposure Draft led us to believe that the special
section of the Proposal relating to SPEs holding financial assets would not require consolidation of CDOs or MSVs.\footnote{See, for example, quotes from Mr. Jenkins and Mr. Lott in “FASB To Exclude Most Securitization SPEs From Consolidation,” by Carol Remond (Associated Press Newswires, May 22, 2002); and “FASB Mulls Excluding Some SPEs from Consolidation Rules,” by Carol Remond (Associated Press Newswires, May 5, 2002).}

Unfortunately, we do not believe that these intentions have been fully realized in the Proposal. Each of the three analytical frameworks included in the Proposal would apparently require some party to consolidate SPEs used in many standard market securitizations, including many CDOs, MSVs and CLNs. In particular, the two paragraphs aimed directly at securitization SPEs may require consolidation in many circumstances where it would not be required under the general variable interests approach. Our comments below are intended to modify paragraphs 22 and 23 so that legitimate risk dispersing securitization SPEs will not be consolidated with any party.

A. The Universe of Risk-Dispersing SPEs.

Paragraph 22.b. of the Proposal incorporates by reference and applies to the SPEs described in that paragraph many of the restrictions that apply to QSPEs under Statement 140. We can understand FASB’s desire to build off of the considerable work that has gone into the QSPE restrictions over the past several years. However, we think that the purpose of those restrictions is sufficiently different from the purpose of paragraph 22.b. that it would be far better for FASB to instead take a fresh start. We propose below a conceptual basis for a revised paragraph 22 that we think is both substantively more consistent with FASB’s goal of identifying risk-dispersing SPEs and procedurally consistent with the desire to issue principle-based standards.

The concepts to be included in paragraph 22 would include:

- Certain SPE transactions serve to disperse the risks and rewards of financial assets. They serve to allocate cash flows of the financial assets and modify or provide for risks in accordance with the substantive terms of various parties’ relationships with the SPE.

- If no party has an interest that effectively recombinates substantially all of the risks and rewards of the SPE transaction, then no party is required to consolidate such a risk-dispersing SPE. Instead, all parties should account for their respective interests in the SPE through the financial-components approach. If any relationships indicate that the entity is not dispersing the risks and rewards to various (at least two) parties, or that any relationship effectively recombinates substantially all of the risks and rewards that have been previously dispersed, the SPE should not be analyzed under paragraph 23. Instead all parties should review the SPE under the general variable interest model.

- Judgment will be required in reviewing the substance of the transaction to ensure that its purpose is to allocate the risks and rewards of the assets among various parties.
If FASB does not follow our suggestion and elects to continue to build on the QSPE limitations, then we request some specific changes to paragraph 22.b.

1. Derivatives.

Among the QSPE restrictions incorporated from Statement 140 are restrictions on holding derivatives. We assume that this would include limitations imposed by the pending amendments to Statement 133 and related D-2 guidance. This will increase the number of derivatives that are deemed to be held by SPEs because of the requirement to bifurcate embedded derivatives in beneficial interests issued by SPEs.

We do not see any relationship between the 133 and 140 restrictions on derivatives, on one hand, and the risk-dispersing function that is supposed to characterize unconsolidated SPEs, on the other hand. In addition, the QSPE-style limitations significantly reduce the potential utility of paragraphs 22 and 23. Specifically, they exclude from paragraph 22 any CDO or other SPE that holds, or has the power to acquire, “synthetic assets,” as well as SPEs used to issue credit-linked notes (since credit-linked notes typically include credit default swaps that may not meet the draft amendment to Statement 133 and proposed Statement 140 limitations on QSPEs). Also, under the impending D-2 guidance, many securitization SPEs will not fall within paragraph 22 because embedded derivatives in beneficial interests issued by the SPE will likely be viewed as pertaining to other derivatives held by the SPE, including those derivatives that simply serve to redistribute or offset other risks.

We oppose these limitations and request that FASB revise the interpretation to eliminate most limitations on the derivatives that may be held by an SPE in order for the SPE to qualify for the treatment prescribed under paragraph 23. Specifically, we ask that the derivatives held by SPEs subject to paragraph 22 should only be subject to the limitation that each such derivative has characteristics that serve to allocate cash flows within the SPE in order to provide for risks and cash flows to the beneficial interest holders that are consistent with the substantive terms of the beneficial interests.

