FASB Emerging Issues Task Force

Issue No: 04-7

Title: Determining Whether an Interest Is a Variable Interest in a Potential Variable Interest Entity

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Previously Distributed EITF Materials: Issue Summary No. 1, dated June 18, 2004; Issue Summary No. 1, Supplement No. 1, dated September 16, 2004

References

FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities* (FAS 133)

FASB Interpretation No. 46 (revised December 2003), *Consolidation of Variable Interest Entities* (FIN 46R)

FASB Concepts Statement No. 7, *Using Cash Flow Information and Present Value in Accounting Measurements* (CON 7)

AICPA Accounting Research Bulletin No. 51, *Consolidated Financial Statements* (ARB 51)

*** The alternative views presented in this Issue Summary are for purposes of discussion by the EITF. No individual views are to be presumed to be acceptable or unacceptable applications of Generally Accepted Accounting Principles until the Task Force makes such a determination and it is ratified by the Board.**

Background

1. At the September 29–30, 2004 EITF Meeting, the Task Force discussed the conceptual merits and viability of both the fair value and cash flow approaches (as described in Views A and B, respectively, of Issue 1 in Issue Summary No. 1, Supplement No.1) in determining whether an interest in a potential variable interest entity (VIE) is a variable interest. Although Task Force members were not asked to reach a consensus on either approach, three Board members expressed concern and indicated that they would not support a consensus on either View A or View B.

2. At that meeting, Task Force members also expressed conceptual concerns with the combined approach (as described in View C of Issue 1 in Supplement No. 1). That approach was perceived to not be operational because (a) there would be an inconsistency with respect to the calculation of expected losses and expected residual returns and to the allocation of those expected losses and expected residual returns to certain types of variable interests (such as equity instruments) and (b) the approach may result in a gross up of the variability of the VIE by treating components of an interest that both absorb and create variability as separate contracts (inflows and outflows).

3. To address the concerns of individual members of the Board and the Task Force, the Task Force requested that the FASB staff further develop a two-step or "screen" approach to determine whether an interest is a variable interest in a potential VIE. Under the proposed approach, an enterprise would first analyze the nature of the activities of the potential VIE to determine the predominant type of variability (that is, fair value or cash flow) the potential VIE was designed to be exposed to and transfer to its variable interest holders. The second step is to apply either the fair value approach or the cash flow approach as described in Views A and B, respectively, of Issue 1 in Supplement No. 1, based on the predominant variability of the VIE.

4. At the November EITF meeting, the FASB staff requests that the Task Force focus on the different approaches provided for discussion under View D, with the expectation that one of those approaches would be selected as the most appropriate. Then, at a subsequent EITF

meeting, that approach would be compared to the approaches provided in View A, View B, and a modified View C (to be modified in a manner that addresses the concerns previously expressed).

5. Many members of the FIN 46(R) Working Group believe that the examples previously presented in Supplement No. 1, appear to be addressing other core issues relative to the application of FIN 46(R), such as measurement of variability and the allocation of variability to variable interests. The FASB staff provided those examples to display how the other facets of FIN 46(R) could be applied using the approaches described in the Views previously presented. The inclusion of those detailed examples was at the request of the Task Force members. Although the Task Force had requested that additional examples be provided illustrating the application of those Views to Financial Instrument, Operating, and Power Producer VIEs, the FASB staff has not provided such examples with this supplement so that at the upcoming meeting Task Force members will first focus their collective attention on the screened approach. The FASB staff would appreciate Task Force members' views on the usefulness of providing such detailed examples for future discussion given the concerns raised regarding the scope of this Issue.

The Two-Step or Screen Approach

6. The two-step or screen approach suggested by the Task Force during the September meeting requires (a) the identification of the predominant variability (fair value or cash flow) that the potential VIE was designed to be exposed to and that is to be transferred to its variable interest holders, followed by (b) the application of either the fair value approach or the cash flow approach based on the predominant variability of the VIE. Both fair value variability and cash flow variability can be created by various types of risk, including credit, interest rate, foreign exchange, equity price, commodity price, and operations risks. This model was proposed in order to address the concerns raised regarding the operationality of the combined approach and the viability of using the fair value approach in certain circumstances and the cash flow approach in other circumstances. The FASB staff believes that there are multiple approaches to determining the predominant variability of a VIE and has prepared various alternatives below for discussion at the November 2004 EITF meeting.

STEP 1: IDENTIFICATION OF THE PREDOMINANT VARIABILITY OF THE POTENTIAL VIE

View D1: Predominant variability of a VIE should be determined based on the instruments that create variability in the VIE.

