Mr. Timothy S. Lucas  
Director of Research and Technical Activities  
Financial Accounting Standards Board  
401 Merritt 7  
P.O. Box 5116  
Norwalk, Connecticut 06856-5116

Re: File Reference No. 194-B  
Exposure Draft on Consolidated Financial Statements: Purpose and Policy, dated February 23, 1999

Dear Mr. Lucas:

The institutions (collectively, the "commenting group") listed on the final page of this letter wish to thank the Financial Accounting Standards Board ("FASB") for this opportunity to comment on the consolidation exposure draft. 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, some of which may be affected by the exposure draft and may be commented upon in other individual or group letters.

We believe that the consolidation standard proposed in the exposure draft is far too subjective and difficult to apply and could lead to an inappropriate ballooning of balance sheets and inconsistencies in reporting across entities. These concerns apply to many common business arrangements, including multi-seller SPEs. We recommend that FASB substantially rework the proposed standard or simply leave existing consolidation policy in place.

In case FASB does not follow this recommendation, our intent in this letter is to identify a few salient points in the exposure draft that are relevant to the relationship between administrative agents and multi-seller SPEs and that should be clarified if FASB ultimately adopts a consolidation standard (the "final consolidation standard") that is substantially similar to the exposure draft. Specifically:
We ask that the final consolidation standard only require consolidation if an entity controls both another entity's ongoing activities and the other entity's individual assets. (See Part II.A.1.)

We ask that the final consolidation standard state more clearly that entities other than general partnerships, trusts and mutual funds may not be controlled by any one party. (See Part II.A.2.)

We ask that the final consolidation standard state that the types of restrictions that might be viewed as merely "protective rights" in the context of an operating company may take on greater significance in the context of an SPE and may preclude any party from having control. (See Part II.A.3.)

We ask that the final consolidation standard recognize the absence of a meaningful equity stake or other residual interest in an entity or its assets as a significant factor weighing against control. (See Part II.A.4.)

We ask that the final consolidation standard contain a rebuttable presumption that an entity does not control a corporation or similar entity unless the first entity owns some specified minimum percentage of the voting equity of the second entity. (See Part II.A.5.)

We ask that FASB delay effectiveness of the final consolidation standard for at least one full fiscal year after it is adopted by FASB. (See Part II.B.)

We ask that FASB provide explicit guidance that the special nonconsolidation rule for qualifying special purpose entities established by EITF Issue No. 96-20 remains in effect after adoption of the final consolidation standard. (See Part II.C.)

Before discussing these points, we provide some background on multi-seller SPEs in Part I.
I. Description of Multi-Seller SPEs.

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

In addition, each of a multi-seller SPE’s transactions typically involves a purchase of receivables or other financial assets from the originator of the assets. Under the applicable transaction documents, the seller (or one of its affiliates) generally retains the right and responsibility to service the assets, subject to termination for cause. Consequently, many routine decisions and tasks that affect the cash flows to the multi-seller SPE from each transaction are left in the hands of a seller/servicer, the identity of which varies among the multi-seller SPE’s various transactions.

Each multi-seller SPE generally has an administrative agent that administers its purchase and funding activities and one or more referral agents that arranges transactions for the 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. The administrative agency and referral agreements may be terminated by the SPE in circumstances that vary from one SPE to another, but generally do not provide for any termination payment to the agent.

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. However, neither the administrative agent nor any of its affiliates owns the SPE’s voting equity. The management of the SPE (other than purchasing and funding activities that are delegated to the administrative agent) is carried out by the equity owner or one of its associates (which is not related to the administrative agent). Among other things, the owner of the SPE’s equity or its manager associate holds the power to terminate the administrative and referral agents, must approve any changes to the SPE’s investment
II. Request for Additional Guidance.

A. Control.

We have four significant comments relating to the concept of "control" as it might be applied to multi-seller SPEs.

1. Individual Assets vs. Ongoing Activities.

One of the key differences between the current exposure draft and the 1995 consolidation exposure draft is FASB’s move from a focus on control of the individual assets of an entity to control of its ongoing activities. We would not suggest that FASB reverse this change and return to an exclusive focus on individual assets. However, in order to meet FASB’s goals for consolidation policy, the final consolidation standard should consider control of both individual assets and ongoing activities.

