February 15, 2012

Ms. Leslie Seidman
Chairman
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-05116

Mr. Hans Hoogervorst
Chairman
International Accounting Standards Board
30 Cannon Street
London EC 4M 6XH
United Kingdom

Re: FASB File Reference No. 2011-220, Proposed ASU, Consolidation (Topic 810): Principal versus Agent Analysis (the "Proposal")

Dear Ms. Seidman and Mr. Hoogervorst:

The Clearing House Association L.L.C. ("The Clearing House"), an association of major commercial banks,[1] appreciates the opportunity to comment on the Proposal.

Executive Summary

We appreciate the efforts of the Financial Accounting Standards Board (the "FASB") and the International Accounting Standards Board (the "IASB") to clarify whether a decision maker is using its power as a principal or an agent in order to make U.S. generally accepted accounting principles ("U.S. GAAP") more consistent and to provide for greater convergence with International Financial Reporting Standards ("IFRS"). Specifically, The Clearing House:

[1] Established in 1853, The Clearing House is the oldest banking association and payments company in the United States. It is owned by the world's largest commercial banks, which collectively employ over 2 million people and hold more than half of all U.S. deposits. The Clearing House Association L.L.C. is a nonpartisan advocacy organization representing—through regulatory comment letters, amicus briefs and white papers—the interests of its owner banks on a variety of systemically important banking issues. Its affiliate, The Clearing House Payments Company L.L.C., provides payment, clearing, and settlement services to its member banks and other financial institutions, clearing almost $2 trillion daily and representing nearly half of the automated-clearing-house, funds-transfer, and check-image payments made in the U.S. *See* The Clearing House's web page at www.theclearinghouse.org.

- *supports* a qualitative analysis that requires the use of judgment to determine whether a decision maker is a principal or an agent and *supports* the framework that the Proposal sets out;

- *agrees* that a general partner should evaluate its relationship with a limited partnership (or similar entity) by applying the same analysis required for evaluating variable interest entities ("VIEs") to determine whether it controls the limited partnership (or similar entity), as this will provide consistency in the consolidation analysis of entities, regardless of their legal form;

- *recommends* that the FASB issue guidance similar to the example contained in the IASB's recently issued staff report[2] which concludes that no consolidation is required for certain securitization entities where there is no ongoing decision-making ability;

- *recommends* that if an entity determines it is acting as agent, no further analysis is required;

- *recommends* that if a decision maker determines (i) its compensation is commensurate with services provided, (ii) the compensation agreement includes only terms, conditions or amounts that are customarily present in arrangements for similar services negotiated on an arm's-length basis and (iii) the decision maker holds no other interests in the entity, these factors should be sufficient to conclude that the decision maker is an agent for U.S. GAAP, and the decision maker should not be required to continue the consolidation assessment. We believe that the magnitude and variability of the fees themselves should not be a consideration so long as the fees meet the above three criteria;

- *supports* an analysis that considers the number and relative ownership interests of the unrelated parties that need to come together to exercise kick-out and participating rights in order to determine if such rights are substantive; and *recommends* that the Proposal provide that once the rights are deemed substantive they should be determinative;

- *recommends* that the likelihood that a kick-out right will be exercised by the holders should not be included in the consideration when determining whether a kick-out right is substantive, as we believe such a determination is too speculative in nature and that it should be similar to the approach taken for participating rights;

- *supports* the Proposal's approach whereby more emphasis is placed on the decision maker's exposure to both negative and positive returns, as we believe exposure to both negative and positive returns is more akin to a direct investment in an entity and, therefore, more indicative of a principal relationship;

[2] IASB Effect Analysis, September 2011, page 25, available at http://www.ifrs.org/NR/rdonlyres/B8C43BF6-EB8B-4275-95FE-EE77335D5E51/0/consolidationeffectanalysis06092011.pdf.

- *recommends* that the existing guidance on determining when a fee paid to a service provider constitutes a variable interest be eliminated as it is redundant, and not entirely consistent with, the proposed guidance on analyzing decision makers' compensation;

- *recommends* that the Proposal be clarified to state that the decision-making authority of an agent must not necessarily be attributed to that of the principal, and we provide an example illustrating when such attribution would not be appropriate;

- *recommends* that the reassessment of whether a decision maker is acting as a principal or an agent be done on a continuous basis, similar to that of the primary beneficiary analysis;

- *does not support* the proposed requirement for a decision maker to include its proportionate indirect interest held through related parties in applying the principal versus agent analysis, as we believe the existing related party guidance is sufficient, and we *recommend* that this requirement be eliminated; and

- *agrees* that money market funds should not be consolidated but are concerned that the Proposal as drafted will not achieve this objective; accordingly, we *recommend* that such funds should be subject to a scope exception, as we believe this is the simplest way to achieve the stated objective.

Our detailed comments follow.

