November 12, 2014

Mr. Russ Golden, Chairman
Financial Accounting Standards Board
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Mr. Hans Hoogervorst, Chairman
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Delivered Electronically

SUBJECT: Tentative decisions in the lease project – sale leaseback transactions

Dear Chairman Golden and Chairman Hoogervorst:

We, the Railcar Leasing Coalition, represent many of the largest railcar lessors doing business in North America, with some companies operating globally as well. According to the Association of American Railroads, more than fifty-seven percent of the 1.6 million railcars used in the US are lessor-owned[1]. This letter supplements our previous letter dated July 15, 2014 concerning the potential interaction of Accounting Standards Update No. 2014-09, Revenue from Contracts with Customers (Topic 606), with the proposed lease accounting model for sale leaseback transactions (SLBs) for both lessees and lessors.

Equipment lessors have a long-held practice of entering into SLBs as both buyer-lessors in transactions with customers and as seller-lessees with other rail car lessors in order to leverage tax efficiencies, manage portfolio flexibility, or obtain financing. We have concerns with the Boards' current approach to SLB accounting, particularly as it applies to transactions involving assets at or near their in-service date, the proposed accounting basis for presenting a failed SLB (especially from a lessor perspective), and transition for which we provide certain recommendations for your consideration.

New asset SLBs

Under Topic 606, a transaction does not qualify for sales treatment if the seller "has an obligation or a right to repurchase the asset (a forward or call option)" because, unless the option

[1] Numbers derived from data in Umler Database. 1 January 2013. Available for purchase from Railinc (www.railinc.com).

is nonsubstantive, the limitation imposed by the forward or call option indicates that the "customer does not obtain control of the asset[2]". This conflicts with the Boards' tentative decision in the leases project that purchase options embedded in a lease should only be factored into lease measurement when the embedded option provides a significant economic incentive, such as a bargain purchase option, that makes exercise of the option reasonably certain at lease inception. Given that purchase options are commonly included as a standard lease feature[3], this results in two different accounting treatments depending on whether the lease is part of a SLB even though the lease contracts are otherwise identical. For lessors, there will be different accounting for identical lease arrangements of identical assets depending on the identity of the previous owner. In particular, we believe this issue will impact many SLBs that are executed at or near the asset's in-service date.

For example, consider a common tri-party arrangement between an equipment manufacturer, an end-user customer, and a finance company whereby the intention is for the end-user customer to ultimately lease the equipment from the finance company for a predetermined period under standard leasing terms. The transaction could occur in one of the following two ways[4] to achieve that business objective:

- Manufacturer sells asset to finance company. Finance company leases asset to end-user customer under a typical lease arrangement that includes a standard fixed price purchase option.
- Manufacturer sells asset to end-user customer. End-user customer subsequently sells asset to finance company and leases it back under a typical lease arrangement that includes a standard fixed price purchase option. No gain or loss results as the finance company/end-user customer transaction occurs within a reasonable time following the manufacturer/end-user customer transaction.

Under the Boards' current tentative approach, the first transaction would be accounted for as a lease by both the finance company and the end-user customer. However, the existence of the standard purchase option (unless determined to be nonsubstantive) would result in the end-user customer accounting for the transaction as a failed sale. In addition, and as a consequence of the proposed lessor accounting model, the finance company would be required to account for the transaction as a failed purchase and would not recognize the underlying asset to be leased under the arrangement.

We believe both transactions should be accounted for as leases and that this difference in treatment impairs comparability between transactions that are economically identical. Furthermore, we believe this difference may have unintended consequences, with the form of the agreement (a standalone lease versus a SLB) driving certain business decisions rather than the

[2] Topic 606, paragraph BC427

[3] Many leases include standard options to return, renew, or purchase the asset. The option to purchase the asset may be at fair value or at a fixed price that, at inception, was intended to approximate a fair value at a future date. Under existing GAAP, options intended to approximate fair value are not considered bargain purchase options.

