



**BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM**  
WASHINGTON, D.C. 20551

**DIVISION OF BANKING  
SUPERVISION AND REGULATION**

September 24, 2002

Ms. Suzanne Bielstein  
Director of Major Projects and Technical Activities  
Financial Accounting Standards Board  
401 Merritt 7  
P.O. Box 5116  
Norwalk, CT 06856-5116

Re: File Reference No. 1082-200

Dear Ms. Bielstein:

The staff of the Federal Reserve Board is pleased to respond to the Financial Accounting Standards Board's (FASB's) Proposed Interpretation, *Consolidation of Certain Special-Purpose Entities, an Interpretation of ARB No. 51*. The Federal Reserve, as the central bank of the United States and a supervisor of banking organizations, has long advocated transparency and high-quality accounting as a means of promoting discipline in financial markets. In our view, market discipline is improved when participants can make more informed decisions. We believe that market discipline promotes and fosters efficient allocation of capital and is a significant complement to effective bank supervision. The foundation of transparency is financial reporting that is relevant and reliable. Thus, continual improvement to accounting principles and disclosure enhance the efficiency of capital markets and the safety and soundness of the financial sector.

**Executive Summary**

We congratulate the FASB for so quickly drafting proposed guidance to address the ambiguous accounting treatment of special purpose entities (SPEs) after recent events demonstrated that significant risks could be concealed within them. Some companies have exploited these ambiguities in generally accepted accounting principles (GAAP) to create entities over which they have effective control, but where legal control lies in the hands of others in order to avoid consolidation in their financial statements. By orchestrating purportedly arm's-length transactions through these surrogates, certain companies were able to distort their risk profile to investors and other stakeholders.

Accordingly, Board staff supports more stringent consolidation standards that better reflect activities involving SPEs. We broadly support the Proposal's concept of variable interests as a means for determining which enterprise is the primary beneficiary of an SPE when effective control diverges from voting control. We also agree with FASB's view that, as indicated in the Proposal's Summary, SPEs effectively disperse risk should generally not be consolidated.

as indicated in the Proposal's summary, SPEs that effectively disperse risk should generally not be consolidated. We are hopeful that the Proposal will significantly dampen opportunities to engineer consolidation through allocations of voting rights that meet the letter of current standards of accounting but that distort companies' risk profiles presented in their financial reports.

While we find the Proposal potentially beneficial in improving transparency, Board staff has suggestions that we believe could further enhance representational faithfulness in accounting for SPEs. We recognize that some concepts in the Proposal are new, such as variable interests, and are likely to raise a number of implementation questions that may be answered after the Proposal is final. We encourage the FASB to consider our observations and comments as it makes its final deliberations on the Proposal. In summary, our comments are as follows:

1. In its current form, the Proposal's stricter consolidation requirements could have a significant effect on the financial statements of banking organizations and other providers and users of credit. Firms that use SPEs may need to alter their financing arrangements. FASB should give serious consideration to providing (i) an adequate transition period for adopting consolidation of the SPEs that now exist, or (ii) grandfather provisions for certain transactions, where warranted.
2. The Proposal's definition of SPE is ambiguous and needs clarification.
3. In some cases, the Proposal would allow enterprises too much latitude to structure entities (even high-risk SPEs) in ways that would avoid consolidation.
4. In other situations, the Proposal seems to result in "over-consolidation," that is, a company could be required to consolidate SPEs in which (i) risks and rewards have either been well dispersed among a large group of stakeholders or (ii) other interest holders, in the aggregate, hold more risk than the company.
5. The FASB's final guidance should be strengthened to include more comprehensive disclosure requirements for companies connected with SPEs.

More detailed comments are provided on page 4.

### **Background and Summary of the Proposal**

We understand that consolidation in accounting follows the straightforward principle that financial reporting should not materially differ for an enterprise that operates either as a single corporate entity or as a group of commonly controlled corporations. Whether a company is to be included as part of a controlled group generally depends on majority ownership of its voting equity by parent and affiliate companies. This criterion for consolidation has been satisfactory for most operating companies, where it presents a complete picture of the enterprise's financial position and performance. The effectiveness of this criterion tends to break down, however, for certain entities in which contractual arrangements lead to effective control and risks and rewards

of ownership that diverge from voting control and, thereby, transfer substantive control from voting shareholders into the hands of another stakeholder. This aspect has been addressed only haphazardly in the accounting literature and enterprises have been inconsistent in applying the available guidance to specific SPE transactions. FASB intends to bring greater consistency and rigor to the consolidation of SPEs with the Proposal and introduces new concepts for evaluating an enterprise's connection with an SPE.