FASB acknowledges in the current exposure draft that "decision-making power over another entity’s assets and the ability to obtain benefits from that power are fundamental characteristics of control." Apparently FASB believes that a standard that focuses on control of ongoing activities would encompass control of individual assets without creating the interpretive issues identified in comments on the 1995 draft. This may sometimes be the case, but it is not the case for multi-seller SPEs.

In securitization SPEs (including multi-seller SPEs), the limited decision-making powers that exist as to the SPE’s ongoing activities are often separated from day-to-day servicing of the SPE’s individual assets (i.e., the receivables or other financial assets that the SPE purchases). As a result, none of the parties that collectively hold the limited decision-making powers as to the SPE’s ongoing activities generally has any practical ability to "direct the policies and management that guide" the servicing of the individual assets “so as to increase its

\[\text{\textsuperscript{1\textsuperscript{1}}} \text{See paragraph 211.}\]
benefits and limit its losses from those assets. Consequently, these parties lack what FASB called a "fundamental characteristic" of control. On the other hand, the servicers of the multi-seller SPE's individual assets do not have control, as their actions are substantially constrained by the rights of the multi-seller SPE and its various service providers.

This separation of control of ongoing activities from servicing of assets is an essential characteristic of multi-seller SPEs and may exist in other circumstances. We submit that where such a separation exists it is a material consideration in terms of whether or not consolidation is appropriate, and we request that FASB address this point in the final consolidation standard. In particular, we request that text like the following be added to paragraph 11 of the standard, or some other appropriate place:

Generally, control of the ongoing activities of an entity will also give the controlling party control over the use of and access to the controlled entity's assets, but this is not always the case. When control of an entity's activities does not result in control of its assets, the party that controls the entity's activities should not be deemed to have control sufficient to require or permit consolidation of the "controlled" entity's financial statements.

2. Entities Whose Ongoing Activities Are Not Controlled by any One Party.

Even in the context of control of an entity's ongoing activities (as opposed to its individual assets), there may not be a single party that exercises control to an extent that justifies consolidation. In particular, control of a multi-seller SPE's ongoing activities is generally shared among multiple parties that are involved with its overall purchasing and funding program (including the manager that represents the equity holders, an administrative and/or referral agent, a program credit enhancer and two or more credit rating organizations).

FASB's staff acknowledged the existence of this type of shared control in its August 31, 1998 comment letter (the "IASC Comment Letter") on the International Accounting Standards Committee's Standing Interpretations Committee Draft Interpretation D12: Consolidation of Special Purpose Entities. In discussing the

2/ See paragraph 6 of the exposure draft.
interplay of various investors' risks and rewards from an SPE and the investors' desire to control an SPE in that comment, the staff noted that:

Those relationships often result in SPEs with provisions that enable each of the significant investors to participate in or share the limited decision-making powers that were not otherwise predetermined by those investors.

Similarly, the program documents for a multi-seller SPE generally contain provisions that enable several interested parties to participate in or share decision-making powers as to the limited universe of decisions that are not predetermined in the program documents.

The exposure draft discusses some important generic situations where no single party has control, including most general partnerships, trusts and mutual funds. However, the exposure draft could be read as assuming that most entities not covered by those identified exceptions will be controlled by someone — so that the only question is who has that control. We do not think this was FASB's intent, and we ask that FASB be more explicit in the final consolidation standard that there can be other entities, including some SPEs, that may not be controlled by any single person.

In paragraph 232 of the exposure draft, FASB says with respect to SPEs that:

The Board acknowledges that governing instruments that limit the objectives, activities, or lives of an entity raise difficult questions about whether the degree of the limitations imposed preclude control of those entities by other entities.

We believe that the FASB should expand upon this thought in the final consolidation standard by stating that some SPEs may be found not to be controlled by any single entity.

Specifically, we ask that FASB include a statement like the following in the final consolidation standard:

In the case of special purpose entities, the governing instruments may limit the objectives, investments, activities or lives of an entity, or grant such significant consent rights to multiple parties, so that no single party has control of the SPE within the meaning of this statement.
3. **Protective Rights.**

FASB is correct to distinguish between true control and mere “protective rights” in most circumstances. However, in the context of SPEs dealing with receivables or other financial assets, restrictive covenants that would be viewed as protective rights in the context of an operating company can take on additional significance. The activities of multi-seller SPEs are limited to dealings with receivables or other financial assets. This leads to a situation where virtually all of a multi-seller SPE’s governing documents are concerned with the same types of restrictions that would appear in the financing documents for an operating company.

