

40 Broad Street
New York, NY 10004-2373
Telephone 212.440.9400
Fax 212.440.5260
www.bondmarkets.com

1399 New York Avenue, NW
Washington, DC 20005-4711
Telephone 202.434.8400
Fax 202.434.8456

St. Michael's House
1 George Yard
London EC3V 9DH
Telephone 44.20.77 43 93 00
Fax 44.20.77 43 93 01

VIA ELECTRONIC MAIL AND FEDERAL EXPRESS



May 29, 2002

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

**Re: Initial Response to SPE Consolidation Criteria
Discussed at May 22nd FASB Meeting**

Dear Mr. Jenkins:

Members of the Joint Industry Working Group on SPEs (the "JIWG")¹ listened with great interest to the Board's May 22nd discussion of forthcoming guidance on consolidation of special-purpose entities (SPEs), and specifically, proposed criteria to exempt certain types of SPEs from those consolidation requirements. In light of those discussions, we believe it is essential for the Board and FASB staff to engage in a direct dialogue with industry participants, prior to the June 5th meeting but in any event prior to the release of a formal Exposure Draft, to address the numerous questions and concerns we have with the most recently discussed guidelines.

The JIWG and the organizations its members represent sincerely appreciate the thoughtful and continuing efforts by the Board to address concerns and recommendations that we and other constituents have previously communicated to you in connection with this project. We are greatly encouraged by the Board's recognition, as reflected in your ongoing deliberations, that certain types of SPEs should be exempt from this revised consolidation guidance. This outcome is appropriate, we believe, for those SPEs whose fundamental business purpose and economic effect is to redistribute risks inherent in underlying assets among numerous transaction participants. In such circumstances, it would be inappropriate, misleading, and most importantly, potentially damaging to the financial markets to require the totality of an SPE's assets and liabilities to be recognized

¹ The Joint Industry Working Group includes senior accounting policy and industry professionals drawn from the respective memberships of The Bond Market Association (TBMA), the International Swaps and Derivatives Association (ISDA), the Securities Industry Association (SIA) and the Loan Syndications Traders Association (LSTA).

on the balance sheet of an entity that neither controls those assets, nor has exposure to those liabilities. Conversely, where the economic risks and rewards of assets held by an SPE are not effectively redistributed, but instead accrue to a single entity (as appears to have been the case with certain off-balance sheet partnership structures arranged by Enron), then consolidation of the SPE by that entity is an entirely appropriate result.

Based upon our preliminary understanding of the proposals that were presented and discussed at the Board's May 22nd meeting, however, we remain deeply concerned that, notwithstanding the Board's well-intentioned efforts, the SPE consolidation model and specific exemptive criteria now under consideration would not achieve these desired outcomes for many types of SPEs

Following is a brief outline of several of our most significant concerns:

- **Need for a Conceptual Framework.** The latest proposals do not set forth any conceptual framework upon which consolidation decisions can be made. In our ongoing dialogue with accounting standards-setters and other policymakers, we have consistently emphasized the need to move toward a "principles-based" approach for accounting guidance. Such an approach best serves the goal of providing a clear and logical accounting policy framework that can be applied to a diverse and constantly evolving financial marketplace. Unfortunately, the latest proposals and exemptive criteria perpetuate an overly detailed and complex "rules-based" approach to SPE consolidation, and offer no unifying conceptual basis for making judgments based on the economic substance of the wide range of financial transactions in which SPEs are used.

The Board's overriding goal should be to create a consolidation model that is sufficiently robust to enable meaningful distinctions to be drawn between SPEs that should be consolidated and those that should not. Such a model should embody a conceptual framework that facilitates making those distinctions based on the underlying economic substance of transactions, rather than exclusive reliance on a series of detailed, "bright line" tests. In this regard, we have previously proposed a two-pronged approach that we think would provide a simpler, yet more comprehensive model. In general terms, this approach would consist of the following two elements: (1) a financial components model for SPEs whose assets are legally isolated, with related risks and rewards redistributed among transaction participants; and (2) a *majority* of variable interest approach (primary beneficiary analysis). This appeared to be the essence of the risk diversification approach ("View B") originally discussed by the Board. In our judgment, it would be worthwhile and productive to continue to pursue the development of specific parameters for View B.

