May 25, 1999

Director of Research and Technical Activities
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

File Reference No. 194-B

Gentlemen:

Bank of America appreciates the opportunity to comment on the Exposure Draft “Consolidated Financial Statements: Purpose and Policy” (ED). In addition to our banking franchise, we have a number of non-banking subsidiaries. We also have investments in various other legal entities, and close contractual relationships with still others. In addition to the significant numbers of financial statements we prepare, in the course of our operations we are one of the largest users of financial statements and financial information in the United States.

We do not believe the proposed standard is necessary to “fix” current practice, practicable to implement, or cost effective. We believe that the proposed standard’s definition of control is very ambiguous and will unnecessarily create diversity in practice. We anticipate that full implementation of the proposed standard will require a significant amount of time and effort on the part of FASB, the EITF, practitioners, reporting entities and the SEC staff -- costs not justified by any improvement in current practice. As a lender we are concerned that diversity created by the proposed standard and the absence of a risk and rewards criterion could adversely impact bank lending activities.

We believe that existing accounting standards requiring consolidation of entities in which we hold a majority voting interest or are the sole general partner are appropriate, and result in the consolidation of those entities that are under our control. However, the EDs second and third of the four presumptions of control are inappropriate, and should be deleted. Lacking that, they should be modified to make them clearer and less burdensome on the potential parent, and to avoid changes in consolidation status due to factors other than actions of the potential parent.

The standard that emerges should not require consolidation of an entity by a party that has no equity and no legal voting rights in the entity. The standard should not require consolidation by a party that has taken no action to exercise control of an entity, even though there may be some evidence that it could achieve effective control if it took such
action. The standard should not require consolidation by a party that has the rights to less than a majority of the financial benefits generated by operation of another entity. At the very least, consolidation should not be required if the potential parent does not have legal control and does not have the rights to a significant share of the financial benefits generated by the entity, such as 25% of the profits.

The standard should allow limited grandfathering of non-consolidation of existing entities. It is unfair to require consolidation of entities due to circumstances that were created when consolidation was governed by the current standards and which cannot be altered or terminated quickly enough to avoid consolidation under the provisions of the ED. If all existing relationships with non-consolidated entities cannot be grandfathered, the Board should at least exempt from consolidation special purpose entities which were created for purposes of particular transactions which occurred prior to the adoption of the new standard, and which will remain in existence only until the assets, liabilities, and contracts generated by those transactions are terminated, disposed of, or completed.

For regulated industries such as banking, the proposed standard may have a significant adverse impact on the level of regulatory capital required of the parent company. Capital may have to be provided for all the assets of an entity that is consolidated because of a determination of effective control without legal control. We believe this is unfair in those instances in which the consolidating entity does not bear the risks of ownership of the consolidated entity’s assets. Importantly, current regulatory capital rules subject a bank to capital requirements for assumption of risk in those instances in which the bank assumes risk but consolidation is not required.

The issues raised by the proposed standard are complex, especially its interaction with current guidance on special purpose entities (such as EITF D-14) and the proposed amendment of SFAS No. 125. Any resulting standard adopted by the Board that addresses these issues will be so changed from the current document that the Board should re-expose it for further comment.

The attached appendix addresses the three issues on which the ED specifically requested responses as well as several additional issues.

We would be happy to discuss the ED and our views with the Board or its staff. Please contact Randy Shearer, Director of Accounting Policy, at (704) 388-8433.

Sincerely,

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Appendix To Bank of America Comment Letter

Issues on Which Comment Was Invited

Issue 1: Does the revised definition of control help clarify when one entity controls another? Will the revised definition and guidance lead to common understandings and application of this statement’s definition of control?

Response to Issue 1: While the revised definition may help clarify when one entity controls another, the definition and related guidance is vague. In particular, the circumstances in which an entity may be found to have effective control of another entity in the absence of legal voting rights is unclear. Based on discussions with other peer companies and public accounting firms, it is apparent that accountants familiar with the guidance in the ED reach varying conclusions based on the same information.

We acknowledge that effective control without legal voting rights is a possibility. However, we submit that a standard that requires consolidation in the absence of legal voting rights should provide clear guidance that will lead different accountants presented with the same facts to reach the same conclusion as to whether or not effective control exists.

The ED’s guidance is not adequate. In particular, the standard should provide additional guidance as to circumstances that would lead to a conclusion of effective control based on sponsorship, documents creating the target entity, or contractual relationships between the supposed parent entity and the target entity. It should also provide additional guidance as to the characteristics that indicate that compensation received and risks borne by an entity through a contractual relationship with the target entity satisfy the second essential characteristic of control (paragraphs 10 and 14).