The Proposal defines an SPE indirectly, by contrasting it with substantive operating entities (SOEs). An SOE conducts business other than that performed for it by an SPE, has employees, and has sufficient capital to fund itself without support from anyone other than its owners. The Proposal also introduces a new concept, variable interests, for purposes of evaluating whether an enterprise should consolidate an SPE. Variable interests are defined as the means through which financial support is provided to an SPE and through which providers gain or lose from activities and events that change the values of the SPE's assets and liabilities. Variable interests are further defined as subjecting the holder to a risk of losing an investment in the SPE or incurring a loss as a result of a contingent obligation to transfer assets or issue securities to the SPE. Contracts to provide services to an SPE in return for a fee negotiated at arm's length under competitive conditions (a market-based fee) are not variable interests unless the holder also has an investment at risk or can be required in certain circumstances to transfer assets or issue its own equity or debt instruments to the SPE or a party with an interest in the SPE. Fees, however, are presumed to be not market-based, unless it can be demonstrated to be comparable to fees in similar observable arm's length transactions or arrangements.

Under the Proposal, if an SPE has a substantial amount of voting equity and meets certain other criteria, only an enterprise having the majority of the voting equity interests must consolidate the SPE. SPEs that do not meet the substantial voting equity criteria are evaluated for consolidation based on a variable interest analysis or, for SPEs holding certain financial instruments and meeting other criteria, under the Proposal's Financial SPE (FSPE) test. Under the variable interests approach, the enterprise that is identified as an SPE's primary beneficiary must consolidate the SPE. The primary beneficiary holds either the majority of variable interests or a significant portion that is significantly more than the variable interests held by any other individual party. Variable interests in an SPE are to be compared according to the expected future losses from the interests. Enterprises that have variable interests with similar expected losses are to evaluate subordination and risk characteristics of the others' variable interests to determine which owner is the primary beneficiary and, thus, must consolidate the SPE.

An FSPE is defined in the Proposal as a qualifying SPE as set forth in SFAS 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, except that an FSPE cannot hold equity securities and is not restricted to acquiring assets only by transfer from a transferor nor subject to restrictions on asset sales. An enterprise involved with an FSPE is deemed to provide significant support through a variable interest if two of three conditions apply: (i) the enterprise has authority to buy and sell assets for the SPE; (ii) the enterprise provides credit or liquidity support to the SPE; and (iii) the enterprise receives a non-market-based fee from the SPE. Where significant support exists, the enterprise must consolidate the SPE.

With respect to disclosure, the primary beneficiary of a consolidated SPE is required to state the amount of assets of the SPE serving as collateral for the SPE's debts. If creditors of a consolidated SPE do not have recourse to the primary beneficiary, that fact is to be disclosed. An administrator of an SPE that is not also a primary beneficiary is required to disclose the amount of assets and liabilities of SPEs it services and describe the purpose of the SPEs.

## Specific Comments

### **1. Transition**

The consequences of adopting the Proposal are difficult to estimate. We believe, however, the Proposal could have a significant effect on the financial statements of banks and other firms, and cause firms that now use SPEs to alter their financing arrangements. For example, some banks may be required to report a significant increase in assets and liabilities, and this could have adverse effects on regulatory capital ratios. Borrowers may report worsened debt-equity ratios and other measures of financial leverage that put them in default of credit agreements. Accordingly, if the Proposal is adopted in current form as authoritative GAAP, affected organizations may experience disruptions that raise the cost of credit or, possibly, restrict its availability unless FASB permits time for an orderly transition. We encourage FASB to give serious consideration to providing (i) an adequate transition period to adopting consolidation of the SPEs that now exist, or ii) grandfather provisions for certain transactions, where warranted.

### **2. Defining a Special Purpose Entity**

The Proposal has a vague definition of what constitutes an SPE. FASB seems to define the term by stating little more than an SPE is not an SOE. For example, the Proposal states that an SOE conducts business operations different from those performed for it by an SPE. This implies that an SPE can engage in a business, which does not fully accord with our understanding of how GAAP currently defines an SPE. It also strikes us that some entities that we believe to be SPEs, such as those used to book trading transactions, may not be SPEs under the Proposal since the administrator engages in the same business.

