

requirements, including these amendments, address a registrant's contingent liabilities and commitments and may obviate the need for this additional disclosure requirement. We will, however, continue to assess the costs and benefits of an MD & A disclosure requirement for aggregate contingent liabilities and commitments in connection with our ongoing review of MD & A.⁷⁵ Pending future Commission action on the subject, registrants should refer to the existing guidance in our Commission Statement to consider whether it would be beneficial to investors to include tabular disclosure of aggregate commercial commitments.⁷⁶

III. Discussion of Amendments

A. Definition of "Off-Balance Sheet Arrangement"

The definition of "off-balance sheet arrangement" primarily targets the means through which companies typically structure off-balance sheet transactions or otherwise incur risks of loss that are not fully transparent to investors. For example, in many cases, in order to facilitate a transfer of assets or otherwise finance the activities of an unconsolidated entity, a company must provide financial support designed to reduce risks to the entity or other third parties. That financial support may assume many different forms, such as financial guarantees, subordinated retained interests, keepwell agreements,⁷⁷ derivative instruments or other contingent arrangements that expose the registrant to continuing risks or material contingent liabilities.⁷⁸ To appropriately capture these transactions, the definition of "off-balance sheet arrangement" includes any contractual arrangement to which

an unconsolidated entity is a party, under which the registrant has:

- Any obligation under certain guarantee contracts;⁷⁹
- A retained or contingent interest in assets transferred to an unconsolidated entity or similar arrangement that serves as credit, liquidity or market risk support to that entity for such assets;
- Any obligation under certain derivative instruments;⁸⁰
- Any obligation under a material variable interest⁸¹ held by the registrant in an unconsolidated entity that provides financing, liquidity, market risk or credit risk support to the registrant, or engages in leasing, hedging or research and development services with the registrant.

1. Guarantees

The definition of "off-balance sheet arrangements" addresses certain guarantees that may be a source of potential risk to a registrant's future liquidity, capital resources and results of operations, regardless of whether or not they are recorded as liabilities. The definition borrows concepts from U.S. GAAP in order to identify the types of guarantee contracts for which disclosure is required. The references to U.S. GAAP apply regardless of the particular GAAP under which a registrant presents its primary financial statements.

The first element of the definition refers to any obligation under a guarantee contract that has any of the characteristics identified in paragraph 3 of FIN 45, and that is not excluded from the initial recognition and measurement provisions of FIN 45.⁸² Paragraph 3 of FIN 45 includes within its scope any contract with one or more of the following four characteristics:

- Contracts that contingently require the guarantor to make payments to the guaranteed party based on changes in an "underlying"⁸³ that is related to an

asset, a liability or an equity security of the guaranteed party (e.g., a financial standby letter of credit, a market value guarantee, a guarantee of the market price of the common stock of the guaranteed party or a guarantee of the collection of the scheduled contractual cash flows from individual financial assets held by an SPE);⁸⁴

- Contracts that contingently require the guarantor to make payments to the guaranteed party based on another entity's failure to perform under an obligating agreement (e.g., a performance guarantee);⁸⁵

• Indemnification agreements (contracts) that contingently require the indemnifying party (guarantor) to make payments to the indemnified party (guaranteed party) based on changes in an underlying that is related to an asset, a liability or an equity security of the indemnified party (e.g., an adverse judgment in a lawsuit or the imposition of additional taxes due to either a change in the tax law or an adverse interpretation of the tax law);⁸⁶ or

- Indirect guarantees of the indebtedness of others, which arise under an agreement that obligates one entity to transfer funds to a second entity upon the occurrence of specified events, under conditions whereby (a) the funds become legally available to creditors of the second entity and (b) those creditors may enforce the second entity's claims against the first entity under the agreement (e.g., keepwell agreements).⁸⁷

The definition of "off-balance sheet arrangement" is designed so that a registrant's application of FIN 45 will provide the basis for determining the guarantee contracts that are subject to disclosure under the amendments.⁸⁸ Paragraphs 6 and 7 of FIN 45 exclude certain guarantee contracts from the recognition and measurements provisions of FIN 45.⁸⁹ These exclusions

Indebtedness of Others (Nov. 2002), ("FIN 45"); and FASB Interpretation No. 46, *Consolidation of Variable Interest Entities* (Jan. 2003), ("FIN 46").

⁷⁵ We are considering future rule proposals or interpretive releases to improve MD & A disclosure, such as requiring an overview about a company's situation and information about the trends that its management follows and evaluates in making decisions about how to guide the company's business.

⁷⁶ See Commission Statement, Release No. 33-8056, FR-61 (Jan. 22, 2002) [67 FR 3746] at Section II.A.3.

⁷⁷ A "keepwell agreement" includes any agreement or undertaking under which a company is, or would be, obligated to provide or arrange for the provision of funds or property to an affiliate or third party.

⁷⁸ For purposes of the amendments, contingent liabilities arising out of litigation, arbitration or regulatory actions are not considered to be off-balance sheet arrangements. See, e.g., Instruction 3 to Paragraph 303(a)(4) of Regulation S-K [17 CFR 229.303].

⁷⁹ The guarantee contracts covered by the definition are consistent with the scope of the recently issued FIN 45.

⁸⁰ For registrants whose financial statements are prepared in accordance with U.S. GAAP, the definition includes a contract that would be accounted for as a derivative instrument, except that it is both indexed to the registrant's own stock and classified in the registrant's statement of stockholders' equity. See FASB Statement of Financial Accounting Standards ("SFAS") No. 133, *Accounting for Derivative Instruments and Hedging Activities* (June 1998), ("SFAS No. 133"), paragraph 11a. For other registrants, the definition includes derivative instruments that are both indexed to the registrant's own stock and classified in stockholders' equity, or not reflected, in the company's statement of financial position.

⁸¹ See FIN 46.

⁸² See, e.g., Item 303(a)(4)(ii)(A) of Regulation S-K [17 CFR 229.303(a)(4)(ii)(A)].

⁸³ An "underlying" is defined as "a specified interest rate, security price, commodity price,

foreign exchange rate, index of prices or rates, or other variable." See FIN 45 at fn. 2.

⁸⁴ See FIN 45, paragraph 3a.

⁸⁵ *Id.*, paragraph 3b.

⁸⁶ *Id.*, paragraph 3c.

⁸⁷ *Id.*, paragraphs 3d and 17.

⁸⁸ A registrant that prepares its financial statements in accordance with a non-U.S. GAAP must apply FIN 45 to reconcile its financial statements with U.S. GAAP.

⁸⁹ Paragraph 6 of FIN 45 excludes: guarantees issued by insurance and reinsurance companies and accounted for under