**MINUTES**

Financial Accounting Standards Board

**To:** Board Members

**From:** Statement 140 and Interpretation 46(R) Teams (Mathys, ext. 446)

**Subject:** Minutes of the November 6, 2008, Roundtable Meeting: Statement 140 and Interpretation 46(R)

**Date:** February 4, 2009

**cc:** FASB: Golden, Bielstein, Lott, Donoghue, Lusniak, Mayer, Burnap, Schonefeld, Sperry, Barker, Roberge, Hood, Chookaszian, Posta, Gabriele, Sutay, Glotzer, Allen, Klimek, Maroney, C. Smith, Mechanick, Nickell, Mathys, Cropsey, Proestakes, Wilkins, Stoklosa, FASB Intranet; IASB: Leisenring, Kusi-Yeboah, Teixeira

*The Roundtable minutes are provided for the information and convenience of constituents who want to follow the Board's deliberations. All of the conclusions reported are tentative and may be changed at future Board meetings. Decisions become final only after a formal written ballot to issue a final Statement, Interpretation, or FASB Staff Position.*

Topic: Statement 140 and Interpretation 46(R) Amendments Roundtable—Morning Session

Basis for Discussion: Proposed Amendments to Statement 140 and Interpretation 46(R)

Length of Discussion: 8:30 a.m. to 12:00 p.m.

Attendance:

Board members present: Herz, Linsmeier, Seidman, L. Smith, and Siegel

Staff in charge of topic: Donoghue, Roberge, Mayer, and Nickel

Other staff at Board table: FASB: Golden and C. Smith
IASB: Teixeira

Participants: Bailey, CSMA; Bascom, KPMG; Coleman, MBA; Dooley, Citigroup; Finnegan, CFA; LaMonte, Moody's; Kroeker, SEC; Merriett, Federal Reserve; Mills, ASF; Pegg, Encima Capital; Pippolo, E&Y; Roth, Credit Suisse; M. Schroeder, Goldman Sachs; Sondhi, CFA Institute; Uhl, Deloitte; Volkov, CFA Institute

Objective of Meeting:

1. The objective of this meeting was to solicit feedback from constituents regarding the proposed FASB Statements, *Accounting for Transfers of Financial Assets*, and *Amendments to FASB Interpretation No. 46(R)*, and FASB Staff Position (FSP) FAS 140- and FIN 46(R)-8, *Disclosures by Public Entities (Enterprises) about Transfers of Financial Assets and Interests in Variable Interest Entities*.

**AMENDMENTS TO STATEMENT 140**

2. Mr. Golden began the discussion by stating that the objective of the proposed Statement on accounting for transfers of financial assets is to improve the relevance and representational faithfulness of transfers of financial assets. The significant improvements that the FASB believes have been accomplished by the proposals include (a) the elimination of the qualifying special-purpose entity concept, (b) a definition of participating interest, and (c) improvements on how to evaluate the isolation condition.

**Issue 1: Objective**

3. Mr. Finnegan indicated that the Chartered Financial Analyst Institute is encouraged and pleased with the direction that the FASB is going with the project. However, he expressed concern that, due to the emphasis on legal assessments of true sales and bankruptcy-remote entities, the project may fall short of providing analysts and users with the information they need to analyze companies' engagements in securitization transactions. This is based on the belief that most, if not all, securitization transactions are financing transactions, and transferors will not jeopardize their funding sources due to risks to their reputations.

4. Mr. Finnegan also requested that the Board provide guidance regarding what constitutes continuing involvement, especially if the notion of continuing involvement is a prohibition of derecognition. If there are economic risks and rewards still to be borne by the transferor, then those risks and rewards should be reflected in the financial statements of the transferor. If derecognition is still

allowed with some level of continuing involvement, then there should be adequate disclosure of those risks and rewards. Linked presentation on the face of the balance sheet with respect to transferred assets and transferred liabilities with any continuing involvement is preferable.

5. Mr. Sondhi stated that from the users' perspective, it is not possible for a company to overstate its position on the balance sheet. When analyzing transfers of financial assets, it is important to determine the yield that the investor in the transfer actually receives. This is because most of the time the yield is rather low relative to the actual risk. Usually, to determine the fundamental economics of the transaction, analysts compare the risk transferred with the investor's risk. If the investor's risk is low, it is assumed that the transferor retained at least some of the risk.

6. Mr. Finnegan added that he would support a rebuttable presumption test imbedded in the discussion of effective control that would state if there are indicators of continuing involvement, the preparer must rebut the presumption that it does not have effective control and must provide that disclosure in the notes to the financial statements. If there is some form of continuing involvement, then it must be disclosed and presented prominently, which is why linked presentation could be very useful for these kinds of transactions.

7. Mr. Herz asked whether separate classification on the balance sheet (rather than full linked presentation) would be acceptable to users.

8. Mr. Finnegan stated that Mr. Herz's suggestion would be helpful, because, in general, he supports any type of segregation on the face of the balance sheet to distinguish between consolidated and non-consolidated assets.

