North American Regional Management

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Financial Accounting Standards Board 401 Merritt 7 P.O. Box 5116 Norwalk, CT. 06856-5116

Subject

EXPOSURE DRAFT: "CONSOLIDATED FINANCIAL STATEMENTS: POLICY AND PROCEDURES"

## Dear Gentlemen/Ladies:

Union Bank of Switzerland ("UBS") is one of the largest banks in the world and the largest Swiss bank. It offers a full range of financial products and services to clients around the world acting as principal or agent. UBS remains one of only a few AAA/Aaa-rated financial institutions.

The primary reporting framework for UBS is Swiss GAAP, which relies on International Accounting Standards in many respects. However, certain of our operations do report under US GAAP. Further, inasmuch as US GAAP is so highly developed, we rely on its guidance for our non-US GAAP reporting in many areas as well. Our future financing plans may include accessing the US capital markets. Last, many of our clients report under US GAAP, and accounting results may have an impact upon their decisions about whether to complete certain transactions, especially highly structured transactions. Accordingly, we have an interest in the development and promulgation of accounting standards in the US.

We agree that there is potential for improvements in the current standards for consolidation. However, we believe that the Exposure Draft (ED) presents several significant concerns:

- The concept of effective control is unwieldy at best, and may result in contradictory positions in practice.
- The ED does not consider adequately the fiduciary duties of an "effectively controlling" entity.
- The concept of "Effective Control" diverges radically from international practice.

Additionally, UBS is a market leader in securitization in the U.S. and globally. UBS has been a key securitization player since the market began in 1985 when UBS enhanced the first publicly traded asset-backed securities. UBS now ranks as a top arranger, underwriter, enhancer, trader and support provider for asset-backed transactions and is one of the largest sponsors of asset-backed multi-seller conduits with over \$5.6 billion, of programs. This market operates efficiently under the current standards. This letter requests that any final consolidation standard (i) does not require consolidation of the various types of special purpose entities (master trusts, owner trusts, or special purpose corporations, including multi-seller conduits) currently used in securitizations with the parties who have sold assets to such entities or who administer such entities and (ii) will not negate valid transfers of financial assets as contemplated by the Exposure Draft, entitled: "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities" (the "Transfer Draft").

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#### **Effective Control**

The Exposure Draft provides that "effective control" of an entity, rather than "legal control" of such entity, should be the primary determinant for consolidation purposes. We believe this approach is not viable for several reasons, each of which is discussed in more detail below:

- 1) the determination of effective control requires a Parent to make assessments about the probable inaction of other stakeholders in a Subsidiary (or entity with potential to be classified as a Subsidiary).
- 2) it appears possible that effective control of a Subsidiary might be held by a Parent even though legal control might be held by another entity.
- 3) the discussion of control over another entity's assets (see paragraph 11 of the E.D.) does not adequately consider the flduciary duties of a controlling shareholder, and may conflict with the definition of an asset in paragraph 25 of FASB Statement of Concepts No. 6.

The existing objective standard permits users of financial statements (both creditors and equity investors) to understand the legal rights associated with the ownership control position. Because of the factors listed above, however, the Exposure Draft would set a more subjective standard which may give rise, in practice, to inconsistent results under identical sets of facts. Under these circumstances, reliability, relevance and comparability are not well served. There would be cost considerations in the restatement of financial reports as well as investor resources necessary to properly evaluate the financial statements of an entity that includes "effectively controlled" Subsidiarles in its consolidated financial statements.

### Assessments about other stakeholders:

The discussion about effective control, especially paragraph 14, is disturbing because actions of others can lead to a requirement for an investor to consolidate or to cease consolidation of another entity. This is true even if the investor (the potential Parent) takes no action and has no change whatsoever in its degree of legal ownership. For example, consider the facts set forth in footnote 2 to paragraph 14 of the ED. If other investors fail to vote at a particular meeting, a 25% investor could be required to consolidate. If a minority shareholder were to then excite the interest of and to organize other shareholders in advance of a subsequent meeting, the 25% investor could easily lose its "effective control", and be required to cease consolidation. We believe that "control" which can be thrust upon and/or wrested from an investor, with no change in the investor's legal ownership interest, is no control at all. Indeed, some forms of "effective control" described in the ED may be considered at most to be temporary.

# Effective control when another entity has legal control:

Assume the following:

- a parent forms a wholly owned subsidiary, financed partly with parent provided secured debt and partly with equity
- the parent and subsidiary transact business for a period of years, entering into contractual relationships covering a substantial, but less than 50%, volume of the subsidiary's output
- the parent then sells a 51% equity interest in the subsidiary to a third party on an arm's length basis, for cash
- the resulting shareholders' agreement provides for cumulative voting in, among other matters, election of directors

Under these circumstances, substantially all of the indicators in paragraph 158 would be present for the 49% shareholder. If that shareholder is deemed to have "effective control", the 51% shareholder would be precluded from consolidating. (See also "Clearer guidance needed" below.)



