



Letter of Comment No: 42
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Ms. Suzanne Bielstein
Director of Major Projects and Technical Activities
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
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**RE: File Reference 1082-200
Exposure Draft on Consolidation of Certain Special-Purpose Entities
Proposed Interpretation of ARB No. 51**

Dear Ms. Bielstein:

The GAAP Financial Reporting Principles Subcommittee (the Committee) of the American Council of Life Insurers (ACLI) appreciates the opportunity to provide its comments to the Financial Accounting Standards Board (FASB) concerning the above referenced Exposure Draft (ED). The ACLI is the principal trade association of life insurance companies, representing 399 members that account for, in the aggregate, 75 percent of the assets of legal reserve life insurance companies in the United States.

The ACLI supports the efforts of the FASB to improve the financial reporting and disclosure of special purpose entities (SPE or SPEs), especially in light of the recent crisis in investor confidence concerning the accuracy of financial statements. As the life insurance industry is one of the largest institutional investors in the United States, the ability to obtain reliable and understandable financial data is critical to the success of the industry. Therefore, the ED concerning the consolidation of special purpose entities is of great interest to life insurers as both a supplier and user of financial statements, analyses and disclosures.

We agree with the FASB that most SPEs serve valid business purposes, especially regarding securitization and reinsurance. While it is the stated objective of this proposal "...not to restrict the use of SPEs but to improve financial reporting by enterprises involved with SPEs", we believe that the ED in its current form will not achieve this objective. We believe that the ED is overly complex and difficult to interpret and apply with consistency. Our primary concern relates to the inappropriate consolidation of certain risk-dispersing SPEs that we believe would arise through application of this proposed guidance.

Specifically, the ACLI is especially concerned with the provisions that would inappropriately require entities with an investment that is structured using an SPE, to reflect the assets, liabilities and results of operations in its consolidated financial statements. Invested assets should be reflected on the financial statements of the investor as assets, with the cash flows generated by the investment structure recorded as investment income in the same way that investments that do not utilize SPEs are reflected. We believe that the current accounting guidance for investments in beneficial interests of an SPE and the proposed guidance (reflected in the ED concerning guarantees) for establishing a liability for guarantees provided to SPEs, appropriately reflects an investor's interests in an SPE. Therefore, the changes in accounting treatment outlined in this ED will affect SPE investors in an extremely negative fashion. Additionally, these changes will not accurately reflect the financial condition of the investors and their maximum exposures to loss. For example, entities would be required to consolidate 100% of the assets and liabilities of an SPE even if it were only exposed to one-third of the variable interests (if that one-third interest was significantly more than the next largest holder). An inflated balance sheet will only serve to complicate the evaluation and explanation of investment returns as well as debt to equity ratios (which may cause violations of debt covenants). We believe that users and analysts will attempt to adjust the inflated financial statements by "backing out" these consolidated amounts to increase the understandability and transparency of the reporting entity. This consolidation treatment also results in entities having to show assets for which it does not have the risks and rewards of ownership and liabilities that they do not have a legal obligation to pay.

Therefore, we propose that the FASB consider making the revisions outlined below for Financial Special Purpose Entities (FSPE or FSPEs). We believe these suggested changes would improve the utilization and practical application of the FSPE concept. Without these changes, we believe many investors would report distorted balance sheets by inappropriately consolidating investment structures established to diversify and share risk among participants.

Financial SPEs

We agree with the concept of creating a new category of SPEs that effectively diversify risks and that these FSPEs should not, in most cases, be consolidated by any entity. Most FSPEs are the result of securitized collateral assets (securitization), where the risk of the financial assets used as the underlying collateral is distributed among the investors. It is not necessary to require consolidation of most types of SPEs utilized in securitizations in order to prevent the types of abuses perpetrated by Enron or other entities. It is inappropriate for any of the investors in these types of SPEs to consolidate the assets and liabilities of the SPE. Such consolidation would produce misleading financial statements. FAS 140 and related EITFs, in combination with the proposed interpretation regarding guarantees would require each party to a securitization to properly reflect in its own financial statements, its share of interests in the SPE as well as its share of obligations to the SPE. The clear and accurate financial statement presentation resulting from these reporting requirements reflect the true economics of the investment in the investor's financial statements.

An entity that invests in an SPE that meets the criteria in paragraph 22, thereby becoming an FSPE, must then evaluate the conditions in paragraph 23 to determine its variable

interest in the FSPE. While we support the concept of an FSPE classification, the guidance provided in paragraphs 22 and 23 as currently drafted, does not capture all the types of structures we believe were intended under the FSPE concept.

In establishing the criteria for an FSPE, paragraph 22 is unclear in its interpretation and appears too narrow in its scope. To clarify and broaden the criteria for an FSPE, we would suggest that paragraph 22 include item 4 with the provisions outlined below:

22 (4) They may hold derivative financial instruments that relate to, and partly or fully but not excessively counteract, some risk associated with beneficial interests issued or sold to parties other than a transferor or the related assets held by the SPE, or serve to allocate cash flows within the SPE in order to provide for risks and cash flows to the beneficial interest holders that are consistent with the substantive terms of the beneficial interests.