9. Mr. Linsmeier asked whether the concerns over "no continuing involvement" are mostly due to enterprises that transfer groups of assets, in which case the proposed Statement on amendments to Interpretation 46(R) will bring the assets back on the book if the enterprise has power and benefits.

10. Mr. Finnegan would prefer that a no continuing involvement threshold be established in both proposed Statements.

11. Mr. Sondhi stated that he does not believe that the proposed Statement on amendments to Interpretation 46(R) alone will solve the problem because, in some cases, the adjustments to FASB Interpretation No. 46 (revised December 2003), *Consolidation of Variable Interest Entities*, do not go far enough.

12. Mr. M. Schroeder agreed with Mr. Sondhi and stated that transferors who take on risks and do not get paid for assuming such risk because they take on lower yielding assets is problematic. He also stated that Interpretation 46(R) is a blunt instrument for consolidation and there is really no room for nuances; therefore, there will be over-consolidation. He would support a risk-and-rewards backstop because if an enterprise takes on risks, it ought to be consolidating. Mr. M. Schroeder also presented a proposal in which all variable interests in a variable interest entity should be accounted for at fair value.

13. Ms. Mills agreed that the consolidation standard is a blunt instrument and that there are many different forms of continuing involvement, so it would be extreme to go to a standard of no continuing involvement. The American Securitization Forum has consistently advocated linked presentation as the solution (to not knowing how much involvement is too much) that gives the necessary presentation on the balance sheet.

**Issue 2: Participating Interest**

14. Mr. Golden directed the discussion to participating interests and asked how participants feel about the FASB approach to participating interests.

15. Mr. Dooley expressed concern with applying a different model for similar events (transfer of 100 percent of assets and subsequently obtaining a beneficial interest compared to transferring a portion of assets while retaining the remainder); he found it to be overly complicated. He stated that he does not currently see many practice issues regarding transfers of portions of financial instruments and was

bothered by the possibility that one can get fundamentally different accounting answers to what seem to be economically similar transactions.

16. Mr. Uhl agreed that the participating interest model does not present the underlying economics of many transactions. He stated that there are two arguments: (a) only have transfers of whole assets to achieve derecognition, and (b) have a components approach in which one can transfer portions of financial assets. He stated that he supports a components approach, but is concerned that the proposed Statement on accounting for transfers of financial assets creates a lot of rules for transferring pro rata interests, which will create implementation issues and may not truly reflect the underlying economics of the transaction.

17. Mr. Uhl further stated that identifying components and how to account for them is a challenge and transparency in this area is very important. He added that it is especially difficult to identify unilateral, voluntary, side agreements, which some people call reputation risk.

18. Mr. Linsmeier asked whether the accounting is complete if it is difficult to identify all obligations that are present in a transfer. He also asked if there will be gains on transfers that are not really gains if an entity does not account for unwritten arrangements.

19. Mr. Uhl believes that the gains are real gains and need to be accounted for, even if one does not control the asset but continuing involvement exists through unidentifiable implicit arrangements. In this situation, the enterprise should have a disclosure requirement discussing the fact that management may be exposed to an obligation. Mr. Golden asked whether Mr. Uhl thinks there should be more than a disclosure requirement to recognize this form of continuing involvement. Mr. Uhl responded that it depends on whether one believes in a control approach or a risks-and-rewards approach. In a control approach, voluntary support with no requirement to support, and no ability to redeem the asset unless the transferee agrees to it does not create control over the asset.

20. Mr. Sondhi stated that while it may no longer be the transferor’s asset, Mr. Uhl’s description of the involvement seems very close to an obligation, even if it does

not meet the definition of a liability. The obligation may, perhaps, be the need to keep the financing mechanisms of the transferor available, and not be one with an intent to step in.

21. Ms. Seidman stated that the pro rata test is a compromise position because some constituents prefer a no continuing involvement model with no legal analysis, while others prefer the model to be based on legal analysis.

22. Ms. Mills agreed that the participating interest concept does seem like a compromise, but that it seems like a workable compromise. She also stated that it is the ideal time to converge with the IASB, but does not believe that IAS 39, *Financial Instruments: Recognition and Measurement,* (as is) is superior to FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*.

23. Mr. Uhl stated that he believes the IAS 39 approach with respect to cash flows is superior to the "middle ground approach" in the proposed Statement on accounting for transfers of financial assets proposal because there are more divisions of cash flows that are acceptable.

24. Ms. Bailey inquired about the circumstances in which the mortgage industry bifurcates A and B notes, but does not actually sell the B note. She noted that it is odd that under the proposed amendments, an enterprise that does not retain significant risk and retains only an investment grade portion would not achieve sale treatment under the proposed amendments.

25. Mr. Dooley also noted that the model does not seem to provide for a scenario in which the enterprise described by Ms. Bailey would sell the senior portion right away and then, two months later, sell the B portion to a separate substantive entity (not a securitization vehicle), but would not achieve sale treatment for either transaction even though the enterprise has disposed of all of the risk and all of its involvements in two separate transactions. Mr. Dooley asserted that if the Board continues with the proposed approach, there should be some accommodation for transfers of portions of assets that end up being a transfer of the whole asset (that is, the enterprise should be able to derecognize the assets).