For an operating company, financing is incidental to its main profit-making activities. If a particular financing is eliminated, the core activities continue. In contrast, financing of receivables or other financial assets in a particular way is the core purpose of a multi-seller SPE. If the financing arrangements were to change materially, the entire purpose and method of operation of the SPE would often be lost, or at least fundamentally altered.

Consequently, in the context of a multi-seller SPE, there is generally no one person that has a level of control that dwarfs the importance of the “protective” rights of other interested parties. Rather, the multi-seller SPE is essentially a network of checks and balances, where no single party’s aggregate rights and risks are so great in comparison to the rights and risks of others as to justify consolidating the financial statements of the multi-seller SPE, except perhaps under the normal presumption relating to a majority voting interest.

FASB’s staff alluded to the blurred line between protective rights and control of SPEs in the IASC Comment Letter. First, the staff criticized one of the sentences in the IASC’s Draft Interpretation D12 by saying that “the sentence ignores the difficulty in determining whether a single party or two or more parties have predetermined the policies and activities of an SPE.” The comment then goes on to state that:

> Often, many, if not most, of the limits that are imposed on the activities of an SPE are specifically designed to protect the interests of two or more parties and ensure that no single party can control the activities of the SPE.
An illustration of the relative importance of the checks and balances present in a multi-seller SPE as compared to protective rights arising from debt, lease or other contractual limitations on an operating company is provided by considering paragraphs 42 and 43 of the exposure draft. Paragraphs 42 and 43 name three factors that distinguish protective rights from true barriers to control in a more conventional operating company context.

- First, paragraph 42 notes that protective rights generally protect the interests of others but do not allow [the holders of protective rights] to share in a parent's decision making.

In contrast, in multi-seller SPEs, there are often at least two parties that have to agree on the most basic decisions (such as approving a transaction to be entered into by the SPE, or approving detailed investment policies that each transaction must satisfy).

- Second, paragraph 43 observes that because the powers of control are broad, a parent usually can use those powers to derive and increase benefits from the activities of a subsidiary in several differing ways. For example, dividend restrictions generally do not preclude a parent from directing the activities of its subsidiary so as to increase its benefits and extract those benefits through a transferable interest in a subsidiary's net assets, through intercompany transactions and synergies, and in other ways.

In contrast, no service provider to a multi-seller SPE typically has the right to extract benefits from a multi-seller SPE through "a transferable interest in [the SPE's] net assets," through transactions between the service provider and the SPE or through other material ways, other than the fees payable to the service provider under the terms of the agreements governing the multi-seller SPE.

- Third, paragraph 43 states that a parent usually can remove protective limits imposed by debt, lease, and other contractual agreements by directing, assisting, or otherwise
causing the subsidiary to pay or refinance the debt or pay a cancellation fee.

In contrast, no single service provider to a multi-seller SPE typically has the unilateral right to cause the SPE to eliminate other contractual limitations in this manner. The rights and responsibilities of the various parties are integral to the organization of the SPE and often cannot be eliminated without fundamental changes to the SPE. These rights and responsibilities are often reflected in both the basic documents that govern the SPE's operations as a whole and the documents governing each of the SPE's transactions. To eliminate them would often be tantamount to dissolving the SPE.

We request that FASB include text in the final consolidation standard which acknowledges that restrictive covenants and the like may take on greater significance in the context of SPEs. Specifically, we ask that text like the following be added to the discussion of protective rights in paragraphs 42 and 43 of the statement:

The significance of contractual and other restrictions on an entity's activities must be determined in the context of the nature and scope of those activities. For instance, restrictive debt covenants and similar contractual limitations that would not prevent a potential parent from having control if the potential subsidiary that was subject to those limitations was an operating company may take on much greater significance and preclude control where the potential subsidiary is a special purpose entity the activities of which are limited to acquiring, holding and financing receivables or other financial assets.