The definition also states that an SOE has adequate capital to operate without additional support, yet an SPE that is consolidated according to voting interests also has a similar capital requirement. Thus, this characteristic does not readily distinguish SPEs from SOEs. This leaves SPEs not having employees as the distinguishing characteristic in the Proposal's definition. This criterion, however, could be met by an SOE that arbitrarily assigns staff to its SPE.

Board staff believes that the Proposal's definition of what constitutes an SPE needs more work. If this definition is carried forward, it will lead to many implementation questions. We are concerned that companies entering into ordinary commercial transactions with customers will likely need to carefully evaluate whether their counterparty is an SPE (and, hence, whether their transaction is a significant variable interest).

likely need to carefully evaluate whether their counterparty is an SPE (and, hence, whether their transaction with an SPE gives rise to a significant variable interest under the Proposal).

Example 1: Consider loans to highly leveraged borrowers such as management buy-outs, real estate loans to limited partnerships, and working capital lines to real estate investment trusts. The first borrower appears to be an active business while the rest are passive entities that hold real property. All are thinly capitalized and might meet the Proposal's definition of SPE. If so, the lender has variable interests in each that, if a substantial variable interest, would require the lender's consolidation.

We find the SPE definition vague and not entirely satisfactory in its current form. Additional criteria are needed to ensure that the financial reporting of SPEs has fidelity with the economic substance of the underlying transactions. We are concerned that if the definition is too vague, companies and their auditors will evaluate ordinary transactions such as the loans in the example to determine whether they are dealing with an SPE and, if so, evaluating their variable interest for significance (as required by the Proposal). We encourage FASB to review whether the definition can have more precision, so that it is neither overly broad nor too narrow.

### **3. Latitude for Enterprises to Engineer Entities that Avoid Consolidation**

In Board staff's opinion, the Proposal appears to create two clear opportunities for companies to plan the outcome of consolidation, despite a majority of variable interests being owned by one party. These two opportunities can arise from (i) when a SOE agrees to consolidate an SPE and (ii) elective criteria that permit an enterprise to qualify as an FSPE.

#### ***Substantive Operating Entities***

The Proposal permits an enterprise to avoid consolidation of an SPE if another SOE elects to consolidate the SPE. This appears to create an opportunity for companies that structure SPEs to determine the consolidation accounting result, regardless of who holds either a significant or majority variable interest. We are certain this was not FASB's intent in developing the Proposal, but if a final rule contains this provision, we fear liberal interpretation by companies could allow existing problems in accounting for SPEs to continue.

#### ***FSPEs***

A sponsor who places equity securities in an SPE disqualifies the entity from being an FSPE. It appears to us that companies could intentionally structure an SPE to fail being an FSPE by contributing nominal amounts of equity securities to the SPE. Companies could later remove the equity securities from the SPE (hence qualifying the SPE as an FSPE) if a more favorable consolidation treatment could be achieved under the FSPE consolidation approach. We are uncertain why FASB included this prohibition. We do not immediately see what benefit companies might gain by manipulating qualification as an FSPE in this way, but nevertheless we raise the issue for FASB's consideration.

#### **4. The Proposal Appears to Overly Favor Consolidation In Some Cases**

Some companies interpret the current GAAP requirements for consolidation liberally enough to operate SPEs that amount to *alter egos*. It is clear to Board staff that these opportunities to distort financial reporting need to be eliminated. By the same token, we do not believe that every SPE must be consolidated. We are in accord with FASB's position that effective dispersal of risk should void the need for consolidation. To ensure the owner or beneficiary of an SPE's residual interest is the most likely candidate to consolidate an SPE, we suggest FASB explore refining the concept of variable interests. In addition, we question whether the Proposal's notion of an FSPE is needed.

##### ***Variable Interests***

Variable interests as set forth by FASB include both debt and equity interests. Thus, a creditor of an SPE may conclude it has a significant variable interest and must consolidate the entity, even though its control is limited to the customary covenants a creditor usually requires. The typical creditor, however, does not so much control a borrower as constrain it (through debt covenants) from taking actions that could adversely affect the lender's risk. Consolidation of an SPE's assets and liabilities by its creditor in such a loan arrangement appears inappropriate to us because the creditor does not have either ownership or effective control over the SPE's assets, or responsibility for the SPE's debts.