### Fiduciary duties:

Paragraph 11 discusses situations in which an entity might direct the use of another's assets toward its own operations, use another's distribution network, etc. Clearly, such types of control could give an entity significant competitive advantages. However, the exercise of such control must consider the rights of all shareholders. The resulting economic benefits must accrue to all shareholders proportionately. If an entity exercises control over another's assets in such a way as to benefit itself, but at the same time, such use of assets is the highest and best use for the benefit of all shareholders, no breach of fiduciary obligations has occurred. Nonetheless, the fiduciary obligation has reduced or removed the control that exists in a pure ownership situation. In such a case, the economic benefits are owned by all the shareholders. There is no question that there are assets to be recognized, but to include such assets on the balance sheet of the "effectively controlling" entity would mislead users of financial statements as to the degree of such control, and about the probable future economic benefits that actually accrue to the benefit of an "effectively controlling" shareholder that observes its fiduciary duties.

# Clearer guidance needed:

If the Board persists in the direction indicated by the ED, it should at least consider including much clearer guidance in the final pronouncement. As currently written, the guidance is so broad that we believe it could lead to substantial diversity in practice, as similar or identical sets of facts result in different conclusions among preparers of financial statements.

### International Considerations:

As an international financial institution, UBS is exposed to the differing accounting standards around the world. The Exposure Draft diverges substantially from current international standards and will make international commerce, credit review, consolidated results, and other reporting more difficult and expensive. It could, furthermore, discourage foreign entities from listing their securities in the U.S.

# Securitization Separates Control:

The Exposure Draft defines control as "power over its assets - power to use or direct the use of the individual assets of another entity in essentially the same ways as the controlling entity can use its own assets."

Control, as defined, is exclusionary so no other entity can control the use of the assets. Given that assets are no longer within the control (as defined in the Exposure Draft) of the originating entity after being transferred into a securitization, the securitization entity should normally not be consolidated with the transferring entity. A clarifying comment in any final standard to this conclusion is requested.

In some securitizations, assets, interests in assets or asset-backed obligations ("Assets") are sold to a special purpose corporation ("SPC") which buys such Assets from various sellers. These investing SPC's are called "multi-seller conduits". With these transactions, the asset-originating entity cedes control over the assets to the conduit. The conduit's day-to-day activities are normally managed by a financial institution pursuant to an administration contract with the conduit. The ultimate management and control over the conduit resides in the third parties who own the conduit's equity. This is evidenced by the conduit owners' ability to fire the administrator, approve transactions, set policies, etc. Under such circumstances, the Exposure Draft states in Paragraph 161 that such conduits should not be consolidated with an administrator. We agree that this is the most accurate approach.

Paragraph 14f notes that owning a sole general partnership in a limited partnership ("GP/LP") is evidence of control. A GP/LP used in a securitization should not warrant that securitization vehicle's consolidation with the GP. A GP/LP is used in order to assure the desired tax result for a securitization (i.e., taxable as a partnership rather than as a corporation, thereby avoiding double taxation). It is not an operating partnership. The partnership does not give the GP any more control than what is negotiated in the securitization documentation and such control may be significantly limited. Since the GP can not gain control in this structure, consolidation should not apply.



Because of the concerns expressed previously about the clarity of the guidance in the ED, we would request that specific guidance excluding securitization SPC's from consolidation be incorporated in any final statement.

### Conflict with Transfer Draft

The Transfer Draft is now being considered and is concerned with recognizing sales of assets, the nature of asset transfers within securitization structures (including the roles of SPC's and other vehicles used to isolate the securitized assets from the originating entity) and other related matters. We respectfully suggest that the ED and the Transfer Draft be reviewed together closely to ensure that the objectives of the Transfer Draft are not negated by the provisions of the ED.

#### Conclusion

The Board notes in Paragraph 48 that any accounting standard should fill a significant need and that the costs imposed to meet that standard, as compared with other alternatives, are justified in relation to the overall benefits of the resulting information. Following in Paragraph 54, the Board notes that consolidated financial statements should be helpful to lenders and investors and that such statements about that entity's total economic resources and activities is essential to a fair assessment of its performance.

Accounting concepts require that they serve the public interest by providing structure and direction to financial accounting and reporting in order to facilitate the provision of evenhanded financial and related information. Such information should be useful in assisting the capital and other markets to function efficiently in allocating scarce resources in the economy. Although optimal financial information for one user may not be the optimal information for another, the information must be relevant, reliable, comparable and consistent, material, and cost effective. We believe the comments provided above will help to ensure that these goals are met.

Representatives of UBS plan to attend the public hearing on the Exposure Draft: "Consolidated Financial Statements: Policy and Procedures" scheduled for February 20 and 21, 1996, and would welcome the opportunity to speak at those hearings. Please contact the undersigned if you are able to accommodate this request, or if you wish any clarification to our comments. Thank you for your consideration.

Very truly yours,

Union Bank of Switzerland

Robert B. Mills Managing Director

Chief Financial Officer