

September 13, 2013

Susan M. Cospers  
Technical Director  
Financial Accounting Standards Board  
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P.O. Box 5116  
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Via email: [director@fasb.org](mailto:director@fasb.org)

**Re: Proposed Accounting Standards Update (Revised), *Leases (Topic 842)* (File Reference No. 2013-270)**

Dear Ms. Cospers:

This letter represents the comments of certain members (see list on page 6) of the Asset Management Industry Accounting Policy Group (“AMIAPG”), comprising a forum of companies primarily engaged in the asset management business. The AMIAPG companies represented by this letter include both publicly traded and privately held asset managers who, as of June 30, 2013, collectively manage more than 5,700 investment funds, both domestically and internationally, including registered investment companies, hedge funds, private equity funds, exchange-traded funds and collective investment trusts, in addition to separate accounts and other sponsored investment products. The companies represented by this letter collectively have subsidiaries registered as investment advisors, broker-dealers, trust banks and insurance companies, and oversee approximately \$7.7 trillion of assets under management as of June 30, 2013.

We appreciate the opportunity to provide comments to the Financial Accounting Standards Board (the “FASB” or the “Board”) on the Proposed Accounting Standards Update (Revised), *Leases (Topic 842)* (the “Proposed ASU”). We support the Board’s objective to improve the financial reporting of leasing activities in light of criticisms that the existing accounting model for leases fails to meet the needs of users of financial statements and we commend the level of effort that the Board and FASB Staff have contributed to this endeavor over the past several years. We also commend the Board’s progress towards achieving convergence with the International Accounting Standards Board (“IASB”) in this area.

We have significant concerns, however, that the Proposed ASU falls short of attaining the initial objective of the project. The proposed model is highly complicated and, in our view, would fail to be responsive to financial statement users’ requests for more decision-useful information regarding leasing activities. We urge the Board to perform additional outreach with financial statement users in an effort to address the growing number of opinions being expressed recently that the proposed model provides no improvement over current GAAP. While we agree with the view that leases convey certain rights and obligations that may meet the definition of assets and liabilities under GAAP, we continue to believe that the cost and effort that will be expended to implement and maintain the guidance in the Proposed ASU far outweigh any benefits to users (particularly with respect to noncore leases which are ancillary to the revenue generating process). This view is consistent with comments submitted by AMIAPG members in response to the FASB’s August 2010 Exposure Draft on Leases (e.g., letters #305, #569 and #598).

However, to the extent the FASB and the IASB continue to proceed with the guidance as outlined in the Proposed ASU, we believe there are a number of areas that would benefit from revisions or further consideration in order to better balance the usefulness of the financial statements with the costs to comply with the Proposed ASU. The main areas for suggested revision include:

- I. Adjustments for changes in index rates;
- II. Transition;
- III. Determination of the discount rate;
- IV. Related party leases; and
- V. Executory costs.

While this letter does not respond to all of the questions posed to users in the Proposed ASU, we have provided our views on Questions 6 and 7 as these are most relevant to our concerns.

## I. **Adjustments for Changes in Index Rates**

**Question 6: Do you agree with the proposals on the measurement of variable lease payments, including reassessment if there is a change in an index or rate used to determine lease payments? Why or why not? If not, how do you propose that a lessee and a lessor should account for variable lease payments and why?**

We generally agree that variable lease payments that depend on an index or rate should be included in the measurement of the lease liability since these costs are unavoidable to the lessee, despite their uncertainty. We also agree with the Board's view that implementing a probability-weighted average approach for variable lease payments based on usage or the performance of the asset would be too costly and would introduce significant complexity and profit and loss volatility. However, the proposal to reassess the variable lease payments whenever the underlying rates or indices change could result in additional costs and complexities for amounts that are not meaningful to financial statement users. We suggest the Board consider either including a statement that reassessment of the lease liability is required only when changes in the index or rate would have a significant impact on the financial statements or requiring a reassessment of the lease liability only when changes in an index or rate result in a contractual change in cash flows (i.e., upon contractual reset of the index or rate).

