Multi-Seller SPE Consolidation Working Group

August 19, 2002

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

Dear Ms. Bielstein:

The institutions (collectively, the “commenting group” or “we”) listed on the final page of this letter thank the Financial Accounting Standards Board for this opportunity to comment on the Exposure Draft referenced above. The members of the commenting group are all commercial banking organizations that act as administrative agents for multi-seller asset-backed commercial paper vehicles (which are referred to below as “multi-seller SPEs”). This letter sets out our comments on the Exposure Draft solely as it might affect us in our capacities as administrative agents for multi-seller SPEs. Each member of the commenting group also has substantial other activities in relation to securitizations, some of which may be affected by the Exposure Draft and may be commented upon in other individual or group letters.

We support FASB’s effort to improve comparability of financial statements by clarifying consolidation rules for SPEs and to provide more complete information about the resources, obligations, risks and opportunities of a consolidated enterprise. However, we have serious concerns about the proposed interpretation. Our central concern is that the proposed interpretation causes an inappropriate result for legitimate risk dispersing securitizations of financial assets carried out in accordance with current market practices, including many multi-seller SPE transactions. These transactions divide risks of assets held by multi-seller SPEs among participants in a manner that makes it inappropriate for any single party to consolidate the assets and liabilities of the multi-seller SPE.

For most securitization SPEs, 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 ("GAAP") to account for and disclose its respective rights and obligations related to the assets in the SPE. To supplement this treatment, we have included in this letter additional disclosure items that we suggest would be applicable only to administrators of multi-seller SPEs below.

An excessively broad consolidation standard is as misleading as an excessively narrow one. Neither accomplishes FASB’s stated purpose. Just as an overly narrow...
standard can impair transparency by omitting assets and liabilities that are material to an enterprise's condition and results, an overly broad consolidation policy could diminish transparency by including assets and liabilities in consolidated statements in circumstances where they make those statements less meaningful. This would require users of financial statements to expend energy in unscrambling the omelet in order to improve comparability. In addition, an overly broad policy is likely to impede economic activity, as parties may be unwilling to execute otherwise beneficial transactions that would inappropriately balloon their balance sheets.

I. Overview of Letter.

Our key comments, each of which is discussed in more detail below, are:

1. We believe that any enterprise that has a relationship to a transaction in a multi-seller SPE should ordinarily analyze such SPE for possible consolidation on a silo-by-silo basis. (See Part III below, beginning on page 5.)

2. We believe that a comparison of variable interests related to each silo in a multi-seller SPE (each, a “Silo SPE”) should include the variable interests issued in any intermediary SPEs that are used to transfer assets or beneficial interests to a multi-seller SPE. (See Part IV below, beginning on page 7.)

3. Each Silo SPE should ordinarily be evaluated for consolidation based on whether any enterprise has a majority of the variable interests. (See Part V below, beginning on page 8.)

4. Paragraph 23 should be modified to require a two-pronged test in order to determine whether an entity provides “significant financial support” through a variable interest: (a) the entity holds a majority of the variable interests in the Silo SPE and (b) the entity meets at least two of the three conditions (as modified by suggested revisions in this letter) specified in paragraph 23. (See Part VI.A. below, beginning on page 10.)

5. Regardless of whether FASB makes the change requested in paragraph 4 above, we request additional changes so that paragraph 23.b. will better identify situations in which an enterprise holds a variable interest that truly provides significant financial support to a Silo SPE. (See Part VI.B. below, beginning on page 11.)

6. Whether or not FASB makes the change requested in paragraph 4 above, we request changes so that paragraph 23.a. will better identify those

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1 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 more than the portions held by others.
situations in which an enterprise's purchase and sale discretion truly is tantamount to a controlling financial interest. (See Part VI.C. below, beginning on page 13.)

7. We suggest additional disclosures that we believe should be required for administrators of multi-seller SPEs under paragraph 25. (See Part VII.A. below, beginning on page 15.)

8. Paragraph 26 does not provide an adequate transition period for any enterprise that is required to consolidate an SPE. (See Part VII.B. below, beginning on page 16.)

9. Transition guidance should reasonably accommodate existing transactions. (See Part VII.C. below, beginning on page 16.)

10. When consolidation of an SPE that holds financial assets is required under the proposed interpretation, we believe that the consolidating entity should display its interest in the SPE using the "matched presentation" described in Appendix E to this letter.

We provide a multi-seller SPE consolidation decision tree that incorporates our proposed changes in Appendix A to this letter.

The commenting group also has a number of other interpretive questions and language suggestions relating to the proposed interpretation, which are set out in Appendix B to this letter.

Before stating our key comments in detail, we have provided some context in Part II below, which provides background on the operation of multi-seller SPEs. Additionally, in Appendix F to this letter, we provide an overview of the size and growth of the multi-seller SPE market.

The remainder of this letter is organized as indicated in the following outline:

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II. Overview of Multi-Seller SPE Operations

Multi-seller SPEs are usually corporations or similar entities (such as limited liability companies). They are formed primarily for the purpose of purchasing interests in, or securities backed by, receivables originated and serviced by multiple entities, all or many of which are unrelated to the multi-seller SPEs and to each other. Multi-seller SPEs fund their purchases primarily by issuing asset-backed commercial paper ("ABCP") and, in some cases, other debt instruments, such as medium term notes. Multi-seller SPEs also enter into agreements with a number of service providers relating to (among other things) administration of their purchase and funding activities, issuing, paying and collateral functions relating to asset-backed securities they issue and liquidity and program credit enhancement facilities.

Each of a multi-seller SPE's transactions typically involves purchasing interests in, or securities backed by, receivables from the originator of the receivables, directly or through one or more intermediary SPEs. Under the applicable transaction documents, the transferor (or one of its affiliates) or an unrelated third party generally holds (a) a first-loss interest (which may be a subordinated or other interest) in the assets that absorbs all of the expected (and almost all of the unexpected) variability in the performance of the assets and (b) in the case of the transferor, the primary continuing involvement with the assets, including the right to acquire or generate the assets to be transferred in the future to the multi-seller SPE and the responsibility to continue to service the assets, including establishment of credit and collection policies, establishment of the terms of a receivable and collection services on the receivables, subject to termination for cause.