For example, assume Entity A sponsors the formation of Entity B, directs the writing of the documents creating Entity B, and enters into a contract to manage Entity B for a fixed, limited time in return for a fee that is normal for the services it will perform. Also assume that all of Entity B’s equity and voting rights are sold to Entity C, a party unrelated to Entity A. What characteristics of sponsorship, content of documents creating the entity, or the management contract would lead to the conclusion that Entity A, rather than Entity C, controls Entity B?

Issue 2: Will guidance in the form of rebuttable presumptions of control be necessary? Are the ones listed appropriate, clear, and operational? Are additional presumptions necessary?

Response to Issue 2: Guidance in the form of rebuttable presumptions of control is necessary to mitigate diversity in practice. However, the proposed standard’s first and fourth presumptions are already embodied in current GAAP and already work well in practice. We do not believe that the proposed standard’s second and third presumptions
are appropriate or operational. Nor do we believe that additional presumptions are necessary.

Issues Involving the Second Presumption

We believe that a holder of a large minority interest should consider whether or not it has effective control, but we do not believe that the ownership of a "large" minority interest should cause a presumption of control. We believe this presumption unfairly places on the owner of a minority interest the burden of proving that it does not have control in order to overcome the presumption. It may be difficult or impossible to prove that control does not exist.

The presumption is not clear. There is no guidance as to what constitutes a large minority interest. It is not clear at what point the size of the minority interest is sufficient to invoke this presumption. If a presumption of control is to be made based on a minority interest, the standard should state the minimum size of a minority interest that will invoke the presumption. We believe this should be an interest of 40%.

If the Board is unwilling to modify this presumption to establish a single percentage of ownership that meets this criterion, we believe that the Board should minimize the resulting diversity in practice by establishing a floor amount where the minority holder’s position is so small that a presumption exists that the minority interest does not control. We believe that this amount should be 30 percent. That is, if a minority interest holder’s ownership is 30 percent or less, that no rebuttable presumption of control exists.

Additionally, basing the second presumption on the number of shares cast in a shareholder vote is not operational because it may be difficult or impossible for the holder of a minority interest to determine whether or not it could exert control over an entity in the absence of an attempt to exert control. We fail to understand how most minority interest holders would be able to know if a group of other holders would organize to keep the minority holder from obtaining control unless the minority holder actually attempted to exercise control. Attempts by a minority interest to exercise control are usually contentious issues leading to a higher number of shareholder votes, reducing the percentage of votes cast in that election by the minority interest. In addition, entrenched management may fight the minority interest holder and may be able to obtain sufficient votes to block control. Therefore, we believe that practical implementation of this criterion requires that there should be evidence of an attempt to exert control corroborating the suspected ability to control.

An entity clearly may have the ability to control another entity through ownership of less than a majority voting interest. However, the mere fact that an entity holds a large minority voting interest and that it knows of no other entity or organized group that holds a significant voting interest does not necessarily indicate that the entity with the large minority interest controls the other entity. Acquiring a large minority interest should require an assessment of whether or not the minority interest creates effective control, but
should not lead to an automatic presumption of control. Even without this presumption, paragraph 16a requires an entity to consider whether or not control exists if it increases or decreases its ownership of voting rights in another entity. That requirement should be sufficient.

The second presumption places the burden on the holder of a large minority interest to determine whether or not there are other holders of significant minority interests or organized groups with significant interests. The presumption assumes that there are no other holders of significant minority interests or organized groups with significant interests unless the holder of a large minority interest is able to identify them. Such groups may exist without the supposed parent being able to prove their existence.

The second presumption also requires the holder of a large minority interest to find out how many votes were cast in past shareholder votes in order to establish that the minority interest is not large enough to create effective control. Those vote totals may be difficult or impossible for the supposed parent to determine. Even if determinable, vote totals in the past do not necessarily indicate the vote totals that would result in a vote on directors nominated by the supposed parent or issues proposed by the supposed parent.

In addition, application of the second presumption will cause entities to be consolidated by a supposed parent entity in some periods and de-consolidated in others as a result of a factor beyond the control of the supposed parent, namely the willingness of other shareholders to vote. In our experience we have noted that the total voting shareholders tends to be low during periods of good returns and non-controversial issues and high when a company is faced with poor returns or controversial matters. Application of the second presumption appears to lead to the illogical result of changes in the consolidation status of a “subsidiary” when the parent’s actual ability to control the “subsidiary” has not changed.

Issues Involving the Third Presumption

The third presumption probably will cause some entities to be consolidated by a supposed parent entity in some periods and de-consolidated in others as a result of factors beyond the control of the supposed parent. The presumption should be eliminated or significantly modified to avoid this on-again, off-again consolidation.