26. Ms. Donoghue stated that in a two-step transaction, derecognition depends on whether the enterprise ultimately transfers the entire asset into an entity that it does not control.

27. Mr. Silva stated that, historically, government sponsored entities were able to do securitizations with and without a trust. When they do not use a trust, it is a participation interest that is being issued in a pool of mortgage loans. If, from a Statement 140 perspective, it is appropriate to derecognize those mortgage loans, the issue in Interpretation 46(R) is that one might have two structures that are identical; however, one is not being captured in the definition of an entity under Interpretation 46(R). In considering the participating interest view holistically, one needs to ensure that the same rules are being applied across the board.

**Issue 3: Elimination of the Qualifying Special-Purpose Entity Concept**

28. Ms. Roth stated that she is concerned that, under the consolidation rules in the proposed Statement on amendments to Interpretation 46(R), more transactions will come on balance sheet even though the consolidating enterprise remains the same.

29. Mr. LaMonte stated that, as part of a rating agency, he is not very concerned about over-consolidation due to the elimination of the qualifying special-purpose entity concept because he often brings securitization structures back on the balance sheet. He does not think rating agencies need a lot of time to adjust to the proposed Statement. He stated that preparers are the ones who will need time to adjust and that, in the interim disclosures will help bring a structure that is currently off balance sheet back on the balance sheet so that the market will end up with reported financial statements that look like rating agency adjusted financial statements.

30. Mr. Merriett stated that banking regulators need as much time as possible to adjust for the proposed amendments and the elimination of the qualifying special-purpose entity concept. However, for this particular proposal, banking regulators are moving quickly and they already have a team in place that are following the project closely. This team also is evaluating some of the structures that are likely to be consolidated under the amendments. Mr. Merriett further stated that banking

regulators are working in a coordinated effort in the United States and internationally to decide whether the current capital adequacy approach that determines the regulatory capital required by regulated financial institutions is effective and appropriate in high-risk situations or whether the requirements need to be adjusted. Mr. Merriett was confident that regulators would not be caught in a position in which accounting rules change and the regulators are not ready to adjust.

31. Mr. Sondhi stated that over-consolidation has never been a problem for users, and he does not expect it to become an issue now. With respect to the capital requirements, analysts will adjust to them either way.

32. Mr. Pippolo stated that he is supportive of the elimination of the qualifying special-purpose entity concept because it has historically created more problems than it has solved. However, he anticipates questions about how to deal with the elimination and changes to the rules under both proposed Statements.

33. Mr. Bascom also expressed support for the elimination of the qualifying special-purpose entity concept because it does not represent the economics of transactions. He also fully expects new challenges with the proposed Statement on transfers of financial assets, but these new challenges are preferable to those arising from qualifying special-purpose entities

34. Mr. Uhl agreed with Mssrs. Pippolo and Bascom and supports elimination of the qualifying special-purpose entities. However, he also expressed some practical and conceptual objections to the proposed amendments to Statement 140. He voiced concerns about eliminating the qualifying special-purpose entity in a hasty manner, which could lead to many implementation issues and create excess costs. He stated that these additional implementation issues will prove burdensome if, through convergence, companies have to change their policies again 12 months later. Mr. M. Schroeder agreed with Mr. Uhl's remarks.

35. Mr. Herz stated that the FASB and the IASB are working together to meet the needs of users and to develop consistent standards to minimize the amount of change in the future.

36. Mr. LaMonte stated that standards today do not necessarily provide users with the information they want or need on the balance sheet. Users also are hampered by poor disclosures that create problems in adding transactions back on to the balance sheet. He stated that he does not believe a joint standard will be completed prior to 2010, and that he supports the FASB's current project and its direction because there is a need for an immediate fix.

37. Mr. Silva believes the issue with qualifying special-purpose entities, in part, is the move away from effective control of the assets in a trust to a rules-based paradigm that has nothing to do with effective control. Therefore, the solution in the interim may be to step back and eliminate those requirements associated with qualifying special-purpose entities that have nothing to do with effective control and evaluate, based on the existing paradigm, whether control is retained. Then, require more financial statement disclosures that give the analysts the information they need about these off-balance-sheet entities.

38. Ms. Seidman disagreed because the issues have nothing to do with effective control. She said the issue is whether or not the entity itself is "brain dead."

39. Mr. M. Schroeder agreed that the qualifying special-purpose entity model is broken, but thinks the IASB is working quickly and that requiring preparers to change 2 times only 12 months apart is inefficient.

40. Mr. Linsmeier suspects that anything done by IASB will be effective two years after the effective date of any FASB standard. He also clarified that the projects on derecognition and consolidation have not been rushed, but, rather, they have been contemplated for the last couple of years and have gone through much due process to reach this point.

41. Mr. Smith inquired about whether interim disclosures could be the solution until a converged standard is reached.

42. Ms. Pegg stated that companies use more than one vehicle to inform users and, although disclosures can give the big picture, they do not always help users figure out the risks of the entity based on all the individual transactions. She stated that

disclosures are a good interim step, but she also thinks a bigger step will be necessary before getting to a final standard that helps users. However, in the current environment, disclosures are beneficial.