4. The Importance of a Meaningful Residual Interest.

FASB has identified the purpose of consolidation as providing more meaningful financial statements and a fair presentation of a group's financial condition and results. We do not believe that this purpose would be served by requiring an entity to consolidate another entity into the first entity's financial statements if neither the first entity nor any of its affiliates has any meaningful residual or equity stake in the second entity.\[^{2}\] Without a residual or equity stake, none of the assets of the

\[^{2}\] We are not advocating a risks and rewards approach to consolidation. We simply believe that some threshold residual interest must be present in order for an entity to have meaningful control.
second entity will be available for the first entity to exchange, hold, use to produce goods or services, exact a price for others' use of such assets or settle the first entity's liabilities—all of which are identified as elements of having an asset in FASB's Concepts Statement No. 6.\footnote{Statement of Financial Accounting Concepts No. 6, Elements of Financial Statements, paragraph 184 (1985). See also paragraph 69 of the exposure draft.} In these circumstances, financial statements that consolidated the second entity with the first entity would mislead or at best confuse users.

Essentially all of a multiple-seller SPE's assets are generally required to settle investors' claims on the SPE. As a result, neither the administrative or referral agent for a multi-seller SPE nor any of a multi-seller SPE's program-level service providers has a meaningful residual or equity stake in the SPE or its assets. This is another feature that may be unique to multi-seller SPEs or may also occur elsewhere. In either case, we believe that it is a relevant consideration for consolidation policy, and we ask that FASB modify the final consolidation standard to take it into account.

Specifically, we ask that FASB include a statement similar to the following in the final consolidation standard:

In deciding whether one entity "controls" another entity (particularly a special purpose entity) within the meaning of this statement, it is relevant whether the potentially controlling entity has a meaningful residual claim on the assets of the potentially controlled entity (through equity securities, call options or other devises). In the absence of such a residual claim, the first entity's ability to increase its benefits and limit its losses from the activities and assets of the second entity may be so limited that consolidation would not be consistent with fair presentation.

5. A Rebuttable Presumption of Non-Control.

To reduce the subjectivity and potential for inconsistent application of the proposed consolidation standard, we recommend that FASB include a rebuttable presumption in the final consolidation standard. Specifically, we ask that the final consolidation standard contain a rebuttable presumption that an entity does not control a corporation or similar entity unless the first entity owns some specified minimum percentage of the voting equity of the second entity. This should be a
one-way presumption: holding more than the threshold amount of equity (if it is less than 50%) should not create a presumption of control.

Because the presumption would be rebuttable, it could be overcome by compelling evidence of control. However, it would provide a much clearer rule. In cases where there was not strong evidence of control by a single party, preparers of financial statements could rely upon the rebuttable presumption. This would save preparers from having to make facts and circumstances decisions on very close cases, which have the greatest potential for inconsistent results.

B. Effective Date.

As indicated, we believe that the consolidation standard proposed in the exposure draft is far too subjective and difficult to apply. If FASB nevertheless adopts a standard substantially similar to the one in the exposure draft, we believe that many preparers of financial statements will need a substantial period of time to sort through all of the necessary decisions and to perform the necessary consolidation procedures. Consequently, we believe that FASB should provide a substantial start-up period after the final consolidation standard is adopted. Specifically, we ask that FASB delay effectiveness of the final consolidation standard for at least one full fiscal year after it is adopted by FASB.

C. Status of EITF Issue 96-20/Amended SFAS 125.

EITF Issue No. 96-20 established a special rule for qualifying special purpose entities, as defined in SFAS 125, under which those entities are not consolidated with entities that transfer financial assets to them. Drafts of an amendment to SFAS 125 that have been circulated indicate that the substance of this special rule will be retained and perhaps extended to cover servicers of financial assets held by QSPEs and sponsors of QSPEs.

We believe that the EITF made the right decision in Issue 96-20, and we support the continuation of the special rule relating to QSPEs and its extension to servicers and sponsors. In light of the stringent limitations upon a QSPE’s activities, no one controls a QSPE within the meaning of the exposure draft. This is just as true for servicers and sponsors as it is for transferors.
We request that FASB state in the financial consolidation standard or the SFAS 125 amendment (or both) that the final consolidation standard does not override or modify the special rule for QSPEs.

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These comments are submitted by:

BANK OF AMERICA
BANK ONE CORPORATION
THE CHASE MANHATTAN CORPORATION
CITIGROUP INC.
FIRST UNION CORPORATION
MORGAN GUARANTY TRUST COMPANY OF NEW YORK
PNC BANK CORP.
STATE STREET BANK AND TRUST COMPANY