Each multi-seller SPE generally has an administrative agent that administers the purchase and funding activities of that multi-seller SPE and one or more referral agents that arrange transactions for the multi-seller SPE. Administrative and referral agents serve multi-seller SPEs under agreements that are similar in many respects to the agreement between a mutual fund and its investment manager.

Multi-seller SPEs provide access to the low cost A-1/P-1 commercial paper market to transferors who might not otherwise have access to the comparably rated corporate commercial paper market. Appendix F provides an overview of the size and growth of multi-seller SPE market. As with the corporate commercial paper market, rating agencies require a liquidity facility to be provided by a highly rated financial institution in order to access the ABCP market. Under U.S. GAAP, the provider of liquidity and program credit enhancement to a multi-seller SPE currently discloses these positions in footnotes to its financial statements and includes these positions in its regulatory capital calculations in the same manner that a provider of liquidity to an unsecured commercial paper program of a corporation does. We do not believe that the presence of an SPE in the transaction should require different accounting for these economically similar positions.

The entity that serves as administrative agent may also serve as referral agent or carry out one or more of the other functions mentioned above. Frequently, the administrative agent provides all or a portion of the program credit enhancement facility
for the multi-seller SPE as a whole, as well as transaction-specific liquidity facilities (i.e. facilities that provide liquidity for one transaction or silo, as opposed to facilities that provide liquidity for all transactions in a multi-seller SPE). These facilities are very rarely drawn upon and are required by rating agencies to cover ABCP market disruptions (in the case of liquidity) or to provide additional protection to ABCP holders required by rating agencies to achieve the high rating on such ABCP (in the case of program credit enhancement). We note that disruptions in the approximately $1.3 trillion commercial paper market, of which approximately $725 billion constitutes ABCP, are virtually nonexistent, even during times of extraordinary stress on the markets generally. A 2001 survey of administrators active in the multi-seller SPE market found that liquidity draws over the life of the market had been less than 0.81% of approximately $652.1 billion of originations, and losses were less than 0.03% of all originations.² Although the absolute dollar amount of a liquidity commitment may be large, based on the stability of the market, there is minimal risk that such commitment would be drawn. Program credit enhancement commitments range from 1-10% of the dollar amount of all transactions within a multi-seller SPE.

Both program credit enhancement and liquidity facilities have the benefit of first loss interests retained by a transferor or held by an unrelated third party, so neither type of facility is expected to bear losses. The providers of program credit enhancement and liquidity receive fees that are consistent with an investment grade level of credit risk.

Economically, a multi-seller SPE functions essentially like a series of single-seller vehicles that are combined into one SPE to achieve administrative efficiencies and economies of scale. FASB has recognized this possibility in paragraph 17 of the Exposure Draft, which requires a party whose involvement with a multi-seller SPE is limited to a single pool of assets to treat those assets and a corresponding portion of the SPE's liabilities as a separate SPE. The transferor, an affiliate of the transferor or an unrelated third party typically holds the economically variable first loss interest, the funding costs are typically passed through to the transferor and all other parties provide services or facilities that support the transferor's access to the ABCP market.

### III. We believe that an enterprise that has a relationship to a transaction in a multi-seller SPE should analyze the multi-seller SPE for possible consolidation on a silo-by-silo basis.

Paragraph 17 of the Exposure Draft requires a party whose involvement with a multi-seller SPE is limited to a single pool of assets to treat those assets and a corresponding portion of the SPE's liabilities as a separate SPE. We support this "silo" approach as consistent with the economic realities of multi-seller SPE transactions. We encourage FASB to extend the silo approach so that all parties who have involvement with more than one silo of assets within a multi-seller SPE, such as administrators and liquidity and credit enhancement providers, also perform the consolidation analysis at the individual transaction silo for each transaction in a multi-seller SPE (each, a "Silo SPE").

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² This survey was conducted by Mayer, Brown & Platt (now known as Mayer, Brown, Rowe & Maw), and the results were reported in a letter to The Basel Committee on Banking Supervision dated May 31, 2001.
The expansion of the "silo" approach should apply whether a Silo SPE is examined under the general variable interests approach or under the special guidance of paragraphs 22 and 23. Without this proposed expansion, it is possible that more than one entity (such as the transferor of assets for a Silo SPE and an administrator of the multi-seller SPE in which such Silo SPE resides) could be required to consolidate the same assets and liabilities.

The underlying premise for our suggested expansion is that the unit that provides the best context for an analysis of the attributes of any multi-seller SPE transaction is the pool of receivables that a given transferor wants to sell or finance. A transferor faces multiple options as to how to obtain funds for its ongoing origination of receivables, which include: on-balance sheet financing in the debt markets (and, to the extent appropriate, equity markets); medium term note securitizations through a QSPE; or sales to either a single seller or multi-seller SPE that issues ABCP. Once a transferor has made the choice to surrender control of the receivables to the extent necessary to achieve legal isolation in order to access the term securitization or ABCP market, the differences among its funding options are not great enough to justify a fundamentally different consolidation analysis for the transferor or any of the other parties to the applicable transaction.

As discussed above, a multi-seller SPE is economically similar to a series of single seller vehicles. Just as a transferor’s relationship with a multi-seller SPE is oriented around and largely limited to the assets it transferred, a material portion of other parties’ relationships with a multi-seller SPE is also oriented around individual transactions. Therefore, the appropriate basis for each party’s consolidation analysis of a multi-seller SPE will generally be the individual transaction silo level.

