

Mr. Russell Golden  
October 30, 2008  
Page 1



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LETTER OF COMMENT NO. 1620-100

**File Reference No: 1620-100**  
**Proposed Statement, *Amendments to FASB Interpretation No. 46(R)***

Dear Mr. Golden,

Citigroup appreciates the opportunity to comment on the proposed FASB Statement, *Amendments to FASB Interpretation No. 46(R)* (proposed Statement). We share the FASB's goal of increased transparency regarding involvement in and risks associated with unconsolidated VIEs, and have demonstrated that commitment through enhanced disclosures in our financial statements since the adoption of FIN 46R. Combined with certain of the proposals included in the proposed FSP FAS 140-e and FIN 46(R)-e, "Disclosures about Transfers of Financial Assets and Interests in Variable Interest Entities" (the proposed FSP), we believe that users of financial statements will be provided significant amounts of relevant information regarding off-balance sheet activities and the associated risks.

Because of this increased transparency provided to financial statement users, we believe that the proposed Statement should not be issued. Rather, the Board should continue deliberations in conjunction with the International Accounting Standards Board (IASB) in an effort to issue a single, converged standard. Accounting standard setters have worked diligently for years to develop a framework for the consolidation of SPEs that meets the needs of financial statement users, which is consistent with the fundamental concept of consolidation based on "controlling financial interests." Indeed, FIN 46 was issued in 2003, revised for 2004, with 6 significant interpretive documents issued since that date. We believe that a further fundamental change to the consolidation model should be made with full consideration of alternative models and comprehensive field testing of the proposal. Collaboration with the IASB would facilitate such a review, as well as avoid the costs and difficulties associated with the implementation of a new consolidation standard under US GAAP, only to effect a further change upon the adoption of International Financial Reporting Standards (IFRS).

However, if the proposed Statement is to be issued, we do have some suggested improvements on the initial measurement of assets and liabilities that are consolidated upon adoption of this standard, continuous re-evaluation, the definition of power, the elimination of the quantitative analysis, and the breadth of disclosures.

### **Initial measurement and transition**

We believe that upon the effective date of the proposed Statement, the assets and liabilities of newly consolidated entities should be reflected at their previous carrying value, to the extent determinable. The transition to FIN 46(R) used this methodology, and we are unaware of any significant practice issues for either preparers or users under that method. The basis for conclusions in the proposed Statement does not offer any explanation why the FASB would mandate a transition at fair value for this amendment, rather than deferring to the previous successful transition guidance.

Where assets and liabilities of newly consolidated VIEs are managed jointly as one business, we are concerned that a requirement to consolidate assets and liabilities of a VIE at fair value upon adoption of the proposed Statement would result in awkward financial reporting, since identical assets would have differing accounting bases. In the case of a loan portfolio, for example, data about the loan loss allowance would be inconsistent – some portion of the allowance would reflect historical reserve rates, while the newly consolidated loans would only build an allowance from the consolidation date. The combined loan loss statistics of the full portfolio would be difficult to explain to financial statement users.

Since this consolidation results from the initial application of a new accounting standard and not from changed circumstances that cause the reporting entity to become the primary beneficiary of a VIE (or former QSPE), we believe a difference in the accounting method used to consolidate the VIE is justifiable. Moreover, using book value is more consistent with the Board's stated view that transfers of financial assets to former QSPEs never should have been off-balance sheet, since it would restore the reporting entity's books to a pre-transfer condition and it is consistent with the initial transition guidance in FIN 46(R). We note that reporting entities that would prefer to consolidate VIEs at fair value at transition may do so by electing the fair value option.

### **Continuous re-evaluation**

We believe that the proposed Statement's requirement to reconsider an entity's status as a variable interest entity or a voting interest entity is not operational – particularly for investees that are businesses as defined in FASB Statement No. 141(R), *Business Combinations*. For enterprises with lending or investing relationships with a wide range of entities, such constant reconsideration would require a frequent re-evaluation of the funding structure (including sufficiency of equity) and voting rights in each investee. Depending on the interpretation of paragraph 14A, in many cases consolidation of the investees will not be at issue: it may be qualitatively clear that the lender or investor does

not have any power to direct activities in any case. However, determination of whether the borrower/investee is a VIE is important due to the required disclosures on unconsolidated VIEs. We acknowledge that footnote 17 of the proposed Statement limits disclosures under paragraphs 22C, 23 and 27 for VIEs, where the primary beneficiary also holds a majority of the voting shares. However, it leaves unresolved the issues regarding disclosure under paragraph 24 for interest holders in a VIE.