43. Mr. Sondhi agreed with Ms. Pegg, and stated that some responsibility also falls on users to communicate better with companies to tell users when disclosures do not work. He stated that waiting for convergence would not be helpful.

44. Mr. Finnegan stated that disclosures alone are not an adequate solution.

45. Mr. Uhl stated that the disclosures add significant costs for an interim solution, which does not seem acceptable to users because they will still have to put everything from the disclosures back on the balance sheet.

46. Mr. Finnegan stated that transitioning straight to a derecognition model that puts transactions back on the balance sheet is not realistic at this time. In the meantime, he supports a robust set of disclosures that would allow users to make adjustments to determine the effects of an entity's financial position if certain structures were consolidated. He also stated that Mr. Silva's suggestion to make pro forma disclosures in the notes to the financial statements would be acceptable, but not for the long ,term.

47. Mr. Kroeker stated that it might be a long time before a converged standard is finished, and users do not seem to be willing to wait very long.

48. Ms. Seidman stated that she does not agree that *any* continuing involvement warrants consolidation.

49. Mr. Finnegan stated that recent events demonstrate that financial institutions have been willing to provide significant financial support to entities in these types of transactions, which in turn has lead to significant financial distress. This history demonstrates that these structures were integral to the financial institutions' business, and the information was buried in notes to financial statements or not disclosed at all so users were unable to understand the risks of these structures to the financial institution. He stated that investors will continue to discount the

value in these companies until there is a set of standards and financial statements that they can have confidence in.

50. Mr. Coleman stated that if the Board goes to a no continuing involvement model, investors may have a hard time segregating which transactions expose transferors to incremental risks and which do not. Mr. Finnegan replied that if the transactions are segregated and clearly labeled with adequate accompanying disclosures in the notes to the financial statements that will not be a problem. Mr. Coleman stated that transactions that result in incremental risks should be recognized on the balance sheet and structures that do not result in incremental risks should only be disclosed in the notes to the financial statements.

51. Mr. Dooley stated that if the Board uses a no continuing involvement model for recognition, the Board will end up with a significant amount of additional secured borrowings recognized on a reporting entity's balance sheet coupled with more disclosures regarding how to determine which transactions expose the entity to risks as opposed to those transactions that do not. He stated that a no continuing involvement model is an inappropriate way to deal with these structures, rather than addressing continuing involvement in the consolidation guidance.

52. In relation to the proposed amendments to Interpretation 46(R), Mr. Silva expressed concern about commingling the interest and credit risk associated with loans transferred to a government sponsored entity off-balance-sheet trust as the result of consolidation by the government sponsored entity. He stated that Fannie Mae is only subject to the credit risk component unless it is an investor in the securities. He stated that the financial statements will not reflect the ultimate risk that the government sponsored entity is exposed to, which he believes is credit risk resulting from the credit guarantee to the trust. Rather, he asserted that financial statement users will see consolidation of a significant amount of loans and debt for which the government sponsored entities are not exposed to anything but credit risk. Therefore, users will have to look to disclosures to understand the risks the company is actually exposed to.

53. Mr. Finnegan stated that it is preferable to have more information on the balance sheet rather than less, and that even if users have to look to footnotes to determine which risks the company is exposed to, it is preferable to recognize all potential risks.

**Issue 4: Proposed Change to Paragraph 9(c)3**

54. Mr. Coleman expressed concern that paragraph 9(c)3 is neither operational nor practical. He found it very problematic that the transferee could have the maximum benefits, which he really believes are with beneficial interest holders and investors because they are guaranteed a return. He stated that there really is not a benefit for the transferor because, legally and contractually, there is no way for the transferor to obtain those assets.

55. Ms. Roth noted that paragraph 54(b) states that the ability of a special-purpose entity to obtain cash flows is not a benefit, but she disagrees. She argued that the ability to obtain cash flows through the assets to pay for the beneficial interest holders is a benefit, whereas the implementation guidance states that it is not a benefit to the transferee.

**AMENDMENTS TO INTERPRETATION 46(R)**

56. Mr. Golden opened the dialogue about the objective and whether the proposed Interpretation 46(R) model meets that objective. He said that he also wanted to specifically discuss kick-out rights, the need for a quantitative analysis, and the removal of reconsideration events because these issues were raised in many comment letters.

57. Mr. Golden asked whether the proposed model, which is focused on a qualitative analysis instead of a quantitative analysis, would be an improvement to existing practice.

58. Ms. Pegg said that a focus on a qualitative analysis would be an improvement. She said that a qualitative assessment would help avoid some unusual results that might result from a quantitative analysis. Ms. Mills said that securitization

structures are inherently of a hybrid nature with some sort of continuing involvement, which makes it difficult to determine what variable interest entities should be consolidated by a particular enterprise. Ms. Mills said that issues with the proposed guidance include shared power, determining when there is shared power, and the "could potentially be significant" language in paragraph 14A(b). Ms. Mills said that the proposed model might lead to an enterprise consolidating assets that are not the enterprise's assets per the definition of assets in the existing conceptual framework. She stated that linked presentation would be a preferable solution, but that the proposed model is acceptable if there is segregated presentation on the balance sheet. Ms. Mills also stated that she has concerns about the definition of control within the proposed Statement.