Additionally, we note paragraph 842-10-25-3a in the Proposed ASU states that changes in market-based factors (such as market rates to lease a comparable asset), shall not, in isolation, trigger reassessment of the lease term. We suggest the Board clarify that, similarly, market-based factors are not considered as an index or rate when assessing variable lease payments as defined in paragraph 842-20-30-3b in the Proposed ASU. That is, we do not believe that a change in lease payments as a result of a change in market-based factors (e.g., market rentals) should result in a reassessment of the lease payments. Accordingly, we propose the following language be added to the end of paragraph 842-20-30-3b; "Other changes in market-based factors (such as market rates to lease a comparable asset) shall not result in a change in the lease liability."

## II. Transition

**Question 7: Transition - Subparagraphs 842-10-65-1(b) through (h) and (k) through (y) state that a lessee and a lessor would recognize and measure leases at the beginning of the earliest period presented using either a modified retrospective approach or a full retrospective approach. Do you agree with those proposals? Why or why not? If not, what transition requirements do you propose and why?**

**Are there any additional transition issues the Boards should consider? If yes, what are they and why?**

We generally agree with the proposed guidance that allows an entity to use a modified retrospective approach or a full retrospective approach, which would require entities to apply the new accounting rules at the commencement of each lease, so as to provide comparative financial information across a number of fiscal years. While we agree with the provision, we believe adequate transition time will be necessary to implement the new guidance.

We are concerned with the practicability of gathering and maintaining the information necessary to account for each existing lease arrangement under a full retrospective approach. This approach will result in a significant effort that will be that much more challenging for lease arrangements with long durations. We believe that the administrative and technical complexity of the Proposed ASU will require a minimum transition period of three to five years from the issuance of the final ASU to allow financial statement preparers time to (1) gather the necessary information, (2) analyze all types of contracts, including those that may not be lease contracts but which may contain lease components and (3) fully integrate changes to current accounting, treasury, leasing, legal, procurement and tax processes and systems.

Among the more significant complexities is the process of identifying all existing lease contracts (as defined by the Proposed ASU), particularly noncore leases, which are typically not centrally managed. Reviewing all of the identified lease arrangements for service components, other ancillary services or other potential clauses that could change the current accounting will be time-consuming and burdensome from a financial and administrative perspective. Additionally, we expect that the requirement to calculate each lease liability will take significant time due to the need to determine either the rate that the lessor charges the lessee or the entity's incremental borrowing rate for debt with similar terms and collateral for each lease to determine the incremental borrowing rate to be used in measuring the lease liability. Among the firms providing commentary within this letter, which are still in the process of inventorying the variety of contracts entered into to determine whether the contracts include lease arrangements, we preliminarily estimate that a collective total of approximately three thousand contracts (for the six firms represented in this letter) will need to be reviewed in order to comply with the Proposed ASU.

Financial statement preparers will need time to customize, develop or purchase systems that can warehouse all types of leases and the information required to generate the necessary accounting entries. In addition, the requirement to reassess the lease term each reporting period will require the development of internal controls over financial reporting even if materiality thresholds are developed for reporting purposes. Preparers will need to be able to determine that both the initial lease obligation and any adjustments each reporting period are, in fact, immaterial and, therefore, materiality will not provide substantial relief from the cost and effort of implementing and maintaining the accounting guidance contained in the Proposed ASU.

### III. **Determination of the Discount Rate**

Under the Proposed ASU, the discount rate used in the determination of a lessee's right-of-use asset and related lease liability is the rate implicit in the lease, or, if the rate is not identifiable, the lessee's incremental borrowing rate. The Proposed ASU defines the incremental borrowing rate as the rate at which the lessee could borrow a similar amount for the same term, *with a similar asset pledged as collateral*.

Under the current guidance, a lessee's incremental borrowing rate is defined as the rate the lessee would have incurred to borrow the funds necessary to purchase the leased asset over a similar term. In practice, many entities estimate this rate using the current risk-free rate or their incremental borrowing rate if the lessee does not have the necessary information to quantify the rate implicit in the lease. We believe the current definition of incremental borrowing rate more accurately reflects the nature of lease transactions, in that most entities are not typically required to provide collateral or similar securities in order to borrow the funds necessary to acquire an asset. Accordingly, we suggest the FASB retain the current definition of incremental borrowing rate, which does not require the consideration of a secured borrowing.