We understand that FASB originally placed limits on derivatives held by QSPEs in order to assure that transferors could not use QSPEs to circumvent the application of Statement 133 and because a QSPE cannot engage in transactions that give it an undue amount of discretion. In light of subsequent developments and the other differences between QSPEs and the SPEs described in paragraph 22.b., neither of these reasons should be relevant to SPEs described in paragraph 22.b. The guidance in Implementation Issue D-2 should address FASB’s concern about circumvention of Statement 133, and the amount of discretion that can be exercised under derivatives does not seem to be greater than the amount of discretion that the Proposal permits a paragraph 22 SPE to have in other areas, particularly as to purchase and sale of assets.7

7 Several members of the ASF are also active in the Joint Industry Working Group of The Bond Market Association, the International Swaps and Derivatives Association and the Securities Industry Association. That Group submitted detailed comments to FASB on the proposed amendment to Statement 133 in a July 1, 2002 letter that discussed these issues in detail in the context of QSPEs.
In light of these facts, we believe that FASB can ease the restrictions on derivatives as suggested above without compromising any of its other objectives. This, together with our other suggestions, would materially increase the utility of paragraphs 22 and 23 in providing appropriate consolidation guidance for risk-dispersing SPEs that hold financial assets.

2. **Other Limitations.**

In general, we believe it would be helpful if FASB restated the relevant paragraphs from Statement 140, with appropriate modifications, in the final interpretation, rather than incorporating them by reference. The incorporation by reference approach creates some interpretive questions, since the Proposal applies to different parties than does Statement 140 (which applies only to transferors). We have attached our suggested language as part of Appendix B. Some of the changes we suggest in Appendix B are intended to draw substantive distinctions between the SPEs described in paragraph 22.b. and QSPEs, and we have highlighted some of those changes below.

Paragraph 22.b.(3) of the Exposure Draft refers to a number of paragraphs in Statement 140 that explain or elaborate upon sub-paragraphs of paragraph 35.d. and indicates that the restrictions in those paragraphs are not required for an SPE to fall under paragraphs 22 and 23 of the Proposal. The natural implication of this statement is that the restrictions in paragraph 35.d. itself also do not apply, with the possible exception of paragraph 35.d.(3), since the paragraphs that explain and elaborate on 35.d.(3) are not referenced in paragraph 22.b.(3). It would be helpful if the final interpretation could confirm this implication. In our suggested reworking of paragraph 22.b. in Appendix B, we have accomplished this by omitting paragraph 35.d.

Our suggested paragraph 22.b.(3) makes three substantive changes in the text that we have incorporated from paragraph 35 of Statement 140. In clause (1), we have requested that these SPEs not be subject to restrictions on the tenor and other terms of beneficial interests issued arising from the resolution of EITF Issue 02-12. In clause (2), we have added language to make it clear that the required restrictions may be made in an amendment that is entered into in response to the issuance of the final interpretation, so that pre-existing SPEs can be retrofitted to these new requirements. In clause (3), we have proposed the manner in which approvals for significant changes in an SPE’s permitted activities would be obtained. With respect to item (1), we believe that the additional discretion permitted to these SPEs, as compared to QSPEs, in purchasing and selling assets would necessitate and justify additional discretion as to the terms of beneficial interests, since the beneficial interests will have to be adapted to any changes in the asset base. We do not believe that this would detract from the risk-dispersing nature of these SPEs.

**B. Paragraph 23.**

We have several comments on paragraph 23.

1. **Paragraph 23 as a Whole.**
We support the idea that FASB should provide additional consolidation guidance for SPEs holding primarily financial assets. However, that guidance should require consolidation less frequently than the general approach, rather than more frequently. This conclusion is consistent with some of FASB's own statements. For instance, in paragraph B19, FASB acknowledged that in SPEs that diversify risk, "[n]o individual party controls the SPE's assets or is responsible for the SPE's liabilities. Each party should account for its rights and obligations related to the assets in the SPE, but it is inappropriate for any party to consolidate the assets and liabilities of the SPE."

Financial assets are uniquely suited to the application of risk dispersing methods, since there are fewer variables affecting the ultimate cash proceeds realized, and those variables are generally susceptible to statistical or financial analysis. The explosive growth of the ABS markets demonstrate these points. Also, other accounting literature provides adequate guidance for each party involved with an SPE that holds financial assets to account for its portion of the assets and liabilities of the SPE.

Paragraph 23 currently tends in the opposite direction. Unlike the general approach, which requires a significant variable interest that is significantly larger than others, paragraph 23 does not appear to have any absolute or relative size requirement for a variable interest that would require consolidation.\(^8\) So a party with a very small variable interest (measured in terms of expected future losses) in the form of any type of subordinated position or guarantee referred to in paragraph 23.b. would apparently nevertheless be required to consolidate if the party also either has the discretion described in paragraph 23.a. or receives a "non-market based fee," regardless of size.

FASB should correct this situation by adding a size threshold to paragraph 23. Consistent with our comments above, we believe the required size should ordinarily be a majority of the variable interests (subject to the same two caveats as above). If FASB does not accept our proposal to adopt a majority approach, then paragraph 23 should at least incorporate the general requirement that the enterprise hold a significant portion of the variable interests that is significantly larger than the portions held by others.