[4] There are other forms of SLBs that exist, such as the monetization of the equity in the asset later in its life. In these cases, an SLB can give rise to full or partial gain recognition. We have not addressed these forms of SLBs in our letter as our focus is on the form of SLB that does not give rise to gain (loss) upon the execution of the SLB.

substance. For example, entities may arrange for third parties to take temporary ownership of the assets until a financing company is identified. Such steps will unnecessarily increase the complexity of the transactions and are likely to impose additional costs for entities to achieve accounting results that are comparable to stand-alone leases.

As stated in our July 15, 2014 letter, we believe that SLBs should be accounted for as a single unit of account under the leasing guidance, rather than under Topic 606. However, we would also support a practical expedient to the Topic 606 for SLBs executed on assets near their in-service date on the basis that such transactions do not result in gain (loss) especially given the Topic 606 effective date is likely to be earlier than the effective date for the new lease accounting model. “Near” could be defined as “without material delay,” which is an existing concept applied for pass-through transactions under IFRS[5]. This approach would result in treatment consistent with US tax laws that provide a 90-day window for determining if an asset involved in a SLB transaction is considered new or used.

Accounting for failed sale leasebacks

From the lessee’s perspective, a failed sale would result in retaining the asset on the books (along with continued depreciation) and the recognition of a liability for the sum of the payments and the purchase option. This appears reasonable and is consistent with existing guidance regarding lessee accounting for failed sales. However, the lessor accounting for a “failed purchase” is less clear.

From the lessor perspective and according to the 2013 exposure draft, the failed sale would require presentation of a receivable in accordance with applicable Standards (IASB version para. 115). However, the following issues are unclear:

- <u>How should the resulting receivable be evaluated for impairment?</u> The receivable resulting from a failed purchase transaction is different from a typical loan in that the full amount of the principal is not required to be repaid by the terms of the agreement. Rather, the buyer-lessor’s asset consists of both the contractual right to receive specified lease payments over the lease term and the right at lease termination to receive either a balloon payment equal to the option exercise price or the physical asset. Essentially, the failed purchase accounting approach would recast the transaction from a lease with an embedded call option to a loan with an embedded put option. As a result, the residual value of the underlying asset may represent a significant portion of the receivable balance. We are unclear how to apply the existing or proposed financial asset impairment guidance to this hybrid asset. Should the buyer/lessor assume the option will be exercised and therefore view the asset as a single receivable amount much like a typical loan with a balloon payment? Should the residual value component be evaluated separately from the receivable as a nonfinancial asset under ASC Topic 360, even though the asset is not “owned” for accounting purposes?

[5] IAS 39.19/IFRS 9 para 3.2.4-3.2.5

- What happens if the purchase option is not exercised? At the exercise date, a lessee may choose not to exercise the purchase option and may return the asset to the seller/lessor. If the lessee returns the asset, the method the lessor should use to derecognize one asset and recognize another asset is unclear, particularly when the returned asset would have been subject to depreciation and impairment during the course of the lease. If the full amount paid for the asset is determined to be a receivable, then the return of the underlying asset would appear similar to a borrower surrendering collateral in lieu of repayment of a secured loan, which typically triggers a fair value remeasurement. However, given that the return of the asset is specifically contemplated (and possibly expected) under the terms of the lease agreement, we question whether that accounting approach faithfully represents the economics of the transaction.

- How will the receivable be treated for regulatory capital requirements? Certain lessors are regulated financial institutions. It is unclear how regulators will treat the receivable for determining capital requirements given the accounting presentation as a financing receivable does not reflect the legal ownership of the non-financial asset, and these assets have different capital requirements.

- How will the accounting presentation satisfy the users of lessor financial statements? Users have expressed the need for transparent information concerning residual asset risk and management thereof. However, the underlying asset, which is legally owned, will not be presented or accounted for as such under the proposed guidance. We have concerns that the failed purchase approach will not appropriately present the lessor's separate exposures to credit and residual risk.