We note, however, that in certain circumstances a putative creditor can have effective control over an SPE; however, our experience indicates this is often accomplished through either explicit or embedded put and call options on the SPE's assets. Put options, such as guarantees, fit within the quantification scheme for variable interests, as does nonrecourse debt in certain situations. Call options, on the other hand, convey rewards rather than risks but do not fit so neatly in the Proposal's analysis of variable interests. Nevertheless, the right to receive rewards and the power to marshal resources to maximize returns are important attributes of ownership of an SPE. In staff's view, as a general rule, consolidation by holders of variable interests having equity attributes would be more appropriate than consolidation by holders of variable interests having only creditor attributes — even if the latter has a higher expected loss than other individual stakeholders.

Board staff sees three possible ways to modify the variable interests methodology. Regardless of the approach FASB ultimately chooses, consolidation should be a matter of judgment, based on evaluation of all information about the SPE and its contractual relationships, as each individual SPE has different facts and circumstances.

##### ***Alternative 1 — Better Distinguish Debt Variable Interests from Equity Variable Interests***

In our supervisory view, strong capital is essential to safety and soundness in the banking system. Board staff often deals with investment instruments that are aimed at qualifying as regulatory capital but probe the boundary between equity and debt. In recent analyses of SPEs in

the banking sector, we have used principles from our capital paradigm to hold that substantive risks and rewards of ownership in SPEs were in the hands of investors whose interests were masquerading as debt. Our analysis begins by reviewing an SPE's debts and equity and gaining an understanding of who would be allocated losses and in what order. We then examine the SPE's assets and assess the probability of loss. Contingent claims such as service fees guarantees, and other terms, are also weighed. Among the claims we consider are rights and economic and structural incentives to convert debt into equity and whether that suggests the holder has effective control. After all of the factors have been considered, it has been clear to us who should consolidate the SPEs.

Staff feels that variable interests as defined in the Proposal do not entirely reflect the nuances in rights and obligations that can distinguish stakes in an SPE that are functionally debt, equity, and executory contracts. As noted earlier, we differentiate between plain debt and debt that has an equity conversion feature. Similarly, written puts, including guarantees, on the residual value of an entity transfer risk such that the recipient's interest resembles equity. On the other hand, it is not always clear that nonrecourse debt secured by property is a guarantee, since it may be a characteristic that is a customary lending practice. It is speculation on our part whether our notion of debt and equity forms of variable interests can be a practical basis for a general rule for consolidating SPEs. Board staff asks FASB, however, to consider ways to better differentiate between the two and to consider requiring consolidation only by those holders of significant or majority equity variable interests when developing a final rule.

If a stakeholder has a significant or majority variable interest that equates to in-substance equity in an SPE, it should consolidate the SPE. We believe FASB can be more discriminating between debt and equity, and we note that existing FASB guidance lends itself to such an analysis. SFAS 140 (while having significant implementation difficulties) recognized contractual rights and obligations as the basis for identifying financial components in securitizations. We see a potential mapping components to a risks and rewards framework (rewards with the component approach's rights and risks with obligations). What the components approach needs for purposes of assessing SPEs is a means for evaluating what kind of interest a stakeholder has when all his rights and obligations are seen in their entirety. We note that FASB has a long-standing project to differentiate between debt and equity other than by the instruments' legal form. We encourage FASB to consider whether further research in this area could determine whether the concept we suggest is both feasible and likely to yield better presentation of a firm's financial position and results.

***Alternative 2 — Consider Majority Ownership of Variable Interests as the Threshold for Consolidation***

If distinguishing variable interests between functional debt and equity instruments is infeasible, FASB might consider raising the threshold of variable interests that determines consolidation. Under the Proposal, consolidation turns on a "significant" standard. This diverges from the general rule for consolidation of non-SPEs (and SPE's meeting the voting-interests test of the Proposal) that uses a "majority" standard. In the past, FASB has found consolidation to be inappropriate for companies operating through subsidiaries in which they

have less than majority control. We suggest FASB consider whether an analogy to the accounting for unconsolidated ordinary subsidiaries might be appropriate for holders of variable interests.

Our position is based partly on a concern that a “significant” threshold might be so low as to produce undesirable outcomes in financial reporting. It is easy to imagine situations where a group of companies might randomly alternate consolidation because the level of variable interests changes from time to time.

Example 2: Assume two banks enter into derivative contracts with an SPE, one a cross- currency swap, the other an interest rate swap. Both derivatives are marked to fair value as required by GAAP. Depending on how much each derivative is in the money, and assuming each derivative is a significant variable interest, consolidation could randomly alternate between the two derivative counterparties depending on transitory market conditions. (We distinguish this example from credit derivatives, which can be used to transfer the risks and rewards of the residual interests in an SPE.)