If the FASB were to reject this proposed expansion of the silo approach for parties that have involvement with more than one pool of assets in a multi-seller SPE (such as an administrator or provider of liquidity or credit enhancement facilities), we believe that all transaction-specific first loss positions should be aggregated and deemed to be one variable interest for purposes of determining whether any of these other parties holds a majority of the variable interests (or significantly more than any other party) of that multi-seller SPE. We believe that this aggregation is essential to address the fact that although first loss credit enhancement is provided by numerous parties on a transaction by transaction basis, these positions absorb losses prior to a liquidity or program credit enhancement position provided by an administrator or other party. A result that could lead to a contrary conclusion without this aggregation would be a result that puts form before substance. In form, the structure of multi-seller SPEs provides that, for example, 100 transferors will each provide $10 of first loss protection for each of their $100 transactions (each $10 dollars of which is expected to cover losses in the related transaction) while a program enhancement provider may provide $500 second loss enhancement for the entire $10,000 program (none of which is expected to bear significant losses). In form, the program credit enhancement provider appears to have an interest that, because of its absolute dollar size, is significantly more than any of the 100 providers of transaction specific enhancement. In substance, however, that program enhancement provider has a relatively stable investment because each of the 100 first loss
enhancers would absorb losses prior to it. If the first loss enhancement were provided by one party, it would be clear that the program credit enhancement provider did not have the most significant variable interest. It is the presence and size of this aggregate layer of first loss protection, not the identity or number of its providers, which makes liquidity and program credit enhancement positions investment grade positions that are not expected to absorb significant losses.

IV. We believe that a comparison of variable interests related to each silo in a multi-seller SPE (each, a “Silo SPE”) should include the variable interests issued in any intermediary SPEs that are used to transfer assets or beneficial interests to a multi-seller SPE.

Transactions in multi-seller SPEs are generally structured to provide first loss credit enhancement in several ways, including: (a) through the transfer of an undivided interest in an entire pool of receivables to a multi-seller SPE with the multi-seller SPE retaining a senior interest in such receivables (i.e. the transfer of an interest in $100 of receivables for which a multi-seller SPE funds a $95 senior interest and the transferor (or an intermediary SPE established by the transferor) holds a $5 residual interest that absorbs loss and is subordinate to the multi-seller SPE’s senior interest) and (b) through the retention by the transferor (or intermediary SPE established by the transferor) of the entire receivables pool and issuance by that entity of a senior interest in the receivables to the multi-seller SPE and the retention or sale by that entity of one or more subordinated interests in the receivables that absorb loss and are subordinate to the senior interest held by the multi-seller SPE (continuing the prior example, in this case the multi-seller SPE would again hold a $95 senior interest and a third party would hold a $5 subordinated interest which would absorb loss and be subordinate to the multi-seller SPE’s interest).

We provide a diagram of each structure in Appendix D to this letter. The risk profile for the interest held by the multi-seller SPE is identical, regardless of whether the multi-seller SPE is the issuer of the interests in the receivables or the multi-seller SPE simply holds an interest in the receivables issued by the transferor (or an intermediary SPE established by the transferor). From the point of view of a multi-seller SPE and its administrator and liquidity and program credit enhancement providers, whether a transaction is structured so the first loss credit enhancement resides within or outside the multi-seller SPE is irrelevant, so long as legal isolation is achieved and the legal structure is appropriately created. Equally irrelevant is whether the first loss interest is held by a substantive operating entity or another SPE (regardless of whether that SPE is a QSPE). What is relevant is that the comparison of the various interests in the transaction take place at the level where those interests were issued so that the relative risks of each party in the underlying asset pool can be determined.

To avoid arbitrary accounting differences between economically identical transactions solely because of the form of a transaction, we recommend that in analyzing any Silo SPE for consolidation, the variable interests in that Silo SPE (and relevant paragraph 23 attributes) should include the variable interests issued in any intermediary SPE that is used to transfer assets or beneficial interests to the multi-seller SPE.
To implement the changes suggested above in Part III and this Part IV, we suggest that FASB revise paragraph 17 as specified in Appendix C.

V. SPEs Should Ordinarily Be Evaluated For Consolidation Based On Whether Any Enterprise Has A Majority Of The Variable Interests.

Although FASB apparently intended paragraphs 22 and 23 as the primary framework for dealing with SPEs used in securitizations of financial assets, we discuss the general variable interest approach first because FASB describes paragraphs 22 and 23 as “additional, more specific guidance” which is meant to be consistent with the general variable interest approach. We believe, however, that when a single enterprise meets two out of the three conditions, the results are often not consistent with the general variable interest approach. Consequently, our comments on the general variable interest approach provide some important context for our comments on paragraphs 22 and 23.

ARB No. 51 requires consolidation where one enterprise holds a controlling financial interest in another. In practice, the great majority of holdings can be analyzed in terms of a simple, operational majority of voting rights rule. While a preparer of financial statements would also review a relationship to determine whether facts and circumstances may exist to give an entity a controlling financial interest without holding a majority of voting interests, this conclusion is the exception to the general rule.

We believe that this general rule should apply to consolidation analysis for SPEs as well, as opposed to the proposed interpretation, which appears to make an exception to the rule. Specifically, the proposed interpretation states that if no party holds a majority of variable interests, then any party that has a significant variable interest that is significantly more than any other party’s is deemed to have a controlling financial interest and is required to consolidate. We strongly oppose this reversal and think it will result in numerous false positives, requiring consolidation by enterprises that in fact do not exercise a controlling financial interest.

This is especially so because the types of interests that may be viewed as variable interests under the proposed interpretation often do not convey any actual controlling financial interest over the SPE or its assets. For instance, a subordinated or mezzanine tranche issued in a securitization often does not convey any control rights in the ordinary course. As a result, it is less appropriate to presume that a controlling financial interest exists because of a significant, non-majority variable interest than it is to require consolidation if a party holds a large, non-majority block of voting stock of an operating company. The board of directors of the operating company may well feel strong motivation to observe the preferences of the holder of a large block of voting stock, but holding a large block of subordinated ABS for most asset classes is unlikely to make the servicer or any other party change its actions in accordance with the holder’s wishes.