7. Proponents of View D1 believe that the identification of the predominant variability of the VIE requires an analysis of the VIE itself, which can be performed using the following procedures (A-D):

Procedure A

Identify the contracts the VIE is a party to and determine whether the contracts create variability for the VIE, absorb variability of the VIE, or both create variability for and absorb variability of the VIE. In applying this procedure, variability would include both fair value and cash flow variability. Assets would generally be considered creators of variability for the VIE.

Procedure B

Analyze the individual contracts, if any, that both create and absorb variability to determine whether such interests should be considered creators of variability for the express purpose of determining the predominant variability of the VIE. Ultimately, regardless of whether such contracts are considered part of the creators of variability, the evaluating entity will still need to determine if the contract is a variable interest when applying either the fair value approach or the cash flow approach to the VIE as a whole as required by Step 2 of the screened approach. This procedure is necessary since the determination as to the predominant variability of the VIE is based on the variability created. The FASB staff has identified the following alternatives to assist in determining whether those contracts that both create and absorb variability are creators of variability (*if View D1 is selected, the Task Force will also be asked to choose one of the alternatives to make that consideration*):

Alternative 1

Only interests that create the variability that the VIE was designed to be exposed to should be considered creators. The determination as to which type of variability the VIE was designed to be exposed to should be based on (a) the contracts that the VIE is a party to and (b) the nature of the operations of the VIE. This determination would consider many factors relevant to the design of the VIE including the following:

- The purpose of the entity, specifically whether it was established to meet specific economic needs of certain interest holders
- The activities of the entity and the interest holder
- The terms of the contract as well as other contracts the entity is a party to
- How the transaction was marketed to potential investors
- The expectations of the investors at inception.

The application of Alternative 1 can be explained using an entity that has fixed-rate assets, a pay fixed/receive variable interest rate swap, and variable-rate liabilities. The investors receive variable rate returns and, as such, expect the VIE to be exposed to cash flow variability from interest rate risk. When the evaluating entity reviews the contracts that create and absorb variability (in this case, the interest rate swap) it will consider the interest rate swap to be a creator of variability for this analysis as long as the component that creates variability (receive leg of the swap) is creating cash flow variability. If it is determined that the predominant variability of the VIE is cash flow variability, then the counterparty to the interest rate swap will not consider the swap a variable interest (assuming no credit risk) when applying the cash flow approach to Step 2 of the model because the counterparty is receiving a fixed rate return, which by definition does not absorb cash flow variability.

Alternative 2

Interests that create and absorb the same type and amount of variability should be considered creators of variability and reflected with other creators in the analysis of predominant variability created. These interests should also be reflected, on a net basis, with the assets that are creating the variability that the absorb component of the contract is absorbing. This essentially will combine the asset and the contract into a "synthetically" created asset that creates one type of variability for the VIE. Interests **that do not** create and absorb the same type and amount of variability should be considered on a bifurcated basis. That is, the interest is analyzed by its separate components in a manner under which the components that create variability are considered creators and the components that absorb variability are considered absorbers. This "bifurcation" is only being performed for the purpose of determining the predominant variability of the VIE.

Example 1: An interest that absorbs and creates the same amount and type of variability

A VIE has fixed rate investment securities, floating rate debt outstanding, and a pay fixed/receive floating interest rate swap. Since the interest rate swap both creates cash flow variability associated with interest rate risk and absorbs fair value variability associated with interest rate risk, which have the same amount of variability, it should be considered a creator of variability. The creators are the fixed rate assets (create fair value variability related to interest rates) plus the interest rate swap, which essentially converts the fair value variability created by the assets to cash flow variability (based on interest rates). Since the absorb component of the interest rate swap is absorbing the variability created by the related assets (fair value variability), the combination of these two contracts creates the same variability (cash flow variability based on interest rates) that a floating rate asset would create and should be analyzed as such. The FASB staff believes that this treatment of the contracts that absorb and create will match the variability created for the VIE with the variability absorbed by its interest holders.

Example 2: An interest that does not absorb and create the same amount and type of variability

A VIE owns equity securities (which create fair value or cash flow variability associated with the equity price risk) funded by variable rate debt (absorber of cash flow variability based on interest rate risk) and is a party to a total return swap in which the VIE will pay the equity return to the counterparty in exchange for the floating interest on the notional amount. Since the total return swap creates a different type of variability (cash flow variability based on interest rates) than the variability it absorbs (cash flow or fair value variability based on equity prices), each component should be considered separately. As such, the VIE has two creators of variability; the equity interests held and the receive variable interest rate leg on the total return swap, and two absorbers of variability; the floating rate debt instruments issued (based on interest rates) and the pay equity price leg of the total return swap (based on equity prices).