Consider, for example, a financial institution that provides a lending facility to a Fortune 500 Corporation. Due to operating losses and difficult market conditions, the book value and market value of the equity of the borrower corporation may decline significantly. Therefore, the lender financial institution will be required to evaluate whether the equity and voting rights of the borrower corporation continue to be sufficient to finance its operations without other support (whether through additional equity issuances, government assistance or guarantees, etc.). If the lender financial institution concludes that the equity is not sufficient, the lender will need to include the borrower in disclosures under paragraphs 22C and 24, including the size and activities of the borrower corporation and maximum exposure to the borrower corporation. We believe that such an evaluation of the equity capital adequacy of all borrowers in a loan portfolio will not be operational, as it will often require a level of information (both historical and forward-looking) that is not typically available to many lenders or minority investors.<sup>1</sup>

Under the proposed Statement, any variable interest is “significant” if it is significant to the variable interest entity, and we believe that it is a fair conclusion that virtually *any* borrowing relationship would be considered “significant” to a distressed or troubled borrower. Thus, lenders would be required to provide disclosures under paragraph 22C and 24. We believe there will be significant operational issues with making capital adequacy evaluations and obtaining required information regarding the size and activities of the borrower entities on a timely basis. Passive investors who have little control or who were not involved in the formation of an entity likely have little access to the required information.

We believe these issues could be avoided in one of two ways. The Board could revise the proposed amendment to require re-evaluation of VIE status only of legal vehicles that are not businesses as defined by Statement 141 (R). This would ensure that structured finance vehicles would continue to be assessed for changes in VIE status, as well as changes in the primary beneficiary, while avoiding the confusing results of subjecting operating businesses to different consolidation models based on their operating results. Alternatively, the Board could narrow the disclosure requirements to limit the quantitative disclosures required for involvement in VIEs that are businesses as defined by Statement 141(R).

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<sup>1</sup> While lenders may have access to information relative to the security or status of their own debt position, the information required to assess capital adequacy of the entity’s entire operations would often be much broader.

### **Definition of significant**

In paragraph 6 of the proposed Statement, a variable interest is considered significant if “the interest is significant to either the variable interest entity or to the enterprise.” We believe that the determination of significant should be dependent upon whether it is significant to the reporting enterprise, as that is whose financial statements are being considered.

### **Definition of power**

In paragraph 14A(a), “the power to direct matters that most significantly impact the activities of a variable interest entity, including, but not limited to, activities that impact the entity’s economic performance” is the power that would indicate that an enterprise has a controlling financial interest. We believe that this power should be required to be a *majority* of the power to impact the activities of the entity. This change would clarify the application to situations where there are multiple decision-makers associated with a legal vehicle, each with responsibility for discrete matters or activities. We believe this change would align the definition of a controlling financial interest with the requirement for a majority of the voting rights when evaluating a voting interest entity for consolidation.

### **Qualitative Analysis**

We believe that the requirement to consider “an assessment of the characteristics of the enterprise’s variable interest or interest and other involvement” is too broad. We believe that this assessment should be limited to involvement with the VIE which are “variable interests.” Currently, the evaluation for consolidation under FIN 46(R) includes only the involvement which is considered a variable interest. We believe this is the correct approach as it incorporates consideration of the design of the entity. This analysis would also include implied variable interests.

### **Elimination of quantitative analysis**

We believe that the quantitative analysis in paragraph 14C is unnecessary. We believe that the qualitative analysis in paragraph 14A is sufficient. Paragraph 14C introduces a consolidation framework that is fundamentally different than paragraph 14A, and *would be expected* to lead to a different consolidation conclusion in many circumstances. We believe it is conceptually flawed to introduce a fundamentally different framework to resolve circumstances where the initial framework is unclear. This introduction will simply encourage debates among preparers, auditors and regulators regarding the “clarity” of the qualitative analysis under paragraph 14A, especially when paragraph 14C would have a different result.

Mr. Russell Golden  
October 30, 2008  
Page 5

## **Disclosures**

Please refer to the comment letter we submitted on proposed FSP FAS 140-e and FIN 46(R)-e for our comments on the proposed disclosures.

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In summary, we believe it would be preferable for the FASB to work with the IASB on one converged standard on consolidation. If the FASB decides to continue with the proposed Statement, we generally support the proposed Statement, but remain concerned with the issues presented above along with the seemingly piecemeal approach to disclosure requirements being taken by the Board.

We thank the Board for its consideration and would welcome the opportunity to further discuss our comments with Board members and their staff. Please do not hesitate to contact me at (212) 559-7721.

Very truly yours,



Robert Traficanti  
Vice President and Deputy Controller  
Citigroup Inc.