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3 Although we discuss SPEs generally throughout the remainder of this comment, based on our comments in Section III, we believe that as applied to multi-seller SPEs, the relevant entity would be each of its Silo SPEs.
The “significant and significantly more” test will also create an extremely burdensome compliance regime with costs far in excess of what would be justified by the resulting benefits. Because the administrator of a multi-seller SPE will need to provide asset and liability data for each Silo SPE, the complexity and subjectivity of the consolidation analysis is likely to create significant administrative compliance expenses. This is further exacerbated by the fact that each party involved with a Silo SPE must perform a consolidation analysis at each reporting date and, therefore, the administrator must provide the necessary reporting data for each reporting date of any party that transacts with a Silo SPE. In addition, under the proposed interpretation 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.

Our suggested approach is to create a presumption that consolidation is only required for a party that holds a majority of variable interests, with two important caveats. First, each enterprise with a relationship with an SPE should be required to make a qualitative assessment of all of its relationships with the SPE in assessing the extent of its variable interests in the SPE, as currently required by the proposed interpretation. Second, if the enterprise has a significant share of the variable interests, but less than a majority, it should be required to consider whether it nevertheless has a de facto controlling financial interest. This would more closely parallel the guidance for non-SPEs, provide a clear general rule and avoid the false positives created by setting a consolidation test at too low of a threshold.

VI. Comments on Paragraphs 22 and 23.

The Exposure Draft appears to recognize that securitizations of financial assets often serve to disperse risks among market participants. For instance the Exposure Draft includes the following statements:

- “[W]hile many SPEs benefit a primary beneficiary, some SPEs effectively diversify risks and potential benefits related to certain assets or activities....No 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.”

- “Qualifying SPEs . . . and other SPEs with similar characteristics are examples of SPEs that 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 proposed interpretation relating to SPEs holding financial assets would recognize that risk dispersing...
securitizations should not be consolidated by any party. Our comments below are intended to modify paragraph 23 to facilitate legitimate risk dispersing securitizations, as we believe that is FASB’s intended purpose.

A. Paragraph 23 should be modified to require a two-pronged test in order to determine whether an entity provides “significant financial support” through a variable interest: (a) the entity holds a majority of the variable interests in the SPE and (b) the entity meets at least two of the three conditions (as modified by suggested revisions in this letter) specified in paragraph 23.

If the final interpretation includes special guidance for SPEs that hold financial assets, that guidance should be calibrated to require consolidation less frequently than would occur under the general variable interest approach, rather than more frequently. We encourage FASB to include special guidance, if it is calibrated properly.

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 existing U.S. GAAP provide adequate guidance for each party involved with an SPE that holds financial assets to account for its portion of the assets of the SPE. We believe the financial components approach of existing U.S. GAAP provides for the appropriate accounting treatment and disclosure of actual exposures (such as liquidity or program credit enhancement positions) to a multi-seller SPE. To supplement this disclosure in part VII.A of this letter, we have suggested additional disclosure items that would be applicable only to administrators of multi-seller SPEs below.

Paragraph 23 seems to have made a start in this direction, by requiring that two out of the three specified tests be met. The problem is that, while the general approach requires a significant variable interest that is significantly more than others, paragraph 23 does not appear to have any absolute or relative size requirement. The initial threshold test should incorporate a general requirement that the enterprise hold a significant portion of the variable interests that is significantly more than the portions held by others, including variable interests in any intermediary SPE used in the transaction for the reasons described in Part IV of this letter.

One reading of paragraph 23.b. of the proposed interpretation 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 “substantial” 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 in paragraph 23 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.
required to consolidate regardless of the size of that interest if the party also either has the
discretion described in paragraph 23.a. or receives a non-market based fee.

This apparent bias against SPEs holding financial assets should be eliminated by
revising paragraph 23 to add a size threshold. First, we believe that an entity should be
required to consolidate an SPE of the type described in paragraph 22 only if (i) it holds a
majority of the variable interests in the SPE (discussed below) and (ii) it satisfies two of
the three conditions specified in paragraph 23. Consistent with our comments above, we
believe the required size threshold in clause (i) should ordinarily be a majority of the
variable interests (subject to the same two caveats as above, relating to the qualitative
assessment of variable interests and the obligation to recognize a de facto controlling
financial interest when it exists without a majority of the variable interests).

If FASB does not accept our proposal to adopt a majority approach, then we
believe that the majority test discussed in clause (i) of the first sentence should be
replaced by a general requirement that the enterprise hold a significant portion of the
variable interests that is significantly more than the portions held by others.

B. Regardless of whether FASB makes the change requested in Part VI.A.
above, we request additional changes so that paragraph 23.b. will better
identify situations in which an enterprise holds a variable interest that truly
provides significant financial support to an SPE.

The proposed interpretation uses variable interests as an indicator of a controlling
financial interest.8 FASB has also recognized that some SPEs (particularly those used in
securitizations) may “effectively disperse risks,” and the proposed interpretation is not
intended to require that such an SPE be consolidated “unless a single party holds an
interest or combination of interests that effectively recombines risks that were previously
dispersed.”9 Within this analytical framework, paragraph 23 is apparently intended to
identify situations where risks either have not been sufficiently dispersed or have been
recombined to an extent that justifies consolidation. We believe that, as applied to multi­
seller SPEs and their administrators, the tests in paragraph 23.a. and 23.b. are overly
broad, so that they may require consolidation in circumstances where risks are not
concentrated enough to justify it. For example, a program credit enhancement provider
typically has a commitment to a multi-seller SPE that is 1-10% of the total program size.
Program credit enhancement generally has the benefit of the first loss protection provided
by a transferor for each Silo SPE in the form of a retained interest and expected losses on
the program credit enhancement are limited in each Silo SPE. To require consolidation
of 100% of the assets and liabilities of a multi-seller SPE based on a maximum
contractual exposure of 1 to 10% of such amount, with significantly lower expected
losses is not justified. Furthermore, the consolidation of all of the assets of each Silo SPE
would have the effect of requiring banks subject to regulatory capital requirements to
hold approximately 10 times more capital against these credit enhancement positions.
We note that bank regulators have been monitoring and fine-tuning the appropriate level

8 Exposure Draft, paragraph 4.
9 Exposure Draft, p. ii.
of capital requirements for liquidity and credit enhancement providers since the inception of the securitization market. While regulators are currently reexamining the proper calibration of risk-based capital requirements for banks, we do not believe the changes being considered will result in such an extreme increase in required capital holding, indeed, in the case of highly rated transactions, we expect that the level of required capital will be reduced to reflect the relatively low level of risk related to these transactions. Neither existing nor proposed risk-based capital regulations support the idea that administrators, credit enhancement providers or liquidity providers bear the types of risks that consolidation implies.