As a result, paragraph 23 would only require consolidation if (1) an enterprise holds a majority of the variable interests (or interests that meet the significant and significantly

\(^8\) One reading of paragraph 13.b. of the Proposal would suggest that FASB did make a size requirement applicable to parties whose consolidation analysis is governed by paragraph 23. The final sentence of paragraph 23 says that "an enterprise that meets at least two of the three listed conditions shall follow the guidance in items (b) and (c) of paragraph 13 (because two enterprises could meet two of those conditions)." Items (b) and (c) require an enterprise to compare itself to other parties that provide financial support through a variable interest, without requiring that the other parties provide "significant" support (which is the language that paragraph 23 uses). This could be read as meaning that a party who met two out of the three conditions would be compared to a party who did not but who nonetheless had a variable interest that was larger (in terms of expected losses) than the variable interest of the party that met two out of the three conditions. If this was FASB's intent, we support it, but request that it be clarified. In particular, statements in both the Basis for Conclusions section and the final sentence of paragraph 23 itself strongly suggest that only parties that meet two out of the three conditions should be taken into account in the paragraph 13 comparison.
larger tests, if FASB retains them) and (2) the enterprise meets two out of the three conditions in current paragraph 23 (subject to our suggested modifications below).

2. **Paragraph 23.b.**

We believe that the tests in paragraph 23.b.\(^9\) may require consolidation of CDOs and MSVs in circumstances where risks are not concentrated enough to justify it.

Collateral managers of CDOs often purchase a portion of one or more subordinated or mezzanine tranches (on the same terms as third party investors) in order to provide assurance to other investors that the collateral manager’s interests are sufficiently aligned with those of the other investors. Administrators of MSVs often provide liquidity and credit enhancements to the SPEs.\(^10\)

None of these positions typically held by collateral managers or administrators of MSVs should be viewed as indicative of a variable interest that provides significant financial support when provided on terms that are now customary in the market. In the case of collateral managers, the securities they hold are portions of a fungible class which entitle the collateral manager, as holder, to a pro rata share of distributions allocable to the class and are purchased on the same terms as other investors.

As to MSVs, the liquidity and credit enhancement facilities provided wholly or in part by administrators are very rarely drawn upon and (in the case of liquidity) are required by rating agencies primarily to cover CP market disruptions. Even using FASB’s definition of expected losses, which would require the assignment of some probability of loss to these positions through the weighting of expected losses, these liquidity and credit enhancement facilities would still have extremely low expected losses and a risk profile that is not significantly variable.

To address this issue as to MSVs, we request that FASB revise paragraph 23.b. to add an additional component to the analysis of whether a subordinated interest carries the risk profile that warrants satisfaction of this condition. We believe an entity should only meet this condition if (a) it holds a subordinated position and (b) significant losses on that subordinated position are reasonably possible. In applying the second part of this test, we believe that significant expected losses would only be reasonably possible if (i) other more deeply subordinated positions in the SPE are not expected to cover the reasonably expected future losses of the SPE and (ii) the level of expected losses in excess of these other more deeply subordinated positions (and thus exposing the subject interest to expected losses) is significant. This refinement would focus the analysis to determine if there was the type of risk exposure on a subordinated position that is potentially consistent with a controlling financial interest.

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\(^9\) As to paragraph 23.c., please see our comments on market-based fees in Part II.C., which also apply to the analysis of paragraph 22 SPEs under paragraph 23.

\(^10\) Liquidity facilities are not usually subordinated and therefore do not appear to fall within paragraph 23.b. Nevertheless we include them in the discussion below for completeness and to discourage FASB from making any changes that would make non-subordinated liquidity facilities fall within paragraph 23.b.
If FASB accepts our suggestion that an enterprise must ordinarily hold a majority of variable interests in order to consolidate an SPE, then collateral managers will be able to address their issue by holding less than a majority. If FASB does not accept that suggestion, then we would further emphasize our request in Part IV.C.1. below relating to ongoing monitoring of the “significant and significantly larger” test. A collateral manager may have some ability to confirm that the collateral manager’s holdings (if significant) are not significantly larger than other parties’ holdings initially, but a collateral manager should not be considered to have acquired a controlling financial interest later if secondary market trades by independent parties disperse the other significant holdings so that the collateral manager’s original holdings become significantly larger than any other party’s holdings.

C. Paragraph 23.a.

Purchase and sale discretion cannot in and of itself constitute a variable interest in economic terms, without some interest that enables the person exercising that discretion to benefit from the results of its exercise (presumably in a form described in paragraph 23.b. or 23.c). Therefore, we infer that FASB must have intended paragraph 23.a. as a way to detect the control component of a controlling financial interest.