If the third presumption is retained, it should be modified. It should clearly state that the expected benefits from temporarily acquiring and holding the majority voting interest by exercising stock equivalents to realize their value should not require consolidation. The realization of the benefit from exercising a stock equivalent requires the sale of either the option or delivery and sale of the stock. We do not believe that stock equivalent pricing when the holder anticipates only a temporary holding of the stock should be incorporated into any proposed standard. Instead, the expected benefits that should be considered are those that would be derived from an other than temporary holding of the
stock. That is, these benefits that the holder could obtain by holding the shares received and using the control obtained through these shares.

Considering the relationship between the market price of the shares and the strike price of the option to acquire the shares as a determining factor is likely to cause the holder of the option to have to consolidate in some periods and not in others, due to fluctuations in the market price of the shares. The market price is not relevant to a decision to exercise the rights in order to gain control. That is amply demonstrated by the premiums over share market price generally paid by the acquirer in a business combination.

The third presumption implicitly assumes that the holder of the rights has the ability to exercise those rights and to hold the resulting equity in the target entity. The exercise of those rights may require the expenditure of funds that the holder does not have and is unable to acquire. Even if the holder is able to borrow the funds necessary to exercise the rights, acquiring the majority of the voting shares does not necessarily give the holder the near term cash flows necessary to service the resulting debt. In that case, control could only be temporary.

There may also be regulatory obstacles to exercise of the rights. For banks, exercise of the rights may trigger regulatory capital requirements that either bars or deters the holder of the rights from exercising. Entities in some regulated industries, such as banks, could only acquire temporary control of an entity in most other industries through exercise of an option to purchase shares of that entity, because current law does not permit such cross-industry mergers.

Issue 3: Should the statement require application in the first interim statements in the year of adoption?

Response to Issue 3: If the Board issues a final standard without substantial changes, we anticipate that a substantial implementation effort will be required. We are concerned that this implementation effort will occur during the implementation of SFAS No. 133. Therefore we believe that the effective date of a new consolidation standard that is not changed for our comments should be fiscal year end 2002.

If the proposed standard is revised to reduce the large amount of judgement necessary for its application by providing concrete voting stock ownership criteria and resolving the issues we have noted with the "control" and "benefits" criteria, we believe that it could be implemented in fiscal year end 2001.

We believe that it is poor financial reporting practice to report on interim quarters and then at year-end show increased reported assets and liabilities at the end of the year. We believe that such treatment is confusing to many financial statement users. However, as discussed above, we have concerns with the overlapping implementation of the SFAS No. 133 and this proposed standard. We are concerned about effectively adopting the proposed standard for the first quarter of 2000. Therefore, we believe that application in
interim financial statements prior to the year of adoption should be optional with early adoption permitted, if a 2000 effective date is required.

Other Issues –

We have noted the following additional issues with the proposed standard. Some of these issues may have been discussed, in part, in other sections of our letter. However, in the interests of raising all significant concerns we may have repeated our concerns here:

No presumption of consolidation – It has become apparent that many readers of the exposure draft, including public accounting firms, have interpreted it to require consolidation of virtually every entity by some other entity. They believe that the standard will require consolidation by the entity that exhibits the greatest degree of control. The final statement should clarify this by explicitly stating that consolidation by someone should not be presumed, and that consolidation should only be required and permitted by a single parent entity and only if that parent entity determines that it has unilateral control of the target entity. There should be no requirement that anyone consolidate an entity over which no other entity has unilateral control, regardless of the degree of influence over that entity possessed by any entity that lacks unilateral control.

Vague criteria for “benefits” – As defined by the proposed standard consolidation requires meeting two criteria: 1) control of the subsidiary and 2) the ability to use that power to increase the benefits derived and limit the losses suffered from the activities of the subsidiary. The proposed standard does not provide adequate guidance on applying the second criterion. As written, it appears that almost any non-fiduciary (with a fixed fee) arrangement would appear to meet the “benefits” criteria. Our discussions with other financial institutions and independent accountants indicate that this concern is broadly shared by others.

We are concerned that traditional lending relationships, many investment advisory relationships, merchant processing and other services provided by Bank of America would meet this criteria and, therefore might force the consolidation of entities not anticipated by the proposed standard. For example, extending a loan exposes a bank to the risk of loss from the actions of the borrower. If the borrower’s credit subsequently deteriorates or the borrower defaults on some portions of the loan contract the bank will or may undertake many actions including obtaining veto approval over management actions or repossession of the property. Under these circumstances we are unclear on whether the proposed standard would require consolidation or whether the existing literature on lending would apply. We anticipate that this lack of clarity will create a substantial amount of diversity of practice and interpretational issues that will consume large amounts of time and energy.