Alternative 3

All interests that create and absorb variability will be considered on a bifurcated basis. That is, each interest will be analyzed by its separate components in a manner under which the components that create variability should be considered creators without any consideration of the components that absorb variability.

Procedure C

For each interest that the VIE is a party to that creates variability for the VIE (the population determined from Procedures A and B), determine the nature of that variability (cash flow or fair value). This procedure answers how the variability manifests itself into the change in the VIE's net assets. The FASB staff believes that the determination as to whether the creators are creating fair value or cash flow variability should be made based on the specific terms of the interest. For instance, assume a VIE is established to distribute the credit risk related to a certain borrower to the VIE's investors. If the VIE's investments have variable terms (such as fair value purchase options or variable rates of interest), then the cash flow approach would appropriately reflect the credit risk created for the VIE. If the investments have fixed terms (fixed price purchase options or fixed rates of interest), then the fair value approach would appropriately reflect the credit risk created for the VIE. If the interests do not have specific fixed or variable terms, the evaluating enterprise can choose either cash flow variability or fair value variability as long as the enterprise is consistent for all interests in the VIEs it is involved with (that is, an entity-wide policy election).

Procedure D

After determining the nature of the variability created by each interest in a VIE, the evaluating enterprise should then determine the predominant nature of the variability in the VIE (cash flow or fair value). The determination of predominance should be determined by the relative variability of each type of creator. The predominant variability created is expected to be the same as the predominant variability absorbed by the interest holders.

8. Proponents of View D1 believe that it establishes a model that can be consistently applied in developing an understanding of the creators of variability for various types of VIEs. Proponents of View D1 believe that it will have the effect of scoping out at-the-money plain vanilla swap transactions from being either variable interests or the primary beneficiary in the following manner: (a) If Alternative 1 is selected for Procedure B, typically an at-the-money swap will convert the cash flow stream of the assets to equate to the liabilities (essentially the variability the entity was designed for) and create the variability that the liabilities absorb, (b) If Alternative 2 is selected for Procedure B, the swap will be considered a creator (netted against the related assets) and, as such, may not be considered a variable interest if the variability that the swap created is the same as the predominant variability of the VIE, and (c) If Alternative 3 is selected for Procedure B, although the counterparty's receive leg of the swap may be considered an absorber of the VIE's variability and therefore a variable interest, the amount of variability absorbed by other variable interest holders in the VIE from the pay leg of the swap will likely equal the amount the receive leg of the swap would create. Thus, the swap counterparty would likely not be considered the primary beneficiary of the VIE. Proponents of View D1 believe that the use of procedure C will at least improve consistency of treatment of certain instruments by the same evaluating entity.

9. Opponents of View D1 believe that the acceptance of Alternative 3 to Procedure B will result in duplication or grossing up of variability of the VIE, which could mask the identity of the true primary beneficiary of the entity. Opponents also believe that the acceptance of Alternative 1 to Procedure B is not operational as it is too subjective of a determination and the determination may not be reliably tested or supported. Opponents also observe that the choice permitted to evaluating entities in evaluating investments with non-specific terms will lead to an

inconsistent selection of predominant variability among different evaluating entities, which would lead to an inconsistent application of FIN46(R) as a whole among these entities.

10. Opponents of View D1 also observe that the additional determination required to be made in View D1 (treatment of contracts that create and absorb, determining the variability designed by the entity, treatment of creators with non-specific terms, and the determination of predominant variability) adds to the difficulty in applying an already complex standard. These opponents also believe that the determination of predominance in Procedure D, which involves a qualitative assessment, is too subjective and will result in inconsistent application of FIN 46(R).

11. Other opponents believe that since this approach will result in the application of either the fair value approach or the cash flow approach, by definition all variability created by the VIE will not always be incorporated. Some proponents will counter that observation if the level of predominance used is sufficiently higher than a majority, which will cause this not to be a concern because the variability left out of the analysis will likely not be a factor in the determination of the primary beneficiary. However, these opponents have a greater concern with predominance defined as a majority, as the subjective nature of some of the required assessments can lead to enterprises that structure such entities picking and choosing which variability to consider in order to achieve a desired VIE determination or primary beneficiary determination.