Because an FSPE, by its definition, diversifies risk, the guidance should require consolidation less frequently than would be required under the general approach. For consolidation, the general approach requires the presence of a variable interest that is significantly larger than others or a majority interest. As currently written, paragraph 23 will most likely produce the opposite result. Unlike the general approach, this paragraph does not contain any absolute or relative size requirement for a variable interest that would require consolidation. Under the ED, an entity with a minute variable interest, perhaps in the form of a subordinated interest as referred to in paragraph 23b, would be required to consolidate if the entity also has the ability to exercise discretion as described in paragraph 23a or receives a non market-based fee. Many asset managers or service providers retain an interest in the securitized assets, but when such interests are not significantly greater than or significantly more variable than any other party's interest, we believe such retained interests should not require consolidation of all of the assets and liabilities of the SPE.

To this end, we propose to replace the three conditions utilized in determining the significance of the financial support through a variable interest as provided in paragraph 23, with the following two conditions, both of which must be met before consolidation would be required:

1. The entity has the authority to both purchase and sell assets for the FSPE and has sufficient discretion in exercising that authority, not materially limited by investment policies that it cannot unilaterally change to affect the revenues, expenses, gains and losses of the SPE in a manner that benefits the entity substantially more than any other party, other than through changes in the volume of the SPEs assets or transactions and excluding dispositions intended to protect beneficial interest holders from losses, preserve the SPEs access to a particular funding market or terminate a transaction [in the ordinary course].
2. The entity holds a majority of the variable interests by virtue of one of the following:
 - a. The entity holds interests in the form of liquidity, credit or asset support that is subordinate to the interests of other parties and are expected to bear losses in the projected scenario. Interests that are issued as a class or

otherwise subject to assignment of syndication will be excluded if the entity under consideration does not own a majority of such interests.

- b. The entity receives a fee that is not market-based.

As it relates to the conditions associated with determining the significance of the variable interest in an FSPE, we also have concerns about the presumption that fees are not market-based. We believe the burden of proof should be flipped to presume the fee is market-based, or at a minimum allow the determination of a market-based fee to be objectively determined. The negative presumption imposes significant burden on entities to prove that fees are consistent with those of its competitors. Additionally, if paragraph 19 were interpreted to imply that an entity must enter into a competitive bidding process to meet the burden of proof that a fee is market-based, this would create a burden for parties that are already experienced in these types of transactions. For entities that do not already have these types of transactions established with similar fee structures, this paragraph implies that the only way to prove a market-based fee is by contacting competitors to request information regarding their fee structure on similar transactions. In addition to the difficulty in researching and obtaining the information needed to comply with these provisions as currently drafted, such research may present anti-trust issues.

As stated above, making these suggested changes would improve the utilization of the FSPE concept and would facilitate its practical application to include asset types such as securitized assets, collateralized debt obligations, asset-backed securities, credit linked notes, certain joint venture structures, mortgage backed securities and synthetic CDOs. We believe this was the original intent of the concept as presented in the ED. Without these changes, we believe that many investors would report distorted balance sheets by inappropriately consolidating SPEs or FSPEs that result from investment structures established to diversify and share risk among the participants.

Credit Tenant Loans

Credit Tenant Loans (CTLs) are another type of investment structure that utilizes SPEs. A CTL is a mortgage loan that is made primarily in reliance on the credit standing of a major tenant and is structured with the assignment of rental payments to the lender in the amount necessary to meet all debt service coverage obligations of the borrower (the SPE). The real property that is owned by the SPE is pledged as collateral in the form of a first lien. The loan is made based on the underlying credit worthiness of the tenant more so than the value of real property pledged as collateral. As such, the lender should not have to consolidate the collateral for the loan, which is the real estate owned by the SPE, onto its financial statements. In the view of the ACLI, a lender should record its CTL to an SPE as a debt investment and not be subject to a consolidation evaluation. Regardless of the value of the property, the lender is due the amount specified in the lending agreement. Similar to a mortgage loan or direct loan, the lender does not share in the increase of value of the underlying collateral property. The lender is only entitled to receipt of its interest and principal as stated in the loan agreement. The lender would only absorb the potential loss in value of a property if it took title as a result of default.

The ACLI recommends that credit tenant loans be excluded from the scope of the FASB Interpretation. Failing this exclusion, the provisions in the ED should not require the

lender to consolidate the SPE in a credit tenant loan transaction unless the lender actually acquires either the SPE or its assets in a separate transaction.

Other Comments

We offer the following additional comments, many of which we believe further support our recommendations above:

Scope of Interpretation

Although we recognize the presently elevated concerns regarding the consolidation of SPEs, we believe that the exposure draft includes substantive guidance that would normally be provided in a Standard. In certain cases (i.e. losses vs. risks and rewards) the ED conflicts with existing guidance [EITF 96-21, 90-15 and D-14] and therefore, appears to go beyond the scope of an interpretation. In addition, the ED provides for different sets of rules depending on the type of SPE (i.e., Qualifying SPEs, Financial SPEs, SPEs that are to be evaluated based on variable interests and SPEs that are to be evaluated on voting interests) without a consistent underlying principle.