I. The analysis should be based on a qualitative assessment and should apply to limited partnerships.

We agree that the analysis of whether a decision maker is a principal or an agent should be based on a qualitative assessment. We believe that a principles-based approach is superior to one that rigidly adheres to the presence or absence of particular factors or conditions, and we believe that the application of judgment in determining how to weigh each factor is an essential component in applying this analysis.

We agree that the evaluation of a decision maker's capacity should consider the following factors:

a. The rights held by other parties;
b. The compensation to which the decision maker is entitled in accordance with its compensation agreement(s); and
c. The decision maker's exposure to variability of returns from other interests that it holds in the entity.

We also agree that a general partner should evaluate its relationship with a limited partnership (or similar entity) by applying the same principal versus agent analysis required for evaluating a VIE to determine whether it controls the limited partnership (or similar entity). We

believe that this will provide consistency in the consolidation analysis and will avoid situations in which the legal form of the entity alone drives the consolidation conclusion. For example, we understand that under current interpretative guidance, a 1% investment by a general partner in a limited partnership is considered by many to be a substantive investment, and that this typically requires the general partner to consolidate the partnership, if the limited partners have no substantive kick-out or participating rights.[3] We believe that a general partner should determine whether its investment in a limited partnership (or similar entity) is significant in the same way that an investor would make this determination for a VIE.

II. Consolidation should not be required for entities with no ongoing decision-making authority.

In addition, we note that the IASB staff issued a report in September 2011 with an example that states that no consolidation is required for a credit default swap structure because there is no ongoing decision-making ability after the initial formation of the entity.[4] We believe this is a useful example and encourage the FASB to take this opportunity to add similar guidance to the Proposal providing that where an entity has no ongoing decision-making authority over an entity, it is not the primary beneficiary of the entity. We believe this would be an appropriate forum to add this guidance as it directly relates to the issue in question, that is, when is an entity a decision maker of a VIE.

III. An entity that determines it is an agent should not be required to conduct further analysis.

We believe that if an entity determines that it is acting as an agent, and the entity and its related parties and de facto agents hold no other interests in the VIE, then that entity can conclude that it is not the primary beneficiary of the VIE or limited partnership and therefore should not be required to conduct further analysis. We recommend the FASB clarify this by adding this point to ASU 810-10-05-10 (and other relevant paragraphs, as appropriate) as follows:

> " . . . In assessing whether a reporting entity has the power to direct the activities of a VIE that most significantly impact the entity's economic performance, a reporting entity should consider whether it has the ability to use its decision-making authority as a principal or an agent. <u>If the reporting entity determines that its decision-making authority is as an agent, and the reporting entity and its related parties and de facto agents hold no other interest in the VIE, the reporting entity is not the primary beneficiary of the VIE, and no further analysis is required by the reporting entity.</u>"

[3] Determining Whether a General Partner Controls a Limited Partnership or Similar Entity and Investor's Accounting When it has a Majority of the Voting Interest but the Minority Shareholder has Certain Approval or Veto Rights, pages 4 and 5 (Ernst & Young July 2005).

[4] IASB Effect Analysis, September 2011, page 25, available at http://www.ifrs.org/NR/rdonlyres/B8C43BF6-EB8B-4275-95FE-EE77335D5E51/0/consolidationeffectanalysis06092011.pdf.

IV. Substantive rights should be determinative of an entity acting as a principal.

We believe that it is appropriate to consider the rights held by others in making a determination of whether an entity is acting as a principal or agent. We also agree that it is appropriate to consider the number and relative ownership interests of the unrelated parties that need to affirmatively exercise the rights, as well as whether any economic interests held by the decision maker present a barrier to exercise removal rights, in order to determine if the kick-out or participating rights are substantive. However, we believe that once the rights are deemed substantive they should be determinative of an entity acting as a principal.

We believe a robust analysis is intended by the guidance in ASU paragraphs 810-10-25-97, 810-10-25-100 through 106 and 810-10-55-1 which would include consideration of the rights' characteristics, including how those rights may be impacted by other economic interests the decision maker holds. Although such an approach will result in many such rights not being deemed substantive, this approach will yield similar results as in the examples in the Proposal and will alleviate confusion over when to disregard rights deemed "substantive" without a full evaluation of the facts and circumstances impacting those rights.

V. The likelihood that a kick-out right will be exercised should not be considered.

In paragraph 810-10-25-103 the Proposal states that the likelihood that participating rights will be exercised shall not be considered when assessing whether a participating right is substantive. We recommend that the FASB include consistent guidance for kick-out rights as we see no reason for treating the two types of rights differently. We believe that an assessment as to whether a right will be exercised is too speculative in nature to be included in the determination of whether a decision maker is acting in a principal or agent capacity. Accordingly, we recommend that a statement be added to paragraph 810-10-25-39E that the likelihood that a kick-out right will be exercised by the holders should not be a consideration when determining whether a kick-out right is substantive.