The issues under paragraph 23.b. arise from the fact that an administrator of a multi-seller SPE often provides liquidity and program credit enhancements to that multi-seller SPE. Liquidity facilities usually rank pari passu with the ABCP issued by an SPE and therefore do not appear to fall within paragraph 23.b. Nevertheless we include them in the discussion below for completeness and to dissuade FASB from making any changes that would make non-subordinated liquidity facilities fall within paragraph 23.b.

Neither liquidity facilities nor program credit enhancement facilities for multi-seller SPEs should be viewed as indicative of a variable interest that provides significant financial support when provided on terms that are customary in the market. These facilities are very rarely drawn upon and are required by rating agencies primarily to cover ABCP market disruptions (in the case of liquidity) or to provide additional protection to ABCP holders to enable the rating agencies to assign a high rating to the ABCP (in the case of program credit enhancement). They also both benefit from transaction-specific credit enhancement (typically in the form of first loss interests in the underlying receivables that are retained by the transferor or placed with other investors), which covers far in excess of the expected losses (and almost all of the unexpected losses) on the receivables. Therefore, none of the parties to multi-seller SPE transactions expects either liquidity facilities or program credit enhancement to bear losses.\textsuperscript{10} All losses are expected to be borne by the transferor or other provider of transaction-specific credit enhancement, which represents the true economic variable interest. 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, credit and liquidity facilities would still have extremely low expected losses and a risk profile significantly less variable than that of the transferor or other provider of transaction-specific credit enhancement.

Neither liquidity facilities nor program credit enhancement facilities recombine risks that have previously been dispersed nor are they first loss positions in a particular transaction. Rather, they are part of a structure that enables a transferor to indirectly issue interests in a pool of receivables to a multi-seller SPE, which in turn disperses this risk through the issuance of highly-rated ABCP supported by liquidity and credit enhancement providers, including transaction specific credit enhancement provided by the holder of the first loss interest in the receivables.

\textsuperscript{10} See footnote 2 and accompanying text above, relating to the infrequency of draws and extremely low losses on liquidity facilities.
To address this issue, 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 the condition. We believe an entity should only meet paragraph 23.b if (a) it holds a subordinated interest position and (b) the possibility of incurring significant losses on that subordinated position is more than remote. In applying the second part of this test, we believe that significant expected losses would only be possible if (i) other more subordinated interests in the SPE are not expected to cover expected losses of the SPE, (ii) the level of expected losses in excess of these other more subordinated interests is significant, and (iii) the chance of incurring losses in excess of the other more subordinated interests is more than remote. If no interest is expected to have significant losses (for instance, because no losses are expected), then the first tranche that covers unexpected losses would meet this condition. This refinement would focus the analysis to determine if there was the type of risk exposure on a subordinated interest that is consistent with a controlling financial interest.

C. Whether or not FASB makes the change requested in Part VI.A above, we request changes so that paragraph 23.a. will better identify situations in which an enterprise has purchase and sale discretion that is tantamount to a controlling financial interest.

Discretion over purchases and sales of an SPE's assets does not directly give a party a variable interest that would absorb any changes in the SPE's financial condition or results of operations that are caused by the purchases and sales. For instance, an investment advisor to a mutual fund has this discretion, within the limits of the fund's investment policy, but any gains or losses resulting from the purchases and sales accrue to the benefit of investors in the fund. Since purchase and sale discretion in and of itself cannot constitute a variable interest in economic terms, we assume that FASB views it instead as an indication of a controlling financial interest, and we support the premise that consolidation of an SPE that holds financial assets should only be required by a party that has both an economically variable interest and significant discretion over the purchase and sale of the assets of the SPE.

However, we believe that paragraph 23.a. could be read as describing some situations where the level and intent of the discretion exercised by an enterprise is not sufficient to justify consolidation. As to multi-seller SPEs, the main issue under paragraph 23.a. is that administrators generally have veto power over the assets purchased by the multi-seller SPE, subject to investment policies that restrict eligible transactions, and rights (for the benefit of various parties that deal with the multi-seller SPE) to remove transactions from the multi-seller SPE.

These rights should not be viewed as indicative of a variable interest that provides significant financial support because:

1. The purpose of these powers is not to enable the administrator to affect the results of the SPE's activities for the administrator's own benefit (other than incremental increases as a result of absolute volume increases described in paragraph 3 below). Rather, these powers are intended to
protect ABCP holders against ABCP market disruptions and, in the case of credit enhancement, losses, and to preserve the multi-seller SPE as an ABCP market access tool for the transferors as a group. Although the various transferors to a multi-seller SPE do not take on risks or receive benefits of other transferors’ assets, the investors are exposed to all of the assets. As a result, if concerns about adverse events affecting one transferor were to make investors or rating agencies concerned about a multi-seller SPE’s ABCP rating, all of the transferors could suffer. Administrators have discretion over SPE purchases and removal of assets from the SPE so that they are in a position to keep any potential or existing transferor from impairing the utility of the SPE for all of the others. In the case of liquidity, sales to a liquidity provider are subject to strict funding formulas to avoid the funding of credit losses by the liquidity purchasers.

2. An administrator’s discretion to cause a multi-seller SPE to purchase assets is not unfettered. Administrators are subject to investment guidelines that restrict the assets eligible for purchase.