However, paragraph 23.a., as currently worded, could be interpreted to cover some situations where the level and intent of the discretion exercised by an enterprise is not sufficient to justify consolidation. These issues relate primarily to MSVs and arise from the fact that administrators generally have veto power over bringing transactions into an MSV, subject to investment policies that restrict eligible transactions, and rights (for the benefit of various parties that deal with the MSV) to remove transactions from the MSV.

We request that paragraph 23.a. of the interpretation be revised to read as follows in order to appropriately narrow that paragraph:

"a. It has authority to purchase and sell assets for the SPE and has sufficient discretion in exercising that authority to significantly affect the revenues, expenses, gains, and losses of the SPE in a manner that benefits the enterprise to a significant extent. This condition is not met, for example, if provisions of the governing documents significantly limit the amounts and types of assets eligible for purchase, and the enterprise cannot unilaterally change such provisions. Similarly, this provision is not met if the enterprise is only permitted to direct dispositions of assets for the purpose of protecting beneficial interest holders from losses, preserving the SPE’s access to a particular funding market or terminating a transaction in the ordinary course."

Also, we note the use of the conjunctive phrase “purchase and sell” in paragraph 23.a., which we interpret to mean that an enterprise must have discretion as to both purchases and sales in order to meet the condition. We strongly believe that to be the appropriate formulation.
Finally, although we have not added any language on this point, we assume that benefits arising purely from the volume of transactions in an MSV would not meet this condition. Otherwise, it would seem that virtually any purchase and sale discretion would meet the condition.

IV. Other Key Comments.

A. Matched Presentation.

When consolidation is required under the proposed interpretation for an SPE holding financial assets, we propose that the consolidating entity display its interest in the SPE using the “matched presentation,” as described in Appendix C to this letter, rather than a conventional consolidation. For the reasons discussed in Appendix C, we believe that this matched presentation would provide a much clearer picture of the balance sheet exposure of the consolidating entity.

B. Consolidation Based On Voting Interests.

The Proposal includes a number of different standards to be applied in determining whether the voting interests of an SPE make up a large enough share of the SPE’s capital base to permit the consolidation analysis to turn upon ownership of the voting interests. We have the following comments relating to these rules:

1. We do not think that an SPE’s capital should have to be compared to the capital of a substantive operating enterprise. Operating enterprises are subject to risks that are not present in SPEs. As FASB acknowledged in the Summary of the Exposure Draft, SPEs provide benefits “by isolating assets or activities to protect the interests of creditors.” The capital of an operating enterprise will generally be higher to cover these additional risks. We propose that the question of whether or not an SPE is capable of financing itself without financial support should be tested by seeing whether or not the SPE has actually been able to do so.

2. We are uncertain whether the “equity investment” must be equity in form. Given the general substance over form orientation of the Proposal, we do not believe that a particular form should be required. The important question should be what rights and risks are associated with any particular security.

3. Paragraph 9.e. apparently does not permit an equity holder to have any other interest in the SPE. We do not see the rationale for this restriction.

C. Compliance Burdens.

Several aspects of the Proposal impose compliance burdens that are either impracticable or in excess of the reasonably expected benefits. We request that FASB take a cost-
benefit analysis into consideration as it finalizes the new interpretation. Some of the main provisions that raise these sorts of concerns are referenced below.

1. **The “Significant and Significantly Larger” Test.**

The complexity and subjectivity of the consolidation analysis is likely to create significant administrative compliance expenses every time that it has to be applied. In addition, under the Proposal an enterprise considering consolidation of an SPE is required to assess not only information relating to its own holdings and other relationships with the SPE, but also non-public information about the holdings and other relationships of other unaffiliated parties. The latter information will often simply not be available.

If, contrary to our suggestion, FASB retains the proposed “significant and significantly larger” test, an enterprise’s obligation to re-examine the factors influencing the consolidation decision should arise only from specific triggering events, rather than automatically on each reporting date. Specifically:

- An enterprise should only be required to reassess its consolidation analysis of an SPE if there has been a change in the variability or quantity of its variable interests.

- For this purpose, an enterprise should not be required to assess changes in the quantity of a variable interest that arise from changes in expected losses due to market events (such as changes in interest or exchange rates) or actions of unaffiliated persons (such as trends in performance by obligors).

- An enterprise should not be required to track changes in the quantity or variability of the variable interests held by other non-affiliated parties. However, if an enterprise has actual knowledge of such changes, and they affect the variability of the enterprise’s own variable interest(s), then the enterprise should give due consideration to those changes.

