Securities Industry Association
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November 24, 2003

Mr. Lawrence Smith
TA & I Director
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

Re: File Ref. No. 1082-300
Consolidation of VIEs; a modification of FIN 46

Dear Mr. Smith:

The Dealer Accounting Committee ("the Committee") of the Securities Industry Association[1] is pleased to offer you our comments on the exposure draft of the proposed interpretation, "Consolidation of Variable Interest Entities a modification of FASB Interpretation No. 46" ("the draft" or "proposed interpretation").

We agree with the Board's general objective of producing accounting standards in a timely fashion. However, we strongly disagree with the issuance of the draft. We think the Board's constituents, including investors and other users of financial statements, would all be better served by delaying the publication of the proposed interpretation. A delay would provide time for a comprehensive review of FIN 46 that could lead to the issuance of a more complete, logical, and user-friendly standard, one that would better serve the Board's mission of providing relevant, transparent and comparable financial information to investors. We believe that a delay in issuance is particularly justified if the Board is intending to address such complex matters as expected loss calculations in a subsequently issued FASB Staff Position ("FSP"). Should the Board decline to delay

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[1] The Securities Industry Association, established in 1972 through the merger of the Association of Stock Exchange Firms and the Investment Banker's Association, brings together the shared interests of more than 600 securities firms to accomplish common goals. SIA member-firms (including investment banks, broker-dealers, and mutual fund companies) are active in all U.S. and foreign markets and in all phases of corporate and public finance. According to the Bureau of Labor Statistics, the U.S. securities industry employs nearly 800,000 individuals. Industry personnel manage the accounts of nearly 93-million investors directly and indirectly through corporate, thrift, and pension plans. In 2002, the industry generated $222 billion in domestic revenue and $356 billion in global revenues. (More information about SIA is available on its home page: www.sia.com)

issuance, the Committee suggests that at a minimum there should be a deferral in the effective date.

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The proposed interpretation does not address many issues that must be clarified if a consistent approach to the application of consolidation policies to variable interest entities ("VIEs") is to be achieved. We find ourselves in agreement with the three Board members identified in the draft[2] who opposed publication, both on the grounds that the proposed interpretation fails to provide clarity regarding key aspects of FIN 46 (such as whether a given entity is a VIE and, if so, who should consolidate it) and that the failure to provide a deferral of the effective date for *all* entities will result in a haphazard and confusing adoption.

Representational Faithfulness of Resulting Application

Three of the Board members believe that it would be better to defer the effective date for FIN 46 for all parties until FASB has clarified how it intends the expected loss and expected residual return tests to be applied. We agree. Given the lack of clarity surrounding the expected loss and expected residual return calculations upon which FIN 46 is predicated and the level of complexity involved in applying the standard, we have serious misgivings about the operationality of FIN 46 and the quality of financial information investors will receive.

The Committee also believes the proposed interpretation contains a major omission because it does not address the income statement mismatch that occurs when the primary beneficiary is required to recognize gains and losses they have no right to receive or obligation to bear. The omission seems certain to result in considerable continued confusion in application, and additional difficulty in understanding issuers' results, as well as impairing the ability to compare one issuer's financial statements with another's. A recent filing with the Securities and Exchange Commission by Lincoln National Corporation provides an illustration of the problem. In its third quarter 2003 financials Lincoln National disclosed that it had a $22 million investment in Collateralized Debt Obligation ("CDO") pools that it manages. Lincoln National also disclosed that it potentially could have to report a $300 million other than temporary impairment charge from declines in the values of CDO assets it would have to consolidate, only to reverse those losses when the related debt was extinguished below its carrying amounts.[3]

The Committee believes that there are fundamental flaws with the FIN 46 guidance such as the consolidation conclusions being reached by asset managers. For example, many asset managers have arrangements in which the manager's fee varies with the total assets under management, and that permit managers to collect fees even if the

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[2] Exposure Draft *Consolidation of VIEs; a modification of FIN 46*; Appendix A; Alternate Views; paragraphs A43 – A46.