The application of failed SLB accounting by the lessor is further challenged by the fact that the leases project introduces accounting for failed purchase transactions when such guidance was not provided in Topic 606. Topic 606 only addresses supplier accounting for contracts with end-user customers and not the accounting by the end-user customer or the buyer/lessor. Therefore, activities such as failed purchase transactions or end-user customer accounting of significant financing components is not addressed in Topic 606 or in other US GAAP standards such as Topic 860, Transfers and Servicing. Since the leases project addresses accounting by both parties to the contract, we believe unintended consequences may arise from establishing accounting guidance that is not addressed by, and may conflict with the existing GAAP framework. Consequently, for the lessor we support an approach offered by the ELFA in their October 14, 2014 letter, which recommends retaining existing GAAP by recognizing the purchased asset and accounting for the lease as a Type A or B lease.

Transition

Given the complexity of evaluating and unwinding transactions that were completed years ago under appropriate accounting guidance, we recommend that the final guidance be applied only to SLBs that occur after the effective date of a final leasing standard.

We believe the Boards' conclusions in ASC 606-10-55-68(a) and tentative decisions in the lease project regarding purchase options embedded in lease contracts will change the accounting for a significant number of prior SLB transactions for both lessee and lessor. From a lessor perspective, existing accounting guidance only addressed the accounting for the lease contract, without consideration for whether it was linked to a failed SLB. Under the new guidance, the lessor will need to review its lease contracts to determine which contracts were part of a SLB and review an asset's history to determine who owned the asset subject to lease prior to its purchase by the lessor. If the lease was part of a SLB, the lessor will also need to determine whether the lease had a purchase option that would have originally resulted in a failed sale to the buyer/lessor. As existing guidance did not require this level of historical detail about assets and their associated leases, this level of analysis may not be possible for lessors without an undue administrative burden, and lessors may have routinely commingled information about SLBs with other stand-alone lease contracts their systems. It is unclear what benefit applying the new guidance to SLBs that occurred before the final leasing standard's effective date will have for users of financial statements. For seller-lessees, we are unclear how to apply the transition guidance in ASC 606-10-65-1(f)(1) for "completed contracts" to SLBs that occurred prior to adoption. If the SLB is viewed as a combined contract at transition, as we believe would be required for any new SLBs, then it is possible transactions previously accounted for as sales and leasebacks would have to be recast as failed sales for the adoption of Topic 606. Here again, entities may incur a significant administrative burden in determining whether assets on lease were previously owned and sold as part of a SLB. Furthermore, the timing as to when the seller-lessee applies the "failed sale" requirements of Topic 606 will be effective earlier than the accounting requirements for the lease component of the transaction provided under the new lease accounting model (public companies under US GAAP).

For these reasons, we believe that the changes made to SLB accounting should be applied only to transactions that occur after the effective date of the leasing standard and that this be clarified under Topic 606, given the sale and the lease are parts of the same transaction. We also note that SLBs may arise in the context of structuring leveraged leases from the lessor perspective. Therefore, a prospective approach would provide symmetry in the transition accounting for both sides of those transactions, given the FASB's recent tentative decision to grandfather leveraged leases existing at the effective date.

Conclusion

We believe the recommendations above will improve comparability for SLBs on assets near their in-service date, will clarify lessor accounting for failed SLBs, and will simplify the transition accounting for both lessees and lessors in SLB transactions.

We are available to assist the Boards and staff and provide any additional information as may be necessary.

Sincerely,

The Railcar Leasing Coalition, consisting of the following organizations:

American Railcar Leasing, LLC
Chicago Freight Car Leasing Co.

Equipment Leasing and Finance Association (ELFA)
First Union Rail Corporation, A Wells Fargo Company
GATX Corporation
GE Capital, Rail Services
The Andersons, Inc.
The Greenbrier Companies, Inc.
Railway Supply Institute
SMBC Rail Services
Trinity Industries, Inc.
VTG Rail, Inc.