3. Administrators do not trade multi-seller SPE assets, and any economic impact on the administrator (in that capacity) from exercise of discretion over the purchase and sale of assets is purely a matter of volume of transactions (i.e. the absolute level of administration fees increases as the volume of assets increases), rather than profit or loss from changes in the fair value of the multi-seller SPE’s assets. We do not believe that this type of incremental benefit as a result of increased volume is the type of significant benefit that would cause these fees to be variable interests.

4. Neither administrators nor multi-seller SPEs themselves sell assets for market gains. Most changes in value of the underlying assets would arise from changes in asset performance or changes in interest rates and would ultimately flow through to the holder of the first loss interest.

5. These administrative rights do not result in recombining risks. Purchases are the means by which assets come into the multi-seller SPE and have their risks dispersed in the first place. Sales are made to react to disruptions in the ABCP market, protect the other beneficiaries of the SPE from event risk relating to any particular beneficiary and to terminate transactions in the ordinary course as permitted by the multi-seller SPE’s governing documents.

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.

We assume that our requested addition of language relating to benefits to the enterprise considering consolidation is merely a clarification because our requested addition is consistent with the definition of “variable interest” in paragraph 7 which states that one of the attributes of a variable interest is that variable interests are “the means . . . through which the providers gain or lose from activities and events that change the values of the SPE’s assets and liabilities.”

Finally, we note the use of the word “and” not “or” in the phrase “purchase and sale” in paragraph 23.a., and we strongly believe that to be the appropriate formulation.

VII. Other Comments.

A. Different disclosures should be required under paragraph 25.

We suggest that an enterprise that is an administrator of a multi-seller SPE 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 SPEs administered by a single administrator, noting differences between SPEs where material.

We believe these disclosures should only be made by the administrator of a multi-seller SPE and that other parties should continue to disclose their exposures (such as liquidity and credit enhancement providers) to a multi-seller SPE in accordance with existing U.S. GAAP.

B. Paragraph 26 does not provide an adequate transition period for any enterprise that is required to consolidate an SPE.

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 be effective for SPEs formed on or after its release date 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 completed in these SPEs as in effect on the release date for the final interpretation) 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. The process of changing the underlying documentation for a multi-seller SPE might require disclosure to its ABCP investors and this could take a significant amount of time. Also sufficient time must be allowed for investors in the ABCP outstanding prior to any changes in the underlying documentation to decide if they will rollover their investments. We believe our transaction recommendations are 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 U.S. GAAP.

C. Transition guidance should reasonably accommodate existing transactions.

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. For existing SPEs that have to be modified to avoid inappropriate consolidation under the proposed interpretation, it is impossible 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.

D. When consolidation is required, we believe that display should be made using matched presentation

When consolidation is required under the proposed interpretation, we believe that the consolidating entity display its interest in the SPE using the "matched presentation" described in Appendix E to this letter. For reasons discussed in Appendix E, we believe that a matched presentation would provide a much clearer picture of the exposure of the consolidating entity.

VIII. Conclusion

As discussed above, we believe that an excessively broad consolidation standard is as misleading as an excessively narrow one. We believe that the proposed interpretation could result in diminishing transparency by requiring consolidation in circumstances where it makes disclosure less meaningful. Furthermore, for most securitization SPEs, 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. GAAP to account for and disclose its respective rights and obligations related to the assets in the SPE. Finally, based on discussions internally and with other market participants and observers, the commenting group believes that an overly broad consolidation policy is likely to materially reduce legitimate risk dispersing activities by multi-seller SPEs and/or materially increase the cost of funds to businesses that access the ABCP market through this medium. We urge FASB to consider these consequences 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 again the subjectivity of the “controlling financial interest” standard, we urge FASB to avoid imposing an overly broad consolidation standard.

With your permission, we would appreciate the opportunity to add to the institutions supporting this letter as additional institutions have an opportunity to obtain internal approval for support of the positions discussed in this letter.
This letter is submitted by the following institutions:

ABN AMRO BANK N.V.
BANK OF AMERICA, N.A.
BANK OF TOKYO-MITSUBISHI, LTD., NEW YORK BRANCH
BANK ONE CORPORATION
BARCLAY’S BANK PLC
CANADIAN IMPERIAL BANK OF COMMERCE
CITIGROUP INC.
J.P. MORGAN CHASE & CO.
ROYAL BANK OF CANADA
SOCIÉTÉ GÉNÉRALE
WACHOVIA CORPORATION
Appendix A

Consolidation Decision Tree
Our Proposed Consolidation Decision Tree for Multi-Seller SPEs

Differences between this proposal and the Exposure Draft are underlined for emphasis.

Is the SPE a GSPE?
  Yes
  No

Is the SPE a GSPE that doesn't hold equities, a "Financial SPE" or a Silo that is a Financial SPE?
  Yes
  No

Do you hold the majority of the SPE's variable interests?
  Yes
  No

You are the Primary Beneficiary and you consolidate the SPE

You do not consolidate the SPE

Note 1. A multi-seller SPE is divided into Silos per paragraph 17. All entities (trusts, liquidity providers, administrators, etc.) that transfer to a Silo use the following analysis process:
  - Is the Silo directly consolidated by another entity in a SPE?
  - Is the SPE the Silo does not apply.
  - Is the Silo an SPE?
  - If yes, apply paragraphs 23-32.
  - If no, apply the variable interests analysis.
  - (See Appendix C, p. 4.)

Note 2. When determining which entities, if any, hold a majority of the variable interests, variable interests for a Silo include (a) allocable amounts of variable interests in the multi-seller SPE that relate to the Silo, and all other variable interests (e.g., owner costs/advances retained by the owner) of a residual interest sold to that entity. (See paragraphs 23-32.

FSPE has no Primary Beneficiary and no-one consolidates

That entity is the Primary Beneficiary and they consolidate

Part III, p. 7.)
Appendix B

Additional Interpretive Questions and Drafting Suggestions

This Appendix is organized sequentially based on the paragraph of the Exposure Draft to which each comment relates.