We understand the underlying rationale for the Proposal to be that FASB has concluded that it is reasonable to infer that an enterprise must have a controlling financial interest if it holds a sufficiently large percentage of the variable interests in an SPE (unless no one holds a controlling financial interest, as in a risk-dispersing securitization). This assumption may or may not always be valid at the time that a new SPE is established, but it appears considerably more tenuous later. For instance, assume that an enterprise holds 30% of the variable interests in an SPE, and at the time that the SPE is established another party holds 40% and the remaining 30% is widely dispersed. The 30% holder would not be required to consolidate initially. Now assume that the 40% holder sells 3 lots of variable interest to other independent parties, who buy 10% each, and no one other than the 30% holder has more than 10% of the variable interests. It is hard to see how the 30% holder could have acquired a controlling financial interest through these transactions when it has taken no action and most likely is not even aware that the 40% holder has made these sales.

2. **Market-Based Fees.**
The required market comparisons simply will not be available in many circumstances, and the antitrust laws severely limit the ability of competing enterprises to share this type of information with one another.

3. Derivatives.

Our proposal to exclude many derivatives from the definition of variable interests is also justified from a cost-benefit and practicality perspective. Large financial intermediaries in the derivatives markets may be parties to thousands of outstanding derivatives at any point in time. Most of these parties have not previously coded these derivatives as to whether their counterparty is an SPE or a substantive operating enterprise. It would be a monumental task for these institutions even to go through their records and determine which counterparties were SPEs. Then they would be required to analyze the variable interests for all the SPE counterparties, and often they would have very little information about an SPE to aid in this analysis. Even going forward for new derivatives, the compliance costs for tracking these transactions and making the required determinations seem clearly disproportionate to the benefits, given the small likelihood that a counterparty under an arm’s length derivative would be the primary beneficiary.

D. Required Disclosures.

For most securitization SPEs that hold financial assets, we believe that the most transparent and useful accounting is for each party to continue to use the financial components approach of existing U.S. generally accepted accounting principles to account for and disclose its respective rights and obligations related to the assets in the SPE. To supplement this treatment, we have included below additional disclosure items that we suggest would be applicable only to administrators of MSVs. We are concerned that paragraph 25. casts an overly broad net and could lead to less transparent and less meaningful disclosures for mere service providers (such as placement agents, dealers and trustees) to SPEs.

We suggest that an enterprise that is an administrator of an MSV be required to include the following footnote disclosures in its financial statements:

1. The purpose of the SPE and the nature of the reporting enterprise’s contractual arrangements with the SPE.

2. The amount and types of ABCP and other securities issued by the SPE outstanding as of the latest balance sheet date and the associated credit ratings.

3. The amount of liquidity commitments provided by the reporting enterprise to the SPE.

4. The amount of any second loss or program-wide credit enhancement provided by the reporting enterprise in the form of subordinated debt, letters of credit or other guarantees and their maturity.
5. Whether and under what circumstances the reporting enterprise could be required to issue its own equity to support the SPE’s transactions.

6. Whether an employee of the reporting enterprise has invested in the SPE.

7. Whether the reporting enterprise has sold any of its own assets to the SPE.

We believe that these disclosures (or any other disclosures required under paragraph 25) may be presented in the aggregate for all MSVs administered by a single administrator, noting differences between MSVs where material.

E. Transition Period.

We recognize that FASB and others perceive the implementation of new consolidation standards as a matter of some urgency. However, the combination of immediate effectiveness for new SPEs and the proposed short transition period for pre-existing SPEs would impose tremendous compliance difficulties on market participants. We request that:

- the final interpretation should be effective for new SPEs entering into transactions beginning in the first fiscal period beginning more than two months after the final interpretation is released; and

- the transition period for pre-existing SPEs (including new transactions in these SPEs) be extended so that the provisions of the interpretation must be applied as of the beginning of the first interim or fiscal period beginning after September 15, 2003) (assuming that the final interpretation is released not too late in the fourth calendar quarter of 2002).

This is still a very rapid implementation schedule for any market participant that faces consolidation of previously unconsolidated SPEs. For pre-existing SPEs that were formed in good faith reliance upon existing consolidation guidance, we believe that grandfathering would be appropriate. Nevertheless, we have instead suggested the expanded transition period as a reasonable compromise between the general desire to quickly bring more consistency and certainty to consolidation policy and the legitimate expectations of parties who entered into existing transactions in reliance upon existing guidance.

F. Other Transition Guidance.

The Statement 140 requirements that are incorporated by reference in paragraph 22 sometimes speak of provisions that must be in an SPE’s governing documents from inception. The legal documentation for many existing SPEs may be modified to avoid inappropriate consolidation under the Proposal. It is impossible for these SPEs to satisfy the from-inception element of these requirements literally. It would be helpful if FASB provided transition guidance that confirmed that amendments made to comply with the new interpretation do not have to satisfy the from-inception timing requirement. We have included appropriate language in paragraph 22.b(3)(2) in Appendix B.
V. **Conclusion.**

Securitizations occupy a very important and visible position in the U.S. capital markets, providing value to a number of constituencies:

- Businesses that use the securitization markets to generate cash from their receivables;
- Consumers, who benefit from lower interest rates that result from securitization; and
- Investors, who appreciate the transparency of asset-backed securities, as well as their ratings stability, soundness through the economic cycle, credit quality and relative freedom from event risk.

