

MINUTES



Financial Accounting Standards Board

To: Board Members
From: Consolidations Team
Subject: Minutes of the October 30, 2002 Board Meeting **Date:** November 11, 2002
Time Code A: CON-P
Cc: Bielstein, Smith, Petrone, Leisenring, Consolidations Team, Swift, Polley, Gabriele, Sutay, Thompson, Mahoney, Martin, Cassel, Wilkins, FASB Intranet

Topics: Transferees' Retained Interests, Special Provisions for Certain Entities that Hold Financial Assets, Silos, Equity Requirements, and Consolidation Procedures

Basis for Discussion: Staff memorandums dated October 8, October 18, October 21, October 22, October 23, and October 28, 2002

Length of Discussion: Starting Time: 1:00 p.m.
Concluding Time: 4:15 p.m.

Attendance:

Board members present: Herz, Crooch, Schipper, Trott, Wulff, Schieneman, and Foster

Board members absent: None

Staff in charge of topics: Lott and Coburn

Other staff at Board table: Smith, Tovey, and R. Richards

Outside participants: Leisenring (IASB)

MATTERS DISCUSSED, DECISIONS REACHED, AND FOLLOW-UP ACTION

The Board discussed the following matters:

1. Transferees' retained interests in transferred assets
2. The special provisions for certain entities that hold financial assets
3. The provisions of the proposed Interpretation related to silos of multiparty entities

4. The requirements for determining which entities are subject to the Interpretation
5. Intercompany eliminations and other consolidation procedures for enterprises applying the Interpretation.

The Board reached the following decisions:

1. The Board decided that transferors' retained interests should not be considered variable interests in transferee entities unless the transferred assets constitute all or substantially all of the entity's assets.
2. The Board decided to eliminate the special provisions for certain entities that hold financial assets (paragraphs 22 and 23 of the Exposure Draft). However, the Board also decided to retain the three conditions in paragraph 23 as a means to identify the primary beneficiary of an entity subject to the Interpretation. An enterprise that satisfies two of the three conditions would be the primary beneficiary. Enterprises that have the authority to purchase or sell assets for the entity and have sufficient discretion in exercising that authority to significantly affect the results of the entity's activities would undergo additional scrutiny in demonstrating that they do not satisfy either the second or third condition of that paragraph.
3. The Board decided not to extend the transferor's exemption under paragraph 8(a) of the proposed Interpretation to other parties with interests in a qualifying SPE. A party other than the transferor might be required to consolidate a qualifying SPE if it holds an interest that would not require the transferor to consolidate.
4. The Board decided to modify the provisions of paragraph 17 to require treatment of portions of an entity as separate silos only if an enterprise's rights and obligations relate to specific assets and liabilities. The proposed Interpretation would have required that same treatment even if liabilities were not specifically associated with specific assets.

5. The Board decided to retain the presumption that an equity investment of less than 10 percent is insufficient for an entity to finance itself. The Board decided to replace the provisions of paragraph 12 for overcoming that presumption with a discussion emphasizing the overriding principle that an entity must be able to finance its activities and include certain indicators that would support that principle.

The Board requested that the staff provide examples to facilitate discussion of consolidation procedures at its November 6, 2002 Board meeting.

DISCUSSION

Transferors' Retained Interests in Transferred Assets

A majority of Board members agreed that transferors' retained interests should not be considered variable interests in transferee entities unless the transferred assets constitute all or substantially all of the entity's assets. They reasoned that transferors' retained interests relate only to the transferred assets, not the entity itself, and that, if transferors' retained interests are variable interests, it will be difficult to compare those interests with variable interests that relate to the entire entity. The Board stated that, in situations where the transferred assets constitute all or substantially all of the entity's assets, transferors' retained interests should be considered variable interests in transferee entities because the transferred assets and the assets of those entities are virtually indistinguishable. Messrs. Herz, Crooch, and Schieneman dissented.

The Board voted unanimously that a transferor would not have a variable interest in an entity that holds beneficial interests in assets transferred to a qualifying SPE. The Board reasoned that holding beneficial interests in an entity holding the transferred assets is fundamentally different from holding the transferred assets.

Identifying the Primary Beneficiary

The Board decided to eliminate the special provisions for certain entities that hold financial assets (paragraphs 22 and 23 of the Exposure Draft), but retain the three conditions in paragraph 23 as a means of identifying the primary beneficiary. The Board reasoned that provisions in paragraph 22 did not achieve their original purpose of identifying entities that effectively disperse risks and had the potential to become a high-maintenance quagmire. The Board stated that the conditions in paragraph 23 should be retained because they are useful in identifying enterprises with interests similar to traditional equity investors—the ability to control, exposure to downside risk, and claims to the residual benefits of the entity.

An enterprise that satisfies two of the three conditions from paragraph 23 would be the primary beneficiary. The Board decided that enterprises that have the authority to purchase or sell assets for entities subject to consolidation based on variable interests should undergo additional scrutiny in demonstrating that they do not satisfy either the second or third condition. The Board reasoned that the ability to control an entity's activities is the strongest indicator of a controlling financial interest and that, typically, only one party controls those activities.

Paragraph 8(a) Exception for Transferors to Qualifying SPEs

A majority of Board members decided not to extend the transferor's exemption in paragraph 8(a) to other parties with interests in a qualifying SPE. Thus, a party other than the transferor might be required to consolidate a qualifying SPE if it holds an interest that would not require the transferor to consolidate. The Board reasoned that it did not want to increase the frequency of nonconsolidation, especially in circumstances where a single party holds a majority of the variable interests in a qualifying SPE (i.e., a third party purchases a transferor's interest in the entity).

Silos of Multiparty Entities

A majority of Board members voted in favor of modifying the provisions in paragraph 17 to require treatment of portions of an entity as separate silos only if an enterprise's rights and obligations relate to specific assets and liabilities.

Those in favor of modifying paragraph 17 stated that the modification would eliminate the problem of consolidating undivided liabilities and result in improved accounting for multi-lessee entities where each lease transaction involves separate assets and liabilities with little or no cross-collateralization. Mr. Foster stated that he would prefer to eliminate paragraph 17 altogether.

Equity Requirements

A majority of Board members decided to retain the presumption that an equity investment of less than 10 percent is insufficient for an entity to finance itself but to replace the provisions for overcoming that presumption with a discussion emphasizing the overriding principle that an entity must be able to finance its activities. Certain indicators to support that principle will also be included. For example, an entity's demonstrable ability to finance its operations with less than 10 percent equity and no additional financial support would overcome the presumption. The Board decided that entities should not be required to reconsider equity sufficiency at each reporting date; they should reconsider only when certain triggering events occur.

SUMMARY FOR ACTION ALERT

Same as Matters Discussed...

GENERAL ANNOUNCEMENTS

None.