We doubt that the Board desires consolidation based upon the existence of a normal “arms length” transaction and the undertaking of other actions to protect the contractual...
amounts owed under this transaction or superceding the existing guidance on loans. The Board should clarify its intent regarding the “benefit” criteria by stating that traditional lending arrangements, all investment advisory relationships, merchant processing contracts and other similar arrangements do not meet this criterion unless the powers of control allow the entity to profit beyond securing its contractual claim.

In addition, to avoid misleading financial statement readers, the Board should establish a threshold under this criterion to avoid situations where consolidation is required and the “parent” derives only a nominal benefit from the “subsidiary”. We suggest that this threshold should be either 10 percent of the residual cash flows, 10 percent of the total cash flows of the entity, or 25 percent of profits.

Inability to obtain financial statements of the supposedly-controlled entity for timely consolidation – The standard should not require consolidation by a supposed parent of an entity whose management is able to refuse the supposed parent access to financial statements covering the same period as the parent’s financial statements within a time period that allows both consolidation of the entity and timely release of the consolidated financial statements. The ability of the target entity’s management to refuse access to its financial statements in advance of their general release is prima facie evidence that the target entity is not under effective control of the supposed parent.

At the least, the standard should address how the consolidating entity should deal with the inability to get financial statements of the target as of the same date as its consolidated statements in time to incorporate them into its consolidated statements and release them in a timely fashion. We do not believe the parent should defer release of its financial statements for this reason, as financial information loses much of its value to statement users if it is not timely. However, we also do not believe the consolidated statements should include statements of a subsidiary that are as of a significantly earlier date than the date of the consolidated statements. A mixture of information as of significantly different dates within the same financial statements is not very useful, and may be misleading.

Interaction of SFAS 125 and the consolidation standard – EITF consensus 96-20 exempted a SFAS 125 QSPE from consolidation by the transferor. The new consolidation standard should explicitly extend this exemption. It does not make sense to require consolidation by a transferor of a QSPE to which the transferor has transferred assets that meet the SFAS 125 sale criteria. The QSPE must be beyond the effective control of the transferor in order to meet the SFAS 125 criteria for a QSPE, both at present and in the proposed amendment to SFAS 125. In effect, a QSPE must be beyond the effective control of anyone in order to be a QSPE.

Effect on other prior consolidation guidance – The new standard should explicitly state that the consolidation guidance in EITF consensus’s 90-15, 96-21 and 97-1, as well as in
Appendix Topic D-14 is superseded by the new standard. In particular, the new standard should explicitly state that no minimum equity investment amount is required in order to avoid consolidation by a lessee, sponsor, or other entity that is not also an equity holder.

**Grandfathering** – Many entities, especially special-purpose entities, have been organized and structured in compliance with current standards such that a sponsor, contractor for services, lessee, or other party with a relationship to the entity is not required to consolidate. It is unfair to require that these entities be consolidated due to a change in standards. At the very least, the standard should provide an exemption for existing relationships in order to allow the relationship between a supposed parent and the controlled entity to be altered or terminated in an orderly fashion without requiring consolidation. In particular, we submit that fairness demands that existing limited-life special purpose entities whose lives will end with the termination of specific assets, liabilities or contractual relationships within a reasonable period following the effective date should be exempted.

**Risks and Rewards** – We believe that a standard should only require consolidation of an entity if the supposed parent bears substantial risks of ownership or has the rights to substantial potential rewards of ownership. It is misleading for us to present financial statements to the public including the assets and liabilities of entities from which we do not have substantial risks and/or rewards of ownership. The inclusion of those assets and liabilities creates the expectation that the operating statement will also include the income effects of those assets and liabilities in both the current period and future periods. This may lead the statement user to expectations that are not justified, resulting in misguided investing or lending decisions. In addition, for banks and similar regulated companies, consolidation in instances in which the consolidating entity does not bear the risks of ownership of the consolidated entity’s assets may lead to an unfair increase in the amount of regulatory capital required.

As a lender and user of financial statements ourselves we are concerned that consolidation of an entity by a parent based upon criteria other than bearing the risk and rewards of its ownership reduces the quality of the financial information we receive and use to extend credit. Reducing the quality of the information provided to financial statement users reduces the quality of the decisions a lender is able to make.

**Treatment of minority interest** – It is unclear how the interest of other parties should be reflected in the consolidated financial statements if an entity consolidates another entity in which it has no equity. The standard should address the manner in which the value of the minority interest should be determined. We submit that the value of equity investment by others in such situations should be proportional to the share of the entity’s earnings to which the equity investors are entitled.