59. Mr. Uhl stated that the proposed Interpretation 46(R) model is moving in the right direction with the focus on control instead of risks and rewards. He stated that there would be a number of implementation issues with this model, including how to identify power, kick-out rights, and shared power. Mr. Uhl said that he would prefer a single, converged standard with the IASB.

60. Mr. M. Schroeder said that he also favors a control model, but has some concerns about the "potential power" wording in the proposed model. Ms. Roth said that she agrees that a qualitative approach is the right direction, but is concerned that the definition of power is too broad and might be capturing decision makers who are really hired service providers.

61. Mr. Sondhi stated that this model is moving in the right direction, but has concerns that the proposed qualitative assessment may not be sufficient. He also said that there is some tension between the control model and the risk and rewards model that should be looked into, and further analysis needs to be performed to understand the problems of the quantitative assessment.

62. Mr. Golden asked what investors thought about "current" versus "potential" power in the proposed model. He stated that the proposed model involves "potential power." Mr. Siegel said that if an enterprise waits to consolidate an entity until the

enterprise exercises its power, then the investors may not receive timely information. Mr. Lamonte agreed with Mr. Siegel.

63. Mr. M. Schroeder said that potential power is a way of broadening the definition of power. Mr. Herz agreed that potential power broadens the definition of power. Mr. M. Schroeder said that he favors a control definition that focuses on practical ability and a majority of risks and rewards similar to the EITF Topic No. D-14, "Transactions Involving Special-Purpose Entities," model, which he felt was misapplied. Mr. Herz said that the problem is that if previous standards had been properly followed, more entities probably would have been consolidated.

64. Mr. Roberge stated that in the proposed model, an enterprise has the power to effect change when the variable interest entity that requires change has current power.

**Issue 2: Whether Power is Adequately Defined**

65. Mr. Golden said that power in the proposed model is intentionally defined broadly and asked whether power is adequately described so that the model can be applied consistently. Mr. Uhl stated that indicators of power would be helpful in identifying which enterprise, if any, has power.

66. Mr. Herz said that his concern is that if some indicators of power are given, the list of indicators will be used to determine whether an enterprise has power without the proper use of judgment. He said that it would be very difficult to create a list of indicators. Mr. Uhl said that the list of indicators did not have to be all-inclusive. Mr. Linsmeier stated that he was afraid a list of indicators might become all-inclusive in practice. Mr. Uhl said that he was concerned that he might have reached different conclusions on some of the examples in Appendix A of the proposed Statement. Specifically, he said that he would have reached a different conclusion in Example 8. He stated that he might have a difficult time implementing the concept of power without additional guidance explaining why some of the examples in Appendix A have different conclusions than he would have reached.

67. Mr. Dooley stated that he also has some concerns about the concept of power, but he agreed it is very difficult to create a detailed list of indicators. He said that he felt additional field testing would be useful. He also stated that he had some concerns about evaluating shared power and contingent power. Mr. Dooley stated that he supported the concept of power and that the examples are useful on a high level, but that the proposed model might lead to diversity in practice with real-world complex situations.

68. Ms. Mills agreed that it would be difficult to create a list of indicators of power. She stated that she did not agree with the definition of power, but understood that it was meant to be principles based. She said that there is diversity in viewpoints as to what constitutes shared power and that additional examples would be helpful. Mr. M. Schroeder agreed with Mr. Dooley and Ms. Mills that, at times, it would be difficult to determine which enterprise, if any, must consolidate an enterprise under the proposed model. Ms. Roth agreed and asked whether a servicer with no residual interest that just collects a fee would be required to consolidate an entity. Mr. Roberge asked Ms. Roth if the servicer had a variable interest under her example, and Ms. Roth responded that the facts and circumstances would determine whether the servicer had a variable interest, but if the servicer could be removed it might suggest that the servicer did not have a variable interest.

69. Mr. M. Schroeder said that it should also be considered that a company might come into servicing late and acquire the lower traunches of a variable interest as an investment that would provide liquidity into the market. Because this proposed model might require an enterprise to consolidate an entity in this situation, it might prevent an enterprise from providing additional liquidity into the market.

70. Mr. Silva stated that one problem with a list of indicators of power is that it could be difficult to determine how many indicators of power an enterprise would need to determine if it had power. For example, it is unclear how many indicators of power an enterprise would need to meet in determining whether the enterprise should consolidate an entity. He said that it would be useful to provide additional guidance on when enterprises share power and exposure. Mr. Dooley stated that in

the examples it is unclear when an enterprise that set up an entity has no power over the entity.

**Issue 3: Kick-Out Rights**

71. Mr. Golden asked whether the kick-out rights in the proposed model are appropriate or whether it would be more appropriate to remove the inconsistencies in dealing with kick-out rights in the proposed model and other literature dealing with consolidation by changing the proposed model or other literature dealing with consolidation.