Based on discussions internally and with other market participants and observers, the ASF believes that an overly broad consolidation policy is likely to materially reduce activities by MSVs or materially increase the cost of funds to businesses that access the ABCP market through MSVs and materially reduce activity in the CDO and CLN markets. For instance, one mid-sized NYSE investment manager with $600 million of total assets has concluded that under paragraph 23 of the Exposure Draft it would be required to consolidate $1.2 billion of assets from the CDOs it manages, even though its investments in those CDOs aggregate only $13 million. Consolidation would triple this company's assets overnight on April 1, 2003. We urge FASB to consider consequences of this type as it finalizes the interpretation.

We recognize that FASB's mission is to set appropriate accounting standards and that FASB cannot be unduly influenced by the economic impacts of implementing those standards. However, recognizing the subjectivity of the "controlling financial interest" standard, we urge FASB to avoid imposing a consolidation standard that is likely to result in numerous false positives.

Like securitizations, derivatives are an efficient method of reallocating specified risks through a large and active market, and the two methods are often combined, by including derivatives in a securitization. Accounting standards should not place artificial constraints on these combinations. While we recognize that FASB has had concerns about the accounting for derivatives, with Statement 133, including its pending amendments, securitization SPEs do not aggravate those concerns. Therefore, we see no reason for the restrictive orientation towards derivatives that appears in the Proposal.

* * *

The ASF appreciates the opportunity to provide the foregoing comments in response to the Exposure Draft and appreciates the opportunity the FASB staff has given it to work directly with them on some of these issues. We continue to be available for further discussions and assistance in identifying real-life examples for the Board to use as a "field test" of its conclusions.
Should you have any questions or desire any clarification concerning the matters addressed in this letter, please do not hesitate to contact Dwight Jenkins, Executive Director of the ASF at 212.440.9431.

Sincerely,

Vernon Wright
Chairman
American Securitization Forum

Dwight Jenkins
Executive Director
American Securitization Forum
**Appendix A**

**Additional Interpretive Questions and Drafting Suggestions**

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<td>8.a.</td>
<td>This paragraph should also exclude qualifying special purpose entities as defined under Statement 125 that are still accounted for under that Statement.</td>
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| 15.e., B27| Paragraph 15.e. requires an enterprise to treat as its own any variable interest held by a "party that has a de facto agency relationship with the enterprise as a result of providing significant amounts of professional services or similar business arrangements."

The quoted phrase could be construed too broadly. Specifically, a commercial or investment bank or other financial institution that risks its own funds in a transaction should not be treated as the customer's de facto agent, notwithstanding that the financial institution may provide various other commercial or investment banking or other financial services to the customer. |
| 18, 20   | Paragraph 20 states in part that "The relative size of variable interests shall be determined by comparing expected future losses from the interests." Paragraph 18 cites ten examples of ways in which variable interests arise. How should the "expected future losses" from the following variable interests cited in paragraph 18 be determined: d. Management contracts or other service contracts; e. Referral agreements; f. Options to acquire assets; g. Purchase contracts; j. Derivative instruments?

At a minimum, we assume that in determining the "expected future losses" from a derivative that calls for two-way payments, the counterparty should base its analysis on net cash flows. |
<p>| 21       | This paragraph appears to be unnecessary. Under the general variable interests approach, consolidation is only required if an enterprise has a significant variable interest that is significantly larger than any other party's variable interests (or, if our comment is accepted, by a holder of the majority of variable interests). Given this standard, the sort of tie that this paragraph is intended to resolve should result in neither party consolidating. |
| 23.b.    | Although on balance we believe it is grammatically clear that the word &quot;subordinate&quot; in this paragraph modifies all of the items in the list that precedes it, some readers have been uncertain about this. In our mark up in Appendix B we have suggested a minor change to clarify this point. |
| B20      | This paragraph states in part that paragraph 22 SPEs &quot;are legally isolated from the enterprises that hold interests in them.&quot; The legal isolation requirement does not otherwise appear in paragraph 22 of the Exposure Draft or in paragraph 35 of Statement 140, which paragraph 22 largely incorporates by reference. The standard used in paragraph 35 is &quot;demonstrably distinct.&quot; We believe that is a more appropriate standard |</p>
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<td>here. The legal isolation component of Statement 140 is in paragraph 9, and we suggest that FASB should view it like other parts of Statement 140 that are derecognition and transferor-oriented and do not need to be carried over to the consolidation analysis of FSPEs.</td>
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Appendix B