[3] Lincoln National Corporation; Form 10Q, for quarter ended September 30, 2003, p. 10.

investment as a whole loses money. Thus, even though in the great majority of cases asset managers will have only a nominal equity interest in and loss exposure to these entities, they will often be deemed the "primary beneficiary" and required to consolidate the entity due to the inequitable result of the paragraph 8(c) calculation. This seems to be an inaccurate and misleading reflection of the real economics at work. Recently, a number of firms have decided to implement FIN 46 earlier than required for interests in VIEs held pre-February 1, 2003. In many cases implementation has resulted in balance sheets increasing very substantially, though we question whether a controlling financial interest is truly present.

For example, BlackRock Inc. implemented FIN 46 in its third quarter 2003 financials. As a consequence, its balance sheet increased by a factor of nearly 3. BlackRock reported that "[w]hile BlackRock is not subject to a majority of the risks of the VIE's, BlackRock was determined to [be the primary beneficiary] based [upon] fees paid to BlackRock for providing collateral manager services. These fees, which amounted to $3.4 million for the three months ended September 30, 2003, represent a minimal economic interest in the operation of these entities which on a combined basis have total assets of approximately $2.6 billion…"[4] Should more firms adopt FIN 46 with the current guidance, we expect that the number of such anomalous results will substantially increase.

Because such mandated changes arising from application of FIN 46 have little economic impact, it's difficult to see them as other than distortive and lacking in relevance. While we expect that issuers will take pains to try to ensure that readers of financial statements are not misled by the changes, the Committee doubts that the resulting disclosures necessary to link the financial statements to a company's economics are in any meaningful sense an improvement.

Need for Comprehensive and Orderly Implementation

We are aware that the Board is attempting to provide some clarity regarding the application of FIN 46 through issuing a number of FASB Staff Positions. While we appreciate the efforts made and the good intentions, in our view continually dealing in a piecemeal fashion with various significant and difficult issues presented by FIN 46 is an indication that the effort is in need of a fundamental review.

All of the firms represented on the Committee have taken steps to implement FIN 46. However, an inescapable problem with the current guidance is that it is illogical, invites inconsistent application through lack of clarity on key points, and fails to truly reflect underlying economics. Notwithstanding our best efforts, at this point we fear that the application of FIN 46 is generating more confusion than insight on the part of investors, analysts, and other users of financial statements. Therefore, rather than rush to issue more guidance which fails to address essential aspects of key concepts, the Committee recommends that the Board defer issuance of any new guidance. While we expect that the Board would be reluctant to do so, the Committee believes that such a step

[4] BlackRock, Inc. Third Quarter 2003 Earnings Release, p.8.

is preferable to additional FSPs that provide for only a very shortened, and therefore limited, due process.

From a cost/benefits perspective, we believe that the above analysis firmly supports a delay in the effective date of FIN 46 -- including for entities' post January 31, 2003 involvement with VIEs -- until such time as the draft can be revised. This will enable a better standard to be fashioned and allow for sufficient clarity regarding its application so as to avoid the patchwork results that have been the outcome since the issuance of FIN 46 and subsequent FSPs, and that seems certain to continue with the expected FSPs and the proposed modifications. Given the size of the assets and liabilities involved, the income statement mismatch, and the attention that has been paid to these types of transactions in the marketplace, we believe that it is inappropriate to require some firms to adopt the standard now and run the risk of having to report one or more material accounting changes in the near future. We believe investors would be better served if preparers were able to issue financial statements with the confidence that the guidance used to apply FIN 46 will not change yet again in the near future. Again, the Committee shares the position of those Board members that was articulated in the draft's Alternate Views that it would be in the best interest of the capital markets for all parties simultaneously to adopt a clarified FIN 46.

If you have any questions about our letter or wish to follow-up with some additional dialogue on the subject, please feel free to contact the undersigned at 212-902-5675 or the Committee staff advisor, Jerry Quinn at 212-618-0507.

Sincerely,

Sarah Smith, Chair
SIA Dealer Accounting Committee