- **Limitations on Derivatives.** The most recent proposals contain a number of detailed requirements that would further limit the use of derivatives that may be held and issued by SPEs. The underlying rationale for these restrictions is not apparent to us, particularly in light of the proposed amendment to FAS 133 and related DIG issues (specifically, DIG Issue D-2 and related guidance), whereby derivatives embedded in

a beneficial interest issued by an SPE would be required to be bifurcated and marked-to-market by investors. In fact, with respect to QSPEs, the Board has acknowledged (paragraph A51) that this guidance addresses the Board's concern that the requirements of FAS 133 could be circumvented by executing transactions through QSPEs. We believe a similar analogy can easily be made for SPEs exempt from the consolidation guidance. In addition, the limitations on permitted uses of derivatives for purposes of the SPE consolidation guidance (e.g., the requirement to satisfy FAS 133 hedge accounting criteria) are much more restrictive than those set forth for QSPEs under FAS 140.

Many of the limitations proposed in the SPE consolidation guidance to address the Board's concerns about the use of derivatives by SPEs are being addressed by the Board in separate proposed guidance on derivatives accounting for securitization beneficial interests. In any case, the models developed for D-2 and SPE consolidation should be considered jointly and rationalized to a much greater degree than is presently the case.

- **Subsequent Accounting and Financial Statement Presentation.** We are very concerned that notwithstanding your efforts to craft appropriate exclusions for certain categories of SPEs (including, among others, certain collateralized debt obligations, conduits, credit-linked notes, repackaging transactions), many of these structures will not be able to satisfy the proposed criteria for non-consolidation--despite the fact that the assets isolated in and liabilities of those SPEs do not represent rights or obligations of the consolidating entity. In our view this would create mismatches in accounting for consolidated assets and liabilities, which in turn will produce adverse financial reporting, regulatory and broader market consequences (e.g., an unwarranted degree of profit and loss volatility, regulatory capital implications, potential violations of debt covenants and financial ratio requirements). We strongly urge the Board to address the subsequent accounting for consolidated assets and liabilities in a fashion that will minimize the likelihood of such disruptive outcomes, including some type of "matched presentation" approach or separate account presentation.

Given the tremendous implications of this guidance for our industry, and the many questions and concerns we have in connection with the most recently proposed guidance, we would like to repeat our offer to meet with you to discuss how this model would be applied to actual transactions and structures, to achieve a better collective understanding of which types of SPEs would be consolidated and which types would not. Such a meeting would provide Board members and FASB staff an opportunity to analyze the complex accounting issues raised by the proposed interpretation with business and accounting policy representatives who have expertise in the financial markets, and in the particular transaction structures in question.

We would be pleased to schedule such a "field test" meeting at your convenience, but strongly prefer to meet in advance of the next Board meeting. At a minimum, we believe that it would be both important and mutually beneficial for such a meeting to take place

Mr. Edmund Jenkins

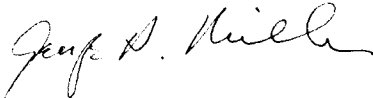
May 29, 2002

Page 4

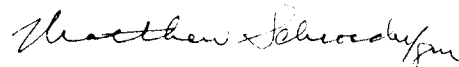
prior to the issuance of an Exposure Draft of the interpretation, as we think this will avoid conceptual and practical difficulties in applying whatever final guidance may be issued.

Again, we sincerely appreciate your continued efforts and willingness to engage in a productive dialogue with members of the financial community in connection with this important project. The members of the JIWG and the organizations they represent stand ready to work with you toward a constructive and effective resolution. We will contact you within the next several days to follow upon our request. Alternatively, please do not hesitate to contact either of the undersigned, at the telephone numbers provided below.

Sincerely,



George P. Miller
Senior Vice President,
Deputy General Counsel
The Bond Market Association
(On Behalf of the JIWG)
212.440.9403



Matthew Schroeder
Chair, Joint Industry Working Group
212.357.8437

cc: G. Michael Crooch, FASB
John M. Neel Foster, FASB
Gary S. Schieneman, FASB
Katharine Schipper, FASB
Edward W. Trott, FASB
John Wulff, FASB
Suzanne Q. Bielstein, FASB
Ron Lott, FASB
Robert Herdman, Securities and Exchange Commission
Jackson Day, Securities and Exchange Commission