72. Mr. Bascom stated that he does not think the kick-out rights concept in the proposed model is appropriate. He said that he looks at the kick-out rights for voting interest entities in the same way he looks at voting rights for voting interest entitites.

73. Mr. Bascom said that he thinks kick-out rights can be substantive even if they are not exercised as frequently as when results are consistent, or when exceeding an entity's plan, voting shareholders may not exercise their voting rights to change the board of directors of a corporation. He stated that he does not think it is appropriate to amend other consolidation guidance to be consistent with the proposed model. In addition, Mr. Bascom stated that the proposed model might lead to money market funds that are variable interest entities being consolidated by an enterprise.

74. Mr. Uhl stated that he was concerned with the fact that enterprises are expected to use judgment in determining power, but are not allowed to use judgment in determining whether kick-out rights are substantive. Mr. Uhl said that he favored the models currently in place for determining if kick-out rights are substantive. Mr. Dooley stated that he believes there is an issue with having inconsistent guidance concerning kick-out rights. Ms. Bailey stated that variable interest entity kick-out rights are being exercised in practice today when things are not going well, even though variable interest entity kick-out rights may not have been exercised in the past when things were going well.

75. Mr. Herz stated that he was concerned enterprises might structure around the power criteria. Mr. Bascom stated that companies are reluctant to actually put in kick-out rights that would be considered substantive under the existing Interpretation 46(R) criteria for substantive kick-out rights because those kick-out rights are relatively easy to exercise and companies do not want to risk losing potential revenue streams. Mr. Bascom also stated that there is empirical evidence that risk and rewards are not a proxy for power. Mr. Herz stated that there is a concern that enterprises may have a majority of the risks and rewards while claiming not to have the power. Mr. Bascom said that this happens under partnerships. Mr. Herz said that this happening in partnerships also is a concern of the users. Mr. M. Schroeder stated that as long as things are going well, people are content not to exercise their kick-out rights, but people do have the right to exercise those kick-out rights if things are not going well.

76. Mr. Pippolo stated that one of the reasons he likes the power and benefits approach is because it is more consistent with a voting interest model, but kick-out rights guidance under the proposed model is inconsistent with the voting interest model. Mr. Pippolo said that he does not think it is appropriate for an enterprise to consolidate when there are substantive kick-out rights. Mr. M. Schroeder stated that there are considerations in determining whether kick-out rights are substantive, including whether a vote for kicking out can be organized.

**Issue 4: Reconsideration**

77. Mr. M. Schroeder favors ongoing assessments of an entity's status as a variable interest entity and whether the enterprise is the primary beneficiary, if there are changes in control indicators. He said that he did not believe market conditions should trigger consolidation.

78. Mr. Smith stated that the comment letters seem to be of the view that many people are against constant reconsideration of whether an entity is a variable interest entity, but are in favor of constant reconsideration of whether an enterprise is the primary beneficiary. Mr. Bascom stated that he is in favor of that view, which is very operational, but constant reconsideration of variable interest entity status

would be very difficult. He said that he believes the variable interest entity reconsideration factors currently in paragraph 7 of Interpretation 46(R) capture the things that need to be captured and can be reasonably determined.

79. Mr. Bascom said that he was concerned about reconsidering variable interest entity status as a result of economic losses because it is inconsistent with the “by design” guidance and it is impracticable.

80. Ms. Roth stated that in determining if an entity is a variable interest entity or a voting interest entity, the entity must determine if there is equity that has power and control. She said that just because an entity is experiencing losses, this does not change the power that was used in the initial assessment. Ms. Roth stated that constant reconsideration of whether equity is sufficient would be extremely onerous, especially if there are different kick-out models because an entity may consider kick-out rights when it is a voting interest entity and then be forced to ignore kick-out rights if equity is insufficient.

81. Mr. Dooley stated that he was more concerned with the required disclosures resulting from constant reconsideration because constant reconsideration might cause an entity to be considered a variable interest entity instead of a voting interest entity, which would require additional disclosures.

82. Mr. Silva stated that it is unclear to him why the guidance for determining a variable interest entity would be reexamined when the guidance for determining a primary beneficiary has been reexamined. Ms. Mills stated that as a practical matter, many institutions would wind up putting together their own list of indicators for determining when an entity should reconsider whether it is a variable interest entity or a voting interest entity.

83. Mr. Golden asked whether people were in favor of constant reconsideration of whether an enterprise is the primary beneficiary. Mr. Dooley stated that continuous reassessment of primary beneficiary status is practicable under the qualitative assessment.

**Issue 4: Quantitative Analysis**

84. Mr. Golden asked whether there are scenarios in which a quantitative assessment is necessary to determine whether an enterprise is the primary beneficiary.

85. Mr. Coleman stated that it is not clear to him when a quantitative assessment would ever be necessary, so he felt that the quantitative assessment should be removed.