Suggested Re-Wording of Paragraphs 17, 22.b, and 23

17. If contractual or other legal provisions or agreements substantially restrict an enterprise's rights and obligations to specifically identified assets of an SPE, and the interests of the creditors of the SPE apply equally to all of the SPE's assets, then (a) that enterprise shall treat those assets and the portions of the SPE's liabilities attributable to those assets as a separate SPE, and (b) a comparison of variable interests related to each such separate SPE should include the variable interests issued in any intermediary SPEs that are used to transfer assets or beneficial interests to the separate SPE, but only if the enterprise has some other direct relationship with the SPE under consideration. However, if an intermediate SPE used in the transaction is a qualifying SPE, within the meaning of Statement 140 or (where still applicable) Statement 125, no transferor to that qualifying SPE will be required to consolidate the separate SPE. In addition, if substantially all of the assets of an SPE are to be treated as separate SPEs for some enterprise in accordance with the preceding sentence, then any other enterprise involved with the actual SPE may also analyze each of the deemed separate SPEs individually, if such an analysis is consistent with the substance of the enterprise's involvement. In applying paragraph 22.b., [as revised below] and 23 to a deemed separate SPE, some requirements shall be applied to the deemed separate SPE and some shall be applied to the actual legal SPE of which it is a part, as follows:

- Applicable to the separate SPE: paragraph 22, item b(1).
- Applicable to the actual legal SPE of which it is a part: paragraph 22, items b(2) and (3).

Similarly, if a single SPE issues (or may issue) multiple series of beneficial interests, and contractual or legal provisions or agreements substantially restrict the rights of the holders of each series of beneficial interests to a specified share of the SPE's assets (subject to sharing of excess allocations among any or all series), then such series shall be treated as a separate SPE.

22.

b. All SPEs that meet all of the following conditions in paragraph 25 of Statement 140 and other paragraphs referenced in paragraph 35 except that:

(1) They may hold equity securities (as defined in Statement 115) only temporarily and then only if those equity securities are obtained as a result of collecting financial assets held by the SPE. [footnote 8 not included here, but it should remain]11

11 The remainder of proposed paragraph 22.b. is deleted, and all of the following text is a proposed addition. The proposed addition is marked to show changes from the corresponding text in Statement 140.
(2) It is demonstrably distinct from the transferor enterprise considering consolidation (paragraph 36). An qualifying SPE is demonstrably distinct from the transferor enterprise only if it cannot be unilaterally dissolved by such enterprise, any transferor, its affiliates, or its agents and in the case of a transferor, either (a) at least 10 percent of the fair value of its beneficial interests is held by parties other than any transferor, its affiliates, or its agents or (b) the transfer transaction is a guaranteed mortgage securitization. An ability to unilaterally dissolve an SPE can take many forms, including but not limited to holding sufficient beneficial interests to demand that the trustee dissolve the SPE, the right to call all the assets held by transferred to the SPE, and a right to call or a prepayment privilege on the beneficial interests held by other parties.

(3) Its permitted activities are significantly limited, but need not be limited as to the tenor and other terms of beneficial interests that may be issued, were entirely specified in the legal documents that established the SPE or created the beneficial interests in the transferred assets that it holds, or amendments to those documents made to adapt the SPE to the requirements of this interpretation, and (3) may be significantly changed only with the approval of the holders of at least a majority of the beneficial interests held by entities other than any transferor enterprise, its affiliates, and its agents or (y) in the case of beneficial interests that have been rated by a nationally recognized statistical rating organization, with evidence that such changes would not cause such organization to reduce or withdraw its then current rating of such beneficial interests.

It may hold only:

(a) Financial assets (excluding derivatives) transferred to it that are passive in nature (and are permitted by item (1) above), (paragraph 39). A financial asset or derivative financial instrument is passive only if holding the asset or instrument does not involve its holder in making decisions other than the decisions inherent in servicing (see guidance in paragraph 61 of Statement 140). An equity instrument is not passive if the qualifying SPE can exercise the voting rights and is permitted to choose how to vote. Investments are not passive if through them, either in themselves or in combination with other investments or rights, the SPE or any related entity, such as the transferor, its affiliates, or its agents, is able to exercise control or significant influence (as defined in generally accepted accounting principles for consolidation policy and for the equity method, respectively) over the investee. A derivative financial instrument is not passive if, for example, it includes an option allowing the SPE to choose or call or put other financial instruments; but other derivative financial instruments.

12 The preceding two sentences are not necessary given the prohibition on holding equity securities.
can be passive, for example, interest rate caps and swaps and forward contracts. Derivative financial instruments that result in liabilities, like other liabilities of a qualifying SPE, are a kind of beneficial interest in the qualifying SPE's assets.

