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January 12, 1996

Mr. Timothy Lucas
Director of Research and Technical Activities
Financial Accounting Standards Board
File Reference No. 154-D
401 Merritt Seven
Norwalk, CT 06856-5116

Letter of Comment No: 63
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COMMENTS TO THE FINANCIAL ACCOUNTING STANDARDS BOARD
EXPOSURE DRAFT: PROPOSED STATEMENT OF FINANCIAL ACCOUNTING STANDARDS
CONSOLIDATED FINANCIAL STATEMENTS: POLICY AND PROCEDURE
ISSUED OCTOBER 16, 1995

Dear Mr. Lucas:

The Exposure Draft regarding Consolidated Financial Statements: Policy and Procedure, which was published on October 16, 1995, may have far reaching implications for the Leasing Industry. We are concerned about the potential conflict between the Exposure Draft and the provisions of Financial Accounting Standard #13 for those transactions which legally reside in special purpose corporations, partnerships, or trusts. This letter contains our response to the exposure draft and an assessment of the impact on our industry. We believe that there is no need to change existing consolidation rules which are clear and can be consistently applied. The ED has singled out leasing transactions owned by special purpose entities (SPE's) even though they are owned by a substantive lessor, are consolidated on the balance sheet of the owner/lessor and are accounted for in compliance with the provisions of FAS# 13 by both the lessee and the investor.

Our comments are specific to the impact of the Exposure Draft on the leasing industry which we believe would be negatively impacted by the adoption of the ED in its current and retroactive form. We believe that the adoption of the ED would have the following consequences for lessees and investors:

1. Conflicting practices by lessors and lessees for leases structured with identical structures and economics under FAS #13 based solely on the legal, tax, and administrative need to insert an SPE between the asset and the investor;

2. The exclusion of classes of investors from the leasing market for certain types of assets;

3. Conflicting consolidation practices based on various interpretations of the effective control;

4. Increased costs to structure transactions due to a reduction in the investor market and increased legal and accounting fees and sales and transfer taxes; and

5. Significant costs to restructure existing transactions due to the retroactive application of the new standards to transactions which were designed and entered into using existing rules.

BOT Financial Corporation and its affiliate, BOT Financial Services, Inc., are engaged in structuring, syndicating, and investing in asset-based, structured finance transactions including leasing transactions. Our leasing activity is broad based and includes a wide variety of lease structures including leveraged leases, single investor true (tax) leases, single investor operating leases (with and without tax benefits), and finance leases. A significant number of the leasing transactions in which the company is involved reside in special purpose entities which are typically consolidated by the owner of the special purpose entity. We have examined our portfolio and those transactions which we structured and syndicated for institutional investors which have the related SPE's consolidated on their balance sheets and have found that $ 3 billion in transactions (measured by asset cost) would need to be evaluated and possibly restructured should the exposure draft be adopted in its current form and if retroactive application is required.

The use of SPE's in a leasing transaction could change the accounting treatment for an otherwise identical transaction under this exposure draft. The ED prescribes a new set of rules for handling leasing transactions, but is restricted only to those transactions in which an SPE has been inserted between the lessee and the investor. We believe that a leasing transaction should be evaluated on the basis of the financial aspects of the transaction, not on its legal form which is consistent with the provisions of FAS #13. The Exposure Draft offers a conflicting means of evaluating the appropriate accounting treatment for a leasing transaction and the path is far from clear. The level of uncertainty will inevitably lead to conflicting practices among lessees and lessors and increased costs to participants in these transactions.

Example Number 5 of the ED describes a transaction which results in effective control resting with the lessee; hence, the Board concludes that the lessee should consolidate. The example does not address a transaction that may be identical but for which no SPE exists and the investor owns the asset directly. In that instance, the ED would not apply and we would conclude that the investor would have the asset on its balance sheet. We are uncertain as to how we might treat a transaction in which 100% of the equipment cost is obtained by a 100% equity investment by the investor. The ED provides a single set of facts and circumstances that cumulatively lead to the conclusion that a lessee must consolidate. It would be helpful for the ED to include examples of other structures, outcomes, and rationales.