Both banks in the example, nevertheless, have only creditor claims against the SPE. For potentially volatile instruments, such as derivatives, the “significance” standard of the Proposal could be very difficult to implement, since all variable interests must be weighed. Furthermore, the financial reporting may not reflect who ultimately controls the SPE. Shifting to a threshold of majority variable interests should give more stability to consolidation determinations. It may also be more likely that consolidation will be precluded for a company that has a significant interest in the form of a creditor’s exposure to the SPE, but who exercises neither effective nor legal control over the assets and liabilities of the SPE.

### *Alternative 3 — Consider Evaluating Classes of Junior Variable Interests as Single Holders*

If FASB rejects majority ownership of variable interests and retains significant ownership of variable interests as the threshold for consolidation, then it should consider allowing holders of variable interests that are senior in liquidation to treat subordinate classes of variable interests as being held by single investors. As we understand the Proposal, a company that has a significant variable interest may have to consolidate because other variable interest holders do not individually have as large an expected loss. Some creditors may be required to consolidate because their loan variable interest is large relative to each individual junior stake.

Example 3: A senior creditor is deemed to hold a variable interest in an SPE. Based on an analysis of each individual investor, it might conclude it holds the single most significant variable interest’s expected loss. Assume a senior creditor to a highly leveraged SPE has an expected loss of \$25 on its variable interest. A subordinated creditor has an expected loss of \$21. Three equity investors have equal investments with expected loss of \$18 each. Total expected loss is \$100.

Our understanding is that the senior creditor would consolidate the SPE. The equity holders, as a class, have 54% of the variable interests — and the equity in its entirety has the greatest expected loss. All variable interests junior to the senior creditor have 75% of the expected loss. Notably, if the three equity investors later merged their interests, the surviving holder would be required to consolidate the SPE since it would have the single largest expected loss. We do not believe that consolidation by the senior creditor is appropriate, absent other factors. Consolidation should be required of the equity holders or, if the risks are viewed as sufficiently dispersed, consolidation by any one enterprise may be inappropriate.

### ***FSPEs***

Board staff is not convinced that there is a need for a separate test for FSPEs. We would suggest instead applying the general rule to these entities for evaluating variable interests and determining the primary beneficiary (taking into account our prior comments). We see the notion of variable interests — appropriately defined — as a promising approach. In particular, if the risks arising from an SPE are well dispersed, consolidation by any one stakeholder in the SPE is inappropriate. In Board staff's view, applying the variable interests method of analysis to FSPEs may be sufficient to either identify the primary beneficiary or determine that interests are well dispersed. The following examples illustrate why we do not feel the separate FSPE criteria are needed.

Example 4: A well-performing manager of a bond mutual fund has unfettered power to buy and sell bonds for the fund, does not guarantee results in any way, and charges a fee for its services that is significantly higher than its competitors. Assume the mutual fund is deemed to be an FSPE. The manager meets two of the three criteria for consolidating an FSPE if it is unable to demonstrate the fee is market based. It appears to us that the parent company of the manager would consolidate the assets and liabilities of the SPE. Under a variable interests approach, consolidation would depend upon whether the fee represents a significant or majority variable interest relative to those of the funds' investors.

Example 5: A bank administers a commercial paper conduit, an FSPE, in return for a market-based fee. The FSPE purchases receivables from 100 individual companies. Each company sells its receivables through a QSPE to the FSPE, but retains the risk of first loss, expected to be \$10, with respect to its receivables. The FSPE gains an investment-grade credit rating on its commercial paper as a result of the bank's standby guarantee that would be drawn after the sellers' first-loss positions have been exhausted. The expected loss on the bank's second-loss position is \$20. Total expected loss is \$1,020. Since the bank can choose who participates in the facility (*i.e.*, has the power to buy and sell assets) and provides credit enhancement but receives a market-based fee, it meets two criteria and would be required to consolidate the SPE under the FSPE rules. Using the variable interests approach, the bank may have to consolidate, depending on whether its variable interest, represented by the guarantee and the fee it collects, is deemed significant relative to other variable interests.