12. Other opponents of View D1 believe that the inclusion of interest rate variability as part of the fair value variability could result in senior debt holders being considered the primary beneficiary of the VIE given the notional amount of their interests relative to more subordinate interests. These opponents believe that such an outcome is inconsistent with paragraph B9 of FIN 46R, as it could result in no primary beneficiary if the senior debt is distributed between at least two unrelated parties.

View D2: Predominant variability of a VIE should be determined based solely on the nature of the operations of the VIE.

13. Proponents of View D2 believe that the determination of the predominant variability should be based solely on the nature of the operations of the VIE. The nature of the operations is dictated by the purpose for which the VIE was designed and should be characterized as either, (a) a VIE buying, holding, or trading in financial instruments or (b) other types of VIEs, such as an operating VIE. The determination is made based on a review of the activities the VIE was designed to perform and the nature of the assets the VIE was designed to hold. Financial VIEs typically are designed to perform only a few activities such as obtaining and managing, for multiple investors, a portfolio of financial instruments (for example, loans, notes, and other fixed and variable rate investments). Operating VIEs typically are designed to perform a multitude of activities that may include the design, production, or sale of products or services.

14. If the VIE is a Financial VIE, proponents of View D2 would apply the Fair Value approach to determining whether interests in the VIE are variable interests, as well as to other determinations required by FIN 46(R). Proponents believe that the Fair Value Approach is most appropriate when dealing with financial instruments since they typically are exposed to interest rate risk, credit risk, or foreign exchange risk.

15. If the VIE is not a Financial VIE, proponents of View D2 would apply the cash flow approach to determine whether interests in the VIE are variable interests, as well as to make other determinations required by FIN 46(R). These proponents believe that the cash flow approach is the most appropriate approach when dealing with operating entities as it will incorporate the operating results (cash flows) of the VIE in the analysis. Typically, these VIEs will lack interest rate risk and, as such, the application of the fair value approach should not result in significantly different conclusions.

16. Regardless of which approach is being applied, proponents do not consider any instruments that create and absorb an offsetting amount of the same type of risk (that is, at the money interest rate swaps or at the money foreign currency swaps) as variable interests for purposes of determining the primary beneficiary of the VIE. This scope out of such instruments can only be used by the counterparty to the instrument, that is other evaluating entities of the VIE would still

need to consider these instruments as either creators or absorbers of variability depending on the approach (fair value or cash flow) used.

17. Proponents believe that View D2 is a model that will achieve a significant amount of consistency among evaluating entities. Proponents acknowledge that there may be instances where a non-Financial VIE has financial assets or a Financial VIE has operating assets. However, these proponents believe that the majority of the assets of the VIE will dictate the consideration as an Operating VIE or a Financial VIE. These proponents observe that View D2 will be the easiest alternative to implement and would reduce the overall complexity in applying FIN 46(R). Proponents of View D2 also believe that, for non-Financial VIEs, the cash flow approach is the approach most commonly used currently in practice. This is because the application of the fair value approach (that is, using multiple discount rates) will most likely not result in significantly different identification of variable interests or amounts computed for expected losses and expected residual returns from the cash flow approach under FIN 46R except when applied to entities with interest sensitive financial instruments.

18. Opponents of View D2 believe that the view could leave a significant amount of variability created in the VIE outside of the analysis and, as such, does not consider all of the variability of the VIE. Opponents also observe that even if a VIE is considered a Financial VIE, there can be considerable amounts of financial assets and liabilities that have floating interest rates (therefore creating cash flows variability) that would not be incorporated in the determination of absorbers of variability under the fair value approach. These opponents observe that an entity with floating rate interests issued and floating rate assets with no credit risk would not be considered to have any variability or variable interests. This approach has the potential to ignore considerable amounts of variability outside of the analysis.

19. Other opponents of View D2 believe that the inclusion of interest rate variability as part of the fair value variability could result in senior debt holders being considered the primary beneficiary of the VIE given the notional amount of their interests relative to more subordinate interests. An example of this relevant to View D2 (as well as View D1) is a VIE with floating rate assets, a pay floating/receive fixed rate interest rate swap and fixed rate interests issued, one

of which is senior to the other. In cases in which the amount of subordinated interest is sufficient to absorb all of the credit risk related variability, the variability in the interest rates and the significance of the amount of senior interest issued to the subordinated interests issued may lead to the senior interest being the primary beneficiary. These opponents believe that such an outcome is inconsistent with paragraph B9 of FIN 46R, as it could result in no primary beneficiary if the senior debt is distributed between at least two unrelated parties.