<table>
<thead>
<tr>
<th>Paragraph</th>
<th>Comment</th>
</tr>
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</table>
| 17        | • We generally support the "silo" approach required by this paragraph as consistent with the economic substance of multi-seller and other shared SPEs.  
• We would like to confirm that our understanding of the appropriate order for application of the silo approach set forth below is correct:  
  • divide a multi-seller SPE into its various silos  
  • looking at each silo, each enterprise would make the following determinations in the following order:  
    • determine whether the silo is consolidated with any other entity, regardless of whether that entity is a substantive operating enterprise or another SPE—if so, analysis stops and only that entity consolidates  
    • determine whether the silo is of the type described in paragraph 22 and, if so, determine whether the enterprise provides significant financial support under paragraph 23—if not, analysis stops and such enterprise would not consolidate the silo  
    • if a silo is not of the type described in paragraph 22 or an enterprise provides significant financial support under paragraph 23—determine whether the enterprise is the primary beneficiary under paragraph 13—if so, such enterprise would consolidate the silo, if not, such enterprise would not consolidate the silo.  
• As discussed in the body of the letter, we believe that the silo treatment should be extended to other parties (such as administrators and liquidity and credit enhancement providers) besides the parties described in paragraph 17. In addition, we believe that FASB should provide additional guidance as to how various principles in the interpretation are to be applied to a silo. We have suggested additional guidance in our proposed revisions of paragraphs 17 and 22 appearing in Appendix C. |
| 19        | • This paragraph states in part; "Because it can be difficult to determine whether a fee...is market based, an enterprise shall presume that its fee from an SPE is not market based unless it can be demonstrated to be comparable to fees in similar observable arm’s length transactions or arrangements." We believe that an enterprise should be able to overcome the presumption that a fee is not market |
based if there is demonstrable bargaining between enterprises to establish the fees. For instance, in the multi-seller SPE market, a transferor will likely have bids from several multi-seller SPEs when it begins a transaction.

- We believe that if an enterprise that is a significant market participant which in the ordinary course of business enters into transactions with clients and investors, which transactions reflect demonstrable bargaining between these enterprises, it should be able to use all of its own transactions to demonstrate the market based nature of its fees as a benchmark based on the premise it has created a market. Other market comparisons simply may not be available in some circumstances, and there are antitrust issues with attempting to obtain that information in private transactions.

- Paragraph 19 also says that “a fee negotiated at arm’s length under competitive conditions (a market-based fee) is not a variable interest unless the holder has an investment at risk or . . . .”
  - We believe that if a fee is truly a market-based fee, the fact that an enterprise has an investment at risk should not be sufficient to require the treatment of the market-based fee as a variable interest. Rather, the enterprise should be required only to analyze whether its investment at risk constitutes a variable interest.
  - If the FASB were to disagree with our position above, we believe that the “investment at risk” should refer only to the types of investments referred to in the next sentence in paragraph 19 (significant incremental investments made in order to earn the fee).

22.b. This paragraph of the proposed interpretation incorporates by reference certain requirements stated in paragraph 35 and related paragraphs of Statement 140. This creates some interpretive questions, since the proposed interpretation applies to different parties than does Statement 140 (which relates only to transferors). It would be helpful if those paragraphs were restated in full, making the necessary adjustments to apply to a non-QSPE and to potential consolidating enterprises other than the transferor. We have attached our suggested language as part of Appendix C. In particular, we believe that changes in our language allowing more flexibility in the ability to issue beneficial interests of varying terms and maturities reflect fundamental differences between the purposes of this Exposure Draft and Statement 140. First, we believe that the ability to more freely issue beneficial interests is fundamental in facilitating the risk dispersing function of transactions in multi-seller SPEs. Second, we believe that the increased ability to purchase and sell assets that the FASB recognizes in paragraph 22 leads to a need for increased flexibility to issue, and vary the terms of, beneficial interests to support such assets.
<table>
<thead>
<tr>
<th>Paragraph</th>
<th>Comment</th>
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<tbody>
<tr>
<td><strong>On a related point, paragraph 22.b(3) of the Exposure Draft refers to a number of paragraphs in Statement 140 that explain or elaborate upon subparagraphs of paragraph 35.d of Statement 140 and indicates that the restrictions in those paragraphs are not required for an SPE to fall under paragraphs 22 and 23 of the proposed interpretation. 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) of the Exposure Draft. It would be helpful if the final interpretation could confirm this implication. In our suggested rewording of paragraph 22.b. in Appendix C, we have accomplished this by leaving 35.d. out of the text that we have reworded for application to SPEs subject to paragraphs 22 and 23 of the Exposure Draft.</strong></td>
<td></td>
</tr>
</tbody>
</table>
| **23.b.** | • Although on balance we believe it is grammatically clear that the word “subordinate” 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 C we have suggested a minor change to clarify this point.  
• We would like to confirm our understanding that if a liquidity or credit enhancement position has been syndicated or is otherwise provided by more than one enterprise through assignment or participation, each provider would only include its allocable share of such position when determining the level of its variable interests. |
| **B20** | This paragraph states in part that SPEs of the type described in paragraph 22 “have limits on their activities and the interests they can issue, and are legally isolated from the enterprises that hold interests in them.”  
• The legal isolation requirement does not otherwise appear in paragraph 22 of the ED or in paragraph 35 of Statement 140, which paragraph 22 largely incorporates by reference. The standard used in paragraph 35 of Statement 140 is “demonstrably distinct.” We believe that is a more appropriate standard here. The legal isolation component of Statement 140 is in paragraph 9, and we suggest that FASB should view it like other parts of 140 that are derecognition and transferor-oriented and do not need to be carried over to the consolidation analysis of SPEs under paragraph 22. |
Appendix C

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 SPE should include the variable interests issued in any intermediary SPEs that are used to transfer assets or beneficial interests to 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 legal 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 paragraphs 22 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, items b(1) and (4) and
- Applicable to the actual legal SPE of which it is a part: paragraph 22, items b(2), (3).