Example 6: For a market-based fee, a bank sets up an SPE and directs it to buy a \$1,000 of loans (a so-called "arbitrage CDO"). The bank underwrites several tranches of investment-grade notes issued by the SPE and retains a residual interest in the SPE that is at first risk of loss. The bank does not provide additional credit or other support to the SPE, hence the bank's \$40 expected loss on its equity piece is its total expected loss, while the investment-grade tranches, as a group, have expected losses of \$1. The bank would consolidate the SPE under the FSPE approach. Later, the bank amends its management agreement by significantly narrowing its power to buy and sell assets. As a result it only meets one of the three consolidation criteria for FSPEs. Under a variable interests approach, however, the bank would likely consolidate the SPE since it has the majority of variable interests.

In Examples 4 and 5, arguably it is the investors in the mutual fund and the sellers to the facility who bear most risks and rewards and are the primary beneficiaries of the respective SPEs. Conversely, in Example 6, the bank bears most risks and rewards. Yet, in all three examples the FSPE criteria, in our view, do not provide a satisfactory result. Consolidation by the fund manager and bank administrator would result in them reporting assets that are not their resources and liabilities that are not their obligations. On the other hand, the underwriter of the CDO may be able to choose whether to consolidate the SPE, using the FSPE criteria. We suggest that FASB consider dropping this alternative set of consolidation criteria for FSPEs or rework it to better reflect who bears most risks and rewards arising from the SPE.

***FSPE Alternative 1 — Draw a Parallel between Silos and Variable Interests***

If FASB retains the FSPE concept to a final rule, we suggest certain changes to better align risks and rewards arising from financial assets with consolidated financial reporting. We find it anomalous, at best, that a variable interest holder with the greatest potential loss can avoid consolidation of its silo by interposing a QSPE between it and the FSPE while the administrator, who is not a transferor of assets and whose loss exposure is contingent on the first-loss positions being exhausted, may have to consolidate the entire entity under the Proposal.

FASB might consider providing more symmetry in how an SPE's administrator and individual transferors to silos evaluate the consolidation issue. For example, the administrator might evaluate each silo for consolidation separately. Under this approach, the administrator would consolidate only those silos in which it has the most significant variable interest. We believe financial reporting is most representative when the party with the equity variable interest having the greatest risk and reward reports the assets. If the SFAS 140 QSPE shields the transferor from consolidation, we are not persuaded the administrator need report the assets of the SPE.

***FSPE Alternative 2 — Change the Burden of Proof for a Market-Based Fee***

We note that FASB has set a very high standard for demonstrating that a fee is market based, principally requiring that it must be observable in the market place. We recognize that parties who do not have adverse interests have structured some SPEs and the agreed terms may not have been at arm's length. As supervisors, though, we have observed that many of these transactions are relatively commonplace financing arrangements such as commercial paper conduits and are negotiated under competitive conditions where many administrators solicit prospective customers. These products do not trade in active markets, however, where price quotes for similar transactions are readily ascertained. We ask FASB to consider whether the determination of whether the fee is market-based is an issue that can be made more neutral, with perhaps some guidance to preparers and auditors indicating that there should be evidence of competitive bidding and that the value received by administrators and others is commensurate with the fee paid.

**5. Disclosure relating to an Enterprise's Use of SPEs**

The Proposal includes very limited disclosures about activities involving SPEs. Notably missing from the Proposal is consideration of additional disclosure that would allow readers of financial statements to understand why the reporting enterprise is using SPEs and how its connections with SPEs change its risk profile and cash flows. Disclosure relating to SPEs should enhance understanding of the impact of SPEs on the company's financial condition and performance. For example, the enterprise should discuss how credit or market risks have been affected by such contractual arrangements as financial guarantees and commitments to SPEs and their stakeholders. Matters for discussion could include potential exposures, events that trigger cash outflows, the probability of triggering events occurring, and potential benefits gained by operating through SPEs. Moreover, disclosures should describe how the company monitors and manages its exposures to SPEs.

Therefore, we recommend that the final interpretation include not only sound accounting guidance but also additional disclosure requirements to render a more complete picture of the effect of activities involving SPEs on companies' risk profiles, financial condition and performance, and risk management practices.

Ms. Suzanne Bielstein

September 24, 2002

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In closing, we reiterate that Board staff strongly supports the FASB in its efforts to develop meaningful, comprehensive accounting and disclosure standards for activities involving SPEs. We would be delighted to discuss with you further our views and any questions you may have about our comments. If you need further information, please call Gerald Edwards, Associate Director and Chief Accountant - Supervision, at (202) 452-2741.

Sincerely,

A handwritten signature in black ink, appearing to read 'Richard Spillenkothen', with a long horizontal stroke extending to the right.

Richard Spillenkothen  
Director