View D3: Predominant variability of a VIE should be determined based on the design of the VIE.

20. Proponents of this view believe that the predominant variability should be determined based on the design of the entity. This approach would analyze the nature of the VIE's operations and the contracts the VIE is a party to in order to determine what variability the VIE was designed to transfer to its interest holders. Proponents believe that regardless of the variability absorbed, interests that are not designed to absorb variability of the entity should not be considered variable interests by either the holder or the other parties involved with the variable interest entity.

21. These proponents observe that paragraph B4 of FIN 46R states, "The labeling of an item as an asset, liability, equity, or as a contractual arrangement does not determine whether that item is a variable interest. It is the role of the item—to absorb or receive the entity's variability—that distinguishes a variable interest. That role, in turn, often depends on the design of the entity." The determination of which type of variability is predominant should be based on many factors with respect to the design of the VIE, including the following:

- The purpose of the entity, specifically whether it was established to meet specific economic needs of certain interest holders
- The activities of the entity and the interest holder
- The terms of the contract as well as other contracts the entity is a party to
- How the transaction was marketed to potential investors
- The expectations of the investors at inception.

22. Proponents of this view would consider contracts that create and absorb variability to be part of the assets because the cash flow stream or changes in fair value of the assets plus the stream from the contract that creates and absorbs variability will result in the ultimate cash flows or type of variability that the interest holders entered into the contract to obtain. These proponents believe that looking at the interests that absorb designed variability would effectively result in all of the variability the entity was designed to be exposed to being analyzed. This approach would also essentially create a scope exception for contracts that create and absorb variability because they would be considered in the same manner as the asset on the whole.

23. Opponents of View D3 believe that it presents too wide of a scope exception to contracts that create and absorb different types of variability. Other opponents argue that many of the factors can be manipulated to achieve a desired outcome. They believe that documenting the consideration of those factors would be extremely difficult and impractical. Opponents also argue that the analysis of factors will involve considerable judgment and subjective information that cannot be objectively verified, raising audit concerns and comparability issues. These opponents also believe that this will lead to further inconsistency as well as auditability concerns for those evaluating entities.

View D4 Predominant variability of a VIE should be determined based on the predominant risks the VIE is exposed to.

24. Proponents of View D4 believe that the predominant variability of the VIE should be determined based solely upon the predominant risk that the VIE is exposed to. The variability of the VIE represents exposure to one or more of the following types of risks (not an all inclusive list):

- Interest Rate Risk
- Credit Risk
- Foreign Exchange Risk
- Operations Risk
- Equity Price Risk
- Commodity Price Risk

Proponents of View D4 would analyze the nature of the VIE and determine the predominant risk in the VIE (that is, which of the above risks was the VIE was designed to expose its interest holders to). Proponents of this view believe that the predominant risk will be apparent from the analysis of the contracts the VIE is a party to and the intention each interest holder had when obtaining its interest in the VIE (this could be determined through analysis of the prospectus delivered to investors prior to their investment). Proponents believe that predominance should be determined by the relative variability of each type of creator. These proponents believe that the model will result in the true risk in the VIE being analyzed and the most appropriate party being considered the absorber of the risk, as well as the primary beneficiary.

25. These proponents believe that once the predominant variability is determined, the evaluating entity would need to determine how this risk manifests itself into either cash flow variability or fair value variability. This determination should be made based on the specific terms of the contracts in a similar manner as Procedure C of View D1 described above. Once this is determined, all other variability and risks need not be considered in the application of the View. An example of this application would be a VIE created to be exposed to credit risk. The risk is inherent in two portfolios of assets, one a fixed rate portfolio comprising 60 percent of the assets and the other a floating rate portfolio comprising 40 percent of the assets. In this example the fair value variability would be considered the predominant variability and the fair value approach would be used for FIN 46(R) computations. This approach would reflect the credit risk for assets from both portfolios, while only reflecting the interest rate risk associated with the fixed rate portfolio of assets.

26. Opponents to this view believe that it inappropriately excludes certain types of variability from the analysis and requires the use of a subjective determination that adds to the complexity of applying FIN 46R as well as reduces the consistency of the application of FIN 46R among evaluating entities. Other opponents observe that this view requires a review of a multitude of contracts that the VIE is a party to, which not all interest holders may have access to, as well as the requirement of frequent reconsideration events, which would make the approach non-operational and increasing the requirement to make multiple judgments in an already

complicated interpretation. These opponents also believe that this will lead to further inconsistency as well as auditability concerns for those evaluating entities.