Although we believe our recommended changes to the FSPE criteria above would alleviate many of our concerns with the ED as currently written, we propose, in addition, that the FASB consider implementing a two-step approach consisting of an interim approach followed by a longer-term solution. The interim approach would enhance footnote disclosures for entities with SPE relationships. Requirements would be to disclose SPEs by category, indicate the nature of the SPE, the relationship to the entity, and describe and quantify the entity's maximum exposure to loss for each category.

In the longer term, we propose that existing accounting guidance for SPEs under FAS 140, various EITFs and the exposure draft on accounting for guarantees be codified and clarified to avoid differences in interpretation. We believe the results of this codification would be that all SPEs are evaluated for consolidation based on whether an enterprise receives the majority of the risk and rewards of the SPEs activities, thereby presumably exercising control. In the case where no one entity receives the majority of the risks and rewards, such as those SPEs meeting the definition of the proposed FSPEs above, each entity should only account for their share of the interest in the SPE. The reported results should be augmented with comprehensive disclosure of all the relevant rights and obligations.

Transparency and Usefulness of Financial Statements

Fluctuations in Financial Results:

For many SPE investors, application of the provisions of the exposure draft as currently written will lead to full consolidation, which will result in unusual financial statement results that will not reflect the investment's true economics to the investor. Upon adoption of the ED, initial consolidation of an SPEs assets, liabilities and non-controlling equity interests must be at fair value with the transition impact reflected in

equity. This would create a situation where there would be immediate gain or loss recognition at the time of consolidation, which result from differences between the carrying value of the investment and the fair value of the items consolidated. This is inconsistent with the accounting for assets and liabilities acquired in a purchase business combination.

Periodic assessment of primary beneficiary status is required with the potential result being consolidation in one period and non-consolidation in the next. Such “ins” and “outs” will create gains and losses in the financial statements although an investor may not have acted to change their investment in the SPE. We believe these fluctuating results would never be meaningful to users of the financial statements. For instance, assume there is a passive investor that has not made any additional investment or changed its relationship with an SPE from period to period. Other parties to the SPE, however, have changed their proportional interests in the SPE. This could likely result in the passive investor reporting gains or losses in its financial results, while otherwise taking no action. The nature of the passive investor’s interest and exposure to loss in the SPE may not have changed, however the investor will be reporting gains and losses in its financial statements. These gains and losses would be reported when the entity’s capital investment or cash return status has not changed in reality, but has only changed with respect to application of accounting rules.

Accounting for Impairments:

If an investor is required to consolidate an SPE, the ED omits provisions related to assessment and accounting for impairments of the assets of a consolidated SPE. If asset impairment is larger than the entity’s exposure of loss to the SPE, can the entity adjust the value of the liabilities and equity interests it has consolidated to reflect this impairment? It would appear that adjustment of these balances would be required in order for the entity to avoid reflecting losses in excess of its economic exposure to the SPE.

Administrative Burden

We believe that this standard, in its current form, will present undue hardship on entities that have relationships with SPEs. The definition of the primary beneficiary creates a set of consolidation standards that is both subjective and complex. A primary beneficiary is defined as an entity that “provides significant financial support...or a significant portion of the total variable interests that is significantly more than the variable interest held by any other entity.” What is not defined, nor quantified, is the threshold for determining “significant.” From an administration standpoint, the process of determining the primary beneficiary of an SPE will, in many instances, be difficult to ascertain because a company 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.

Further, entities are required to calculate and determine primary beneficiary status for each reporting period, even though they may not have changed anything with respect to their investment. The inability to gather the appropriate information on the part of all parties will most likely lead to inconsistencies in the determination of the primary

beneficiary among all parties of a particular SPE. This will result in situations where no entity will consolidate or multiple entities will consolidate.

Meeting reporting deadlines may be compromised due to the inaccessibility of information needed on a quarterly basis. Obtaining quarter-end values of each SPEs asset, liabilities and equity, coupled with sharing that information, variable interest information, etc. among all parties in the structure in time to meet the reporting deadlines, which are now being accelerated, is an astronomical task.

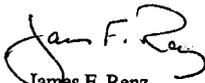
Effective Date

In the unfortunate event that the provisions of the ED are adopted as currently written, we believe implementation should be delayed so that entities may devise strategies and processes in an attempt to lessen the administrative burdens imposed by the ED. We recommend that the provisions should be applied as of the first fiscal period ended after December 15, 2003 for all SPEs created before the issuance date and still existing on December 15, 2003.

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Thank you for the opportunity to share the concerns of the life insurance industry and to offer constructive suggestions and recommendations to improve upon the ED's provisions pertaining to applicability and scope, as well as offer disclosure alternatives for reporting the information that should be provided to financial statement users. The modification of the FSPE qualifications along with the suggested disclosure alternatives would serve to segregate and make transparent the reporting of an entity's relationship with an SPE and improve the understandability of the reported financial statement results.

Sincerely,



James F. Renz
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American Council of Life Insurers