VI. Magnitude and variability of fees should not be considered.

In assessing a decision maker's compensation, we recommend that if a decision maker determines (i) its compensation is commensurate with services provided, (ii) the compensation agreement includes only terms, conditions or amounts that are customarily present in arrangements for similar services negotiated on an arm's-length basis and (iii) the decision maker and its related parties and de facto agents hold no other interests in the entity, these factors should be sufficient to conclude the decision maker is an agent, and the decision maker should not be required to continue the consolidation assessment. The magnitude and variability of the fees themselves should not be a consideration as long as the fees meet the above three criteria. In this regard, we suggest that paragraph 810-10-25-39I of the Proposal be eliminated, and that the examples, such as that included in 810-10-55-3R of the Proposal, be modified to eliminate the reference to consideration of the magnitude and variability of fees.

We agree that when performing the principal versus agent analysis, the evaluation of a decision maker's capacity should place more emphasis on the decision maker's exposure to both negative and positive returns than interests that only expose the decision maker to positive returns. We believe that exposure to both negative and positive returns is more akin to a direct investment in an entity and, therefore, is more indicative of a principal relationship. We also agree that the seniority of the fee relative to the entity's other operating liabilities that arise in the normal course of the entity's activities should not be solely determinative of a decision maker's capacity as we believe that, in practice, this has less bearing on whether an entity is acting as an agent or a principal.

Finally, we recommend that the guidance in 810-10-55-37 be eliminated, as this guidance is effectively captured in 810-10-25-39J and 39K and is therefore redundant. We believe that the guidance in 810-10-25-39J and 39K is appropriately formulated and consistent with the objectives set out by the FASB in this Proposal. The guidance in 810-10-55-37 was intended to determine when an interest held by a service provider constituted a variable interest in a VIE and therefore is not relevant to the new analysis.

VII. The authority of the agent should not always be attributed to the principal.

We are concerned that the decision-making authority of the agent always would be ascribed to the principal (*e.g.,* ASU 810-10-25-86 and BC8), thus requiring the principal to consolidate. Consider the following fact pattern:

- A general partner ("GP") holds a 0.01% *pro rata* investment in a limited partnership;
- There are 3 limited partners ("LPs") in the limited partnership, as follows: LP1 has a 60% investment, LP2 has a 20% investment, and LP3 has a 19.99% investment;
- The GP is responsible for making all substantive decisions regarding the operations and activities of the partnership;
- For its services, the GP receives a fee of 2% of assets under management per annum;
- The fee is commensurate with services provided, is on customary terms and conditions negotiated on an arm's-length basis, and the GP holds no other substantive interests in the partnership; and
- The LPs have no substantive participating rights in the partnership or substantive kick-out rights with respect to the GP.

In this example, we would conclude that the GP is the decision maker. Because the GP's fees are commensurate with services provided, on customary terms and conditions negotiated on an arm's-length basis and the GP holds no other substantive interests in the entity, we would also conclude that the GP is acting as an agent for the partnership. LP1 has a majority interest in the partnership. However, because it does not have any substantive participating or substantive kick-out rights and cannot participate actively in managing the limited partnership (which would result in losing the protection of limited liability), we would not conclude that LP1 is the principal and should consolidate the partnership. Accordingly, we recommend that the

FASB clarify that the decision-making authority of an agent must not necessarily be attributed to that of the principal in all instances.

VIII. Reassessment should be continuous.

Currently, the Proposal provides that a reporting entity would be required to evaluate whether there has been a change in the decision maker's capacity by considering whether there has been a change in the purpose and design of the entity. We believe this requirement should be explicitly expanded to be either an ongoing test similar to the primary beneficiary analysis or at least expanded so as to incorporate changes in the amount of interests held by the decision maker. While we agree that the purpose and design of the entity may change if the entity issues additional equity that is at risk to the decision maker, we believe that it would be more straightforward to include an explicit requirement to reassess the decision maker's role whenever there is a change in the decision maker's investment in the entity.

IX. Money market funds should be excluded from the scope.

We are concerned that the Proposal as currently drafted will not achieve the FASB's stated objective that money market funds will not be consolidated by their investment managers. We agree that money market funds should not be consolidated, as we do not believe that consolidation provides useful information to investors. Rather than adding additional factors or criteria to the overall framework to ensure this outcome, we believe that such funds should be subject to a scope exception. Although, in general, we do not support this type of a rules-based approach, we believe that it is more straightforward than revising the framework itself, which we believe is robust and should not be modified solely to accommodate these funds.

X. Current guidance on related parties is sufficient.

We disagree with the proposed amendments that would require a decision maker to include its proportionate indirect interest held through related parties for purposes of applying the principal versus agent analysis. We believe that the existing guidance on the consideration of related parties and de facto agents is sufficiently comprehensive such that these interests would already be a part of the analysis, such that further enhancements to this guidance are not needed.

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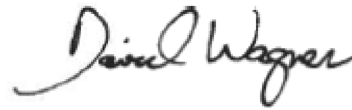
If you have any questions or are in need of any further information, please contact me at (212) 613-9883 (email: david.wagner@theclearinghouse.org) or Gail Haas at (212) 612-9233 (email: gail.haas@theclearinghouse.org).

Sincerely yours,



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