STEP 2: APPLICATION OF THE APPROACH THAT MATCHES THE PREDOMINANT VARIABILITY

27. After analyzing a VIE and determining the nature of the predominant variability being transferred from the creators of variability for the VIE to the absorbers, an enterprise should select either the fair value approach (View A in the Issue Summary) or the cash flow approach (View B in the Issue Summary) for determining which interests are variable interests.

28. The alternative selected should be used not only for making the determination of what interests are variable interests, but also for the expected loss and expected residual return computation for the VIE and the determination of the identity of the primary beneficiary of the VIE. Interests that both create and absorb variability may only be considered on a net basis for the specific purpose of determining the predominant variability of the VIE as required by the application of most of the alternative approaches. These interests must be evaluated as either an absorber or a creator of the predominant variability in determining (a) whether the interest is a variable interest (that is, whether the interest absorbs the predominant variability in the VIE), (b) the expected losses and expected residual returns of the VIE, and (c) the primary beneficiary of the VIE. When determining which interests are variable interests, if the cash flow approach is used, a plain vanilla interest rate swap that pays the VIE a fixed rate and receives a floating rate from the VIE would be considered a variable interest for the counterparty due to its receive floating stream (absorber of cash flow variability) from the VIE, regardless of the pay fixed leg.

29. In developing a consistent model to be used by all constituents for identifying the predominant variability, additional questions that the Task Force may want to consider addressing are as follows:

Question 1. What is meant by predominant variability?

Some believe that predominant variability should be defined as the type of variability that is the overwhelming majority of the VIE's variability. These proponents believe that predominance is a much higher threshold to meet than majority, as it is expected to be significant enough to clearly identify the type of variability existing in the VIE. These proponents express concern with a simple majority because there will be many instances in which the computation of majority could be modified to arrive at a certain answer.

Others believe that predominant variability should be defined as a majority of the VIE's variability. These proponents believe that equating predominance to a majority is appropriate as it will ensure the usage of either the fair value approach or the cash flow approach, both of which are considered operational approaches to this issue. These proponents also observe that it is highly unlikely that whatever variability omitted from the analysis as a result of using the simple majority would have resulted in a different party being considered the primary beneficiary.

Still others believe that it is not necessary for the Task Force to define predominance as it is an accepted term and is commonplace in practice.

Question 2. What happens if there is no predominant variability?

(This question does not need to be answered if predominance is established at majority.)

Some believe that if there is no predominant variability in the VIE, a modified View C would be used when determining which interests are variable interests. Opponents of this view do not believe that a modified View C is operational and would therefore require that either View A or View B be selected. However, some proponents of the default to a modified View C counter this by observing that the use of a simple majority may require evaluating entities to perform an additional expected loss and expected residual return computation to determine predominance, which seems to be an unwanted complexity in the eyes of many.

Others believe that the evaluating entity can make an accounting policy election to use the fair value approach (or the cash flow approach) when neither variability is considered predominant. Proponents believe that this will increase consistency of approach by each entity.

Still others believe that if there is no predominant variability in the VIE, the nature of the operations of the VIE should dictate the approach used to determine whether interests are variable interests. This is an approach that is similar in some respects to View D2 previously described in this Supplement.

Question 3. How will predominance be determined?

Some believe that predominance can be determined by qualitatively assessing the activities the VIE is engaged in.

Others believe that if it is unclear what variability is predominant from a qualitative assessment, then an additional expected loss and expected residual return calculation for all instruments the VIE is a party to based on their variability created (cash flow or fair value) can be made. The determination could also be made by looking at the expected losses and expected residual returns of the interests absorbing variability, but the staff would expect both approaches to arrive at the same answer.

Still others believe that this determination could be made by comparing the fair value of the creators of fair value variability to the fair value of creators of cash flow variability.

Yet others believe that if it is unclear what variability is predominant from a qualitative or quantitative assessment, then there is no predominant variability and, as such, a modified View C should be applied.

30. Given the issues previously described and the questions listed above, the FASB staff would like the Task Force to address the following at the November EITF meeting:

- Address whether transactions that create and absorb the same amount and type of variability should be treated on a net basis as a creator of variability (that is, should at-the-money plain vanilla swap transactions be scoped out of the application of FIN46(R)?)
- Reach a tentative conclusion on View D to be considered with Views A through C at the March meeting
- Address what is meant by predominant
- Address what happens if there is no predominant variability
- Address how predominance will be determined.