### IV. **Related Party Leases**

The Related Party Leases (FASB Only) section within the Summary and Questions for Respondents on page 9 of the Proposed ASU states that the FASB decided that the recognition and measurement requirements for leases between related parties should be based on the legally enforceable terms and conditions of the leases, acknowledging that some related party transactions are not documented and/or the terms are not necessarily at arm's length. This decision is not documented within the text of the Proposed ASU, but is instead summarized in the Basis for Conclusions (BC293 and BC331). We recommend language be added to the Accounting Standards Codification, as the Basis for Conclusions is not codified within US GAAP.

Additionally, we note that the example in 842-30-55-7 through 55-20 utilizes two interest rates for imputing interest income as a lessor (as the result of initial direct costs): 1) an imputed interest rate applied to the lessor's lease receivable and 2) the rate implicit in the lease applied to the residual asset. A lessee for that same lease would apply only one rate to impute interest expense on its lease liability. We question whether, in the case of leases between entities under common control, this treatment could result in a difference between the lessor's interest income and the lessee's interest expense in elimination and, if so, whether this was the Board's intent.

## V. **Executory Costs**

We request the Board clarify the treatment of executory costs (e.g., taxes, maintenance, insurance) related to leased property and equipment. The Proposed ASU requires nonlease components to be excluded from lease payments when calculating the lease liability and right-of-use assets; however, because the guidance does not define nonlease components, it is unclear whether executory costs should be excluded when calculating the lease liability and the right-of-use asset. ASC 840-10-15-17 (Leases) is clear that executory costs are treated similarly to other nonlease elements and excluded from the classification, recognition, measurement and disclosure requirements of ASC 840. Therefore, we request that the Board define nonlease components within the Proposed ASU and include executory costs in the definition.

## VI. **Other Considerations**

We are also concerned with the implications of the Proposed ASU on the regulatory environment in which our firms operate. A number of firms that comprise the AMIAPG have broker-dealer and banking subsidiaries that are required to maintain minimum capital requirements and capital ratios that are closely monitored by regulators such as the SEC. For example, the net capital calculation and maximum debt-to-equity ratio for broker-dealers required by SEC Rule 15c3-1, *Net Capital Requirements for Brokers or Dealers*, may be adversely affected as a result of additional lease liabilities recorded on the balance sheet. If the right-of-use assets are classified as intangible assets and receive nonallowable treatment in the capital requirements (similar to the current treatment of fixed assets), net capital calculations and debt-to-equity ratios may be adversely affected. These changes may force a significant capital contribution to the broker-dealer subsidiary in order to ensure sufficient capital requirements. Banking institutions also are required to meet certain capital requirements and ratios which may also be adversely affected as a result of the Proposed ASU. We request the Board work closely with the regulators to consider the implications on the regulatory requirements of the businesses in which we operate.

In addition, we are concerned with the income tax implications of the Proposed ASU on reporting entities. For example, under the current guidance, the depreciation of fixed assets subject to capital lease is tax-deductible. Further, reporting entities may also be allowed to deduct the full carrying value of certain leased assets pursuant to section 179 of the IRS Tax Code. Under the Proposed ASU, reporting entities will no longer recognize such assets and, instead, will recognize a right-of-use asset on its balance sheet. It is currently unclear as to how the amortization of the right-of-use asset will be treated for income tax purposes. Accordingly, we recommend the Board consider the possible income tax implications resulting from the Proposed ASU and work with the IRS to determine if any changes to the existing tax rules are warranted as a result of the Proposed ASU.

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We appreciate the opportunity to provide comments on the Proposed ASU. Should you have any questions, please feel free to contact any of the representatives below.

|  |                                |                |
|--|--------------------------------|----------------|
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| /s/ Ann M. Cavanaugh,<br>Managing Director – Global Accounting Policy                | BlackRock, Inc.                | (212) 810-5467 |
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| /s/ Leah A. Kwartler,<br>Vice President, Accounting Policy and Standards             | Fidelity Investments           | (617) 392-2692 |
| /s/ Elaine Sabatino,<br>Vice President – Accounting and Financial Reporting          | Franklin Templeton Investments | (650) 312-3239 |
| /s/ Timothy J. Lorber,<br>Director, Head of Accounting Policy and Corporate Controls | Legg Mason, Inc.               | (410) 454-2839 |