We are uncertain as to how to apply the ED to non-real estate transactions that are similar in many respects to Example Number 5. For instance, Corporation I enters into a lease of office equipment with Company J (a substantive leasing company with multiple assets) under a structure which qualifies as an operating lease in accordance with FAS #13. Company J obtains a third party guarantee of the residual value such that the lease qualifies as a direct financing lease to the lessor and obtains non-recourse debt for 80% of equipment cost. The lease has an initial term of 5 years followed by a series of one year renewal options. Corporation I, at any renewal point may terminate the lease agreement and elect to purchase the property at a predetermined option price. If the equipment sustains significant physical damage, Corporation I agree to either purchase the property at the option price or restore the equipment to its previous condition. If Corporation I does not exercise its purchase or lease renewal options by the end of the lease term and Company J disposes of the equipment at less than the option price, Corporation I is liable to Company J for a limited amount of the difference between the option price and the sales proceeds. If Company J receives more than the option price, Corporation I is entitled to the excess of the proceeds over the option price.

The office equipment lease is recorded as an operating lease by Corporation I and as a leveraged lease by Company J based on the application of FAS #13. However, if the equipment was an aircraft rather than office equipment, an SPE (Trust A) would be inserted in the transaction with Company J having at 20% equity at risk. In this instance, the ED calls for both the lessee and Company J to examine who has effective control, even though the economics of both transactions are the same. The ED does not provide sufficient guidance for us to determine what facts and circumstances would cause Corporation I to consolidate Trust A nor why that would be an appropriate result given that the only significant difference between the two transactions is the insertion of an SPE for other than accounting reasons.

It may be helpful to elaborate on the reasons that SPE's are used in leasing transactions. Typically, the use of an SPE in a leasing transaction is intended to achieve legal, administrative, and tax objectives which are not available via direct ownership. The fact that an SPE has been utilized does not change the manner in which the lessee and the investor record the transaction on its books. If a special purpose entity owns the asset, we treat the legal owner of the SPE as the lessor and consolidate the entity as lessor. The clarity of existing accounting rules makes the determination of the owner of an SPE clear. In most cases, the ownership of the SPE is a single owner. In leasing transactions, we then look to FAS #13 that sets forth clear guidelines to determine the appropriate balance sheet and income statement treatment for both lessors and lessees. While we recognize that abuses in practice may exist it has been our experience, in most instances, that leasing SPE's have clear, substantive owners who consolidate the SPE.

The use of special purpose entities significantly expands the market for investors in leasing transactions to include institutions who may be prohibited from direct investment due to regulatory restrictions. We believe that the expanded market for leasing transactions heightens competition and lowers the cost of leasing transactions to lessees. For example, US federal government rules restrict direct ownership of certain asset classes including aircraft and vessels that cannot be owned directly by a "noncitizen" of the United States. Certain types of financial institutions also encounter government agency restrictions in real estate transactions. Special purpose entities allow for the participation of noncitizens in aircraft and vessel transactions and certain financial institutions in real estate which would not otherwise be enabled. The insurance industry in many jurisdictions looks more favorably on investments via trusts and SPE's than direct ownership of assets. It may be prohibitive for these institutions to participate in certain leasing transactions were the use of an SPE to change the accounting treatment for the lessee.

Some jurisdictions require local ownership for certain asset types. The use of Trust Companies qualified in specific states enables out-of-state investors to participate in transactions in other states as well as multi-state transactions. The use of trusts expands the market to out-of-state investors and reduces the administrative costs of participating in these transactions and ultimately, the cost to the lessee.

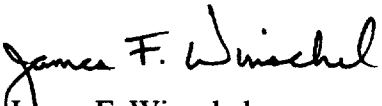
SPE's are often required to reduce asset risks for both the lessee and the lessor including environmental and casualty risks. SPE's are utilized to reduce the risks to multiple participants in large transactions should one or more participants be in bankruptcy. Protection from participant bankruptcy is often sought by both lessors and lessees.

The fact that the Exposure Draft recommends an accounting change for existing transactions is alarming due to the costs that lessees and lessors will incur to restructure existing transactions that were structured specifically to achieve the expected results by both lessors and lessees. In cases where the aspect of control may not be clear to accountants, it may be necessary to restructure the entity, sell its assets to the lessor directly, and/or to dissolve the entities in order to meet the new consolidation standard. The costs would include legal fees, transfer and/or sales taxes, equipment retitling, as well as accounting fees. We believe that these costs would range from 65 to 100 basis points of equipment cost for legal, accounting, and retitling expenses plus 3-10% of cost for transfer taxes. While these costs may be a boon to legal and accounting industry firms as well as to certain taxing jurisdictions, they will be unnecessarily burdensome to lessors and to lessees.

In summary, we believe that the adoption of the exposure draft will result in inconsistent practices among lessees and lessors, less competition, higher transaction costs, and considerable conflict with existing leasing standards. Further, we believe that the retroactively of the new rules will result in unnecessary costs to investors and to lessees

Please contact us if you need any clarification on our comments.

Sincerely,



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