(2)(b) Passive Derivative financial instruments that pertain to beneficial interests (other than another derivative financial instrument) issued or sold to parties other than the transferor, its affiliates, or its agents (paragraphs 39 and 40) have characteristics that serve to allocate cash flows within the SPE in order to provide for risks and cash flows to the beneficial interest holders that are consistent with the substantive terms of the beneficial interests. 

(3)(c) Financial assets (for example, guarantees or rights to collateral) that would reimburse it if others were to fail to adequately service financial assets transferred to held by it or to timely pay obligations due to it and that it entered into when it was established, when assets were acquired by transferred to it, or when beneficial interests (other than derivative financial instruments) were issued by the SPE.

(4)(d) Servicing rights related to financial assets that it holds

(5)(e) Temporarily, nonfinancial assets obtained in connection with the collection of financial assets that it holds (see guidance in paragraph 41 of Statement 140).

(6)(f) Cash collected from assets that it holds and investments purchased with that cash pending distribution to holders of beneficial interests that are appropriate for that purpose (that is, money-market or other relatively risk-free instruments without options and with maturities no later than the expected distribution date).

23. An enterprise involved with an SPE of the type described in paragraph 22 is considered to provide significant financial support through a variable interest only if it (a) holds a majority of the variable interests in the SPE and (b) meets at least two of the following three conditions:

a. It has authority to purchase and sell assets for the SPE and has sufficient discretion in exercising that authority to significantly affect the revenues, expenses, gains, and losses of the SPE in a manner that benefits the enterprise to a significant extent. This condition is not met, for example, if provisions of the governing documents significantly limit the amounts and

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13 See Part III.A. of the main body of our comment letter.
14 If FASB does not accept our proposal to adopt a majority approach, then we believe that the initial threshold test should incorporate a general requirement that the enterprise hold a significant portion of the variable interests that is significantly larger than the portions held by others.
types of assets eligible for purchase, and the enterprise cannot unilaterally change such provisions. Similarly, this provision is not met if the enterprise is only permitted to direct dispositions of assets for the purpose of protecting beneficial interest holders from losses, preserving the SPE’s access to a particular funding market or terminating a transaction in the ordinary course.

b. (i) It provides a guarantee, a back-up lending arrangement, or other form of liquidity, credit or asset support, in any case, that is subordinate to the interests of other parties and (ii) losses on that subordinated position are reasonably expected to be significant.

c. It receives a fee that is not market based (refer to paragraph 19).

If no enterprise holds a majority of the variable interests in the SPE and meets at least two of those three conditions, that SPE has no primary beneficiary. An enterprise that meets at least two of those conditions provides significant financial support through a variable interest and shall follow the guidance in items (b) and (e) of paragraph 13 (because two enterprises could meet two of those conditions).

15 If FASB retains the “significant and significantly larger” test, then this last sentence should be retained but modified to apply to enterprises that meet the significant and significantly larger test, as well as two out of three of the conditions in 23.(b).a. through 23.(b).c.
Appendix C

Matched Presentation

Matched presentation is a disclosure alternative to traditional consolidation for SPEs holding financial assets in a risk-dispersing securitization.

Under the matched presentation (similar to linked presentation in the UK), a separate section of the Assets side of the balance sheet would be devoted to display certain SPEs. An SPE's gross assets would be shown on a separate line, immediately followed by a deduction for the non-recourse debt and third party equity interests issued by the SPE, arriving at a net interest in the SPE.

Example for a CDO collateral manager (in which the collateral manager owns 20% of the residual interests in the CDO, and the total residual interests in the CDO equal 5% of the total assets in the CDO):

Net investment in Special-Purpose Entities (see Note X):

Total financial assets under management agreement .......... $500,000,000
Less: collateralized debt obligations ......................... (475,000,000)
Less: third party equity interests............................ (20,000,000)
Net investment in special-purpose entities.................. $5,000,000

Similarly, a separate section of the income statement would be devoted to the interest and other income of the SPE, followed by the interest and other expenses and third party equity interests in the income of the SPE.

One of the difficulties with the SPE consolidation issue is that it ends up with an all or nothing solution. One could argue that it is just as misleading to consolidate the whole as it is to consolidate nothing when the transferor retains rights only to certain portions of the cash flows of a financial asset.

The matched presentation adds transparency to the financial statements since the information is on display on the face of the balance sheet, supplemented by additional disclosure in the notes to the financial statements. It is not a netting approach; rather it represents the grossing up of an entity's investment in residual cash flows. Traditional balance sheet ratios and debt covenants are not disturbed like they would be by adding liabilities which are not truly obligations of the primary beneficiary. Similarly, regulatory capital requirements would not be increased like they would be by adding assets which are not truly owned by the primary beneficiary.