86. Mr. Bascom stated that he believes it is possible to determine whether power does or does not exist; therefore it is not necessary to have the quantitative assessment. He said that he favors eliminating the quantitative assessment because he is afraid that the quantitative assessment might be used as an option to achieve a different result than would have been achieved under the qualitative assessment.

87. Mr. Siegel asked whether users would prefer that the quantitative assessment be eliminated. Mr. Lamont responded that he would prefer that the quantitative assessment be eliminated. Ms. Pegg agreed.

88. Mr. Sondhi said that it seems reasonable to go to the quantitative assessment only when the qualitative assessment is inconclusive. He stated that he struggles with how people enter into arrangements with negotiated risk sharing without quantitatively assessing how much risk is involved and whether they are being paid an appropriate amount. Mr. Sondhi said that he would like it to be disclosed when companies enter into complex situations without assessing the quantitative risks.

89. Mr. Sondhi also stated that he is unsure that a qualitative assessment will always be conclusive. Mr. Linsmeier stated that he is concerned there are issues related to shared power. He asked whether it might be helpful to also have a quantitative assessment to determine the primary beneficiary. Mr. Dooley said that if the model is intended to be a control model, it is not clear to him when the risks and rewards model would be appropriate. Mr. Pippolo stated that the qualitative assessment and the quantitative assessment are fundamentally incompatible

models. He said that risks and rewards should be considered when determining power, but there should not be a qualitative and a quantitative assessment. Mr. M. Schroeder stated that he supports a majority risk and rewards framework in the context of a power definition because it is practical. He also said that the expected loss model has been discredited so it should not be used as a quantitative assessment. Ms. Mills stated that defaulting to the quantitative assessment is inappropriate.

**Issue 5: Linked Presentation**

90. Ms. Seidman stated that the Board has thought about linked presentation and there were concerns about the qualification for when one can link. She said the Board was concerned that the qualifications for a qualifying special-purpose entity would be moved into when one can link. Ms. Seidman stated that the Board also was concerned about the approach to measurement of the components of whatever elements could potentially be linked. She said that the IASB has concerns about linked presentation. Ms. Seidman stated that the Board is considering separate presentation of assets that are pledged to satisfy a specific liability either on the face of the financial statements or in the footnotes. Ms. Mills stated that scoping is a definite issue, but she felt strongly that any linked classification should be on the face of the balance sheet and that the measurement attribute should be fair value. Mr. Linsmeier said that commingling is an issue and it is difficult to determine when to stop linking. Mr. Herz stated that linkage is very porous and can move over time.

**DISCLOSURE FSP**

**Issue 1: Objectives**

91. Mr. Golden began a discussion of whether the disclosure objectives were effective. He solicited information from the roundtable attendees.

92. Ms. Mills stated that overall they supported the objectives of the FSP and felt that that the guidance would be sufficient solely through the principles. She felt that the detailed requirements created unnecessary complexity and were overly

proscriptive. She specifically mentioned that the existing sensitivity analysis does not provide adequate information.

93. Ms. Mills suggested that within the FSP, it would be less cumbersome to apply an earlier effective date if the disclosure guidance was based solely on principles. Mr. Smith noted that additional time also would be required for auditors and preparers to agree to a sufficient level of disclosure to comply with a principles-based standard. Mr. Herz expressed concern that the current disclosure requirements are principles based and that adequate disclosures were not being provided.

94. Mr. Finnegan stated that, overall, he was supportive of the disclosures. He feels that disclosures around continuing involvement (specifically, why a transferor would chose to have a continuing involvement) are very useful to investors.

95. Mr. Sondhi agreed that the sensitivity analysis did not provide adequate information due to the proscriptive nature of the required disclosure. Mr. M. Schroeder suggested integrating the disclosures with an enterprise risk disclosure viewpoint.

**Issue 2: Implicit Arrangements**

96. Mr. Bascom stated that he was supportive of the principles overall. He also stated that the requirement to consider implicit arrangements, based on the experience gained in applying similar guidance under Interpretation 46(R), would be complex. He noted that Statement 140 is based highly on a legal basis and that an increased focus on implicit arrangements would be problematic. He added that additional guidance regarding implicit arrangements would be helpful, at least to provide consistency with the current guidance in FSP FIN 46(R)-5, *Implicit Variable Interests under FASB Interpretation No. 46 (revised December 2003)*.

97. Mr. Golden indicated that a broader discussion would take place during the afternoon session of the roundtable. He asked if preparers have controls in place to know when they have an implicit arrangement. Ms. Roth stated that actions taken by companies have been reactions to events that they did not anticipate occurring. She added that she felt it would be difficult to capture the types of arrangements that were being considered within the proposed guidance.

98. Mr. M. Schroeder stated that an issue for preparers is the consistency of current sales practices by varying operations of large companies. Mr. Sondhi indicated that there is currently an obligation for public companies, as SEC filers, to provide similar disclosures.

99. Several preparers and auditors stated that companies do not actively consider potential circumstances that would case them to step in and act on the behalf of its investors.