22.

b. An SPEs that meets all of the following conditions in paragraph 35 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

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 any transferor, its affiliates, or its agents and either (a) in the case of a transferor, 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

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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.
sufficient beneficial interests to demand that the trust deed dissolve SPE be dissolved, the right to call all the assets transferred to the SPE, and a right to call or prepayment privilege on the beneficial interests held by other parties.

(3) Its permitted activities (1) are significantly limited, but need not be limited as to the tenor and other terms of beneficial interests that may be issued, (2) were entirely specified in the legal documents that established the SPE, conformed the SPE to the requirements of this interpretation or created the beneficial interests in the transferred assets that it holds, and (3) may be significantly changed only (x) with the approval of the holders of at least a majority of the beneficial interests held by entities other than any transferor, 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 (paragraphs 37 and 38). 37. The powers of the SPE must be limited to those activities allowed by paragraph 35 for it to be a qualifying SPE. Many kinds of entities are not so limited. For example, any bank, insurance company, pension plan, or investment company has powers that cannot be sufficiently limited for it to be an qualifying SPE that meets the conditions in this paragraph 38. The beneficial interest holders other than any transferor, the enterprise considering consolidation, its affiliates, or its agents may have the ability to change the powers of an qualifying SPE. If the powers of an previously qualifying SPE are changed so that the SPE is no longer qualifying described in this paragraph 22, unless the conditions in paragraph 9(b) are then met by the SPE itself and the conditions in paragraph 9(a) and 9(c) continue to be met, that change would bring the transferred assets held in require the enterprise to reassess consolidation of the SPE back under the control of the transferor (paragraph 55).

(4) It may hold only:

(4)(a) Financial assets (excluding derivatives) transferred to it that are passive in nature. (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 transferee the enterprise considering consolidation, 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 sell or put other
financial instruments; but other derivative financial instruments
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 d 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 of 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. 12

(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 transferred to it, when beneficial
interests (other than derivative financial instruments) were issued
by the SPE or which were amended in connection with the
adoption of this paragraph 22 b.

(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 SPE13 and (b) meets at
least two of the following three conditions:

12 See Part III B, of the ASF Letter.
13 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 more than the portions held by others.
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.

b. (i) It provides a guaranty, 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) the possibility of incurring significant losses on that subordinated position is more than remote.

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 (c) of paragraph 12 (because two enterprises could meet two of those conditions).  

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

Structure Examples
Example 1.

A. The transferor transfers the receivables to SPE I in exchange for $100 of consideration, which may be in the form of a cash purchase price paid by SPE I or an increase in equity investment through a capital contribution by the transferor or both. Legal isolation of the assets from the transferor occurs at this level.

B. SPE I transfers $100 in receivables in exchange for $95 from the multi-seller SPE and the issuance by the multi-seller SPE to SPE I of a $5 residual interest in the receivables that is fully subordinated to the interest of the multi-seller SPE in the receivables.

Example 2.

A. The transferor transfers the receivables to SPE I in exchange for $100 of consideration, which may be in the form of a cash purchase price paid by SPE I or an increase in equity investment through a capital contribution by the transferor or both. Legal isolation of the assets from the transferor occurs at this level.

B. SPE I transfers a $95 senior interest in the receivables and retains (or finds another buyer for) a $5 subordinated interest that is fully subordinated to the senior interest held by the multi-seller SPE.

The only difference between examples 1 and 2 is one of form, not substance. In both cases, the multi-seller SPE has the benefit of the subordinated interest, regardless of whether it resides in the multi-seller SPE or the intermediate SPE.
Appendix E
Matched Presentation

Matched presentation is a display alternative to traditional consolidation for SPEs related to the transfer of financial assets.

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

Example of a multi-seller SPE:

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

Gross assets under administration agreement....... 100,000,000
Commercial paper and third party equity interests....... 100,000,000
Net investment in special-purpose entities............ -0

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.

A matched presentation adds transparency to the financial statements since the information is on the face of the balance sheet, supplemented by additional disclosure in the footnotes to the financial statements. Traditional balance sheet ratios and debt covenants are not disturbed like they would by adding liabilities which are not legal obligations of the consolidating enterprise. Similarly, regulatory capital requirements would not be increased like they would by adding assets which are not legally owned by the consolidating enterprise.
Appendix F

Overview of the Size and Growth Multi-Seller SPE Market

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

- Businesses that finance their operations in part through this market or through the term securitization market, since multi-seller SPEs are important investors in mezzanine ABS and provide a low cost funding alternative that might not otherwise be available to some businesses.

- Consumers, who benefit from lower interest rates that result from:
  - efficient financing for consumer lenders through the securitization markets; and
  - competition among consumer lenders, which is increased by securitization, since securitization tends to level the playing field between very large and smaller lenders.

- Investors, who appreciate the transparency of ABCP, including its credit quality and relative freedom from event risk. The growing reliance of investors upon ABCP as a high quality liquid asset is illustrated the tables on the next page, which show that ABCP has grown to represent a majority of the overall commercial paper market. The importance of multi-seller SPEs in particular is shown by the large share of ABCP outstandings that are issued by multi-sellers.
The following table breaks out outstanding ABCP as of March 31, 2002 by program type. As the table shows, multi-seller SPEs are the largest type of ABCP program, making up just under 60% of ABCP outstandings at the measurement date.

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<thead>
<tr>
<th>Program Type</th>
<th>Outstandings (billions)</th>
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<td>Multiseller</td>
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<tr>
<td>Securities Arbitrage</td>
<td>161.40</td>
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<tr>
<td>Single-Seller</td>
<td>85.28</td>
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</table>

Source: Moody's Investors Service.
<table>
<thead>
<tr>
<th>Category</th>
<th>Amount</th>
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<tr>
<td>Hybrid</td>
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<tr>
<td>Loan-Backed</td>
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<tr>
<td>Other</td>
<td>8.61</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$724.13</strong></td>
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