100. Mr. Bascom stated that there is a challenge in that there are two types of implicit arrangements: (a) when there is an actual agreement that creates an obligation and (b) when, due to the interests of maintaining a business arrangement, it is in the company's best interest to take an action that it is under no obligation to take. The first type of implicit interest is identifiable and one can ascertain whether these arrangements exist or not. The second type requires that a preparer provide representation to its auditor that it would never take a supporting action. Furthermore, if the company ever does take an action, it may discredit the previous representation provided.

101. Mr. Bascom provided an example that in the case of money market funds, companies provided financial support when they were not legally obligated to do so. As an auditor, he is forced to assume that once this action is taken, the preparer has implied that they have an implicit obligation to absorb all of the credit risk associated with the financing structure.

102. Mr. Siegel remarked that he agrees that there are two types of implicit arrangements, as noted by Mr. Bascom. He felt that full consideration of the first type would provide a much better picture than there currently is today, even if consideration of potential events that have not yet occurred is not attainable.

103. Mr. Sondhi commented that there is a motivation for these companies to step in. In the case of the money market accounts, the company decides to step to maintain the stream of income from the line of business. As an investor, Mr. Sondhi indicated that knowing that the company will step in is an operating cost of the business line that he must consider to adequately value the business activities as a whole. He commented that this is not dissimilar from sales of inventory. When a

company takes a return of inventory when it is not obligated to do so, does this taint all of the sales due to implied rights of return?

104. Mr. Finnegan stated that the disclosure should allow an investor to evaluate whether a company would, in response to certain events, provide financial support under an obligation that does not exist. Mr. Sondhi agreed that there is a fundamental need for investors to know about these implicit obligations.

105. Mr. Bascom indicated that this analysis becomes problematic when a company may feel obligated to step into an implicit arrangement due to the actions of a competitor. Mr. LaMonte expressed concern that this would result in a boilerplate disclosure that a company may provide financial support when the economics of providing the support are more favorable than a decision not to provide the support. He also expressed concern that disclosure relative to these unpredictable events would be difficult and possibly impractical to provide.

106. Mr. Pippolo stated that the company would make what it believes to be the best economic decision at a particular time based on a cost-benefit analysis of the present circumstances, not by generating a list of multiple scenarios and deciding on generic circumstances prior to the actual events. Mr. Dooley agreed and expressed concern that these disclosures would rely too much upon the predictive ability of management.

107. Mr. Finnegan added that there is informative value in knowing that management is considering these risks and contingencies.

108. Mr. Smith indicated that there is a current requirement under AICPA Statement of Position 94-6, *Disclosure of Certain Significant Risks and Uncertainties,* to consider these types of events in a 12-month window. He also noted that the disclosures that some users request would take more space in the financial statements than is practicable. Mr. Sondhi noted that SOP 94-6 compliance is not encouraging. He also noted that he would like to have the information, notwithstanding the large amount of space that it would take.

**Issue 3: Effective Date**

109. Mr. Golden inquired of preparers what they felt would be overly burdensome to provide by the end of the year.

110. Mr. Dooley stated that he felt his company would be able to comply with the disclosure requirements at the proposed effective date, but felt that some of the disclosures were overly burdensome. Preparers raised concerns regarding the availability of data, specifically related to sponsors of variable interest entities, passive investors in qualifying special-purpose entities, risk positions (such as third-party guarantees) held by third parties, and cash flow disclosures.

111. Some preparers were concerned about the ability of companies to design, test, and potentially remediate the internal controls around the financial reporting requirements required by the Sarbanes-Oxley Act.

112. Other preparers questioned the usefulness of the robust disclosures for certain types of transactions. Specifically, a concern was raised regarding passive investments in structures in which the passive investor has no risk of ever consolidating the trust under both current and proposed guidance. Also, Ms. Mills expressed concern over the costs and benefits of providing the proscriptive guidance.

113. Mr. M. Schroeder indicated that there are several new standards to implement at this time. He added that the additional time of two months (the time difference between the release of year-end and first quarter financial reports) would provide a great deal of time to financial statement preparers without asking for too much time from financial statement users.

114. Mr. Golden asked for input from users regarding when they would want the information. Ms. Pegg said that the information would be best provided as soon as possible; however, she noted that if some requirements were difficult, perhaps phasing in more difficult requirements would be helpful. Other users agreed that disclosures would be helpful sooner rather than later.

115. Mr. Smith stated that the Board had a goal to provide final amendments to Statement 140 and Interpretation 46(R) by the end of 2008 and that the disclosures

were separated from the remainder of the project to provide timely guidance, since the proposed amendments will not be completed in time to be applicable by the end of 2008. He expressed concern that if the FASB took time to speak with preparers and users to determine which proposed amendments would be most effective and practicable for the end of 2008, there would not be enough time to complete the drafting and due process of the proposed Statements for the intended time period.

## IASB UPDATE

116. Mr. Teixeira noted that the IASB is currently working on standards for both of these topics as well. He stated that the IASB and the FASB are communicating to align the principles of the standards as closely as possible. He also stated that the comments made to potentially eliminate the option of a quantitative model of evaluating variable interest entities would bring the two models closer together. He continued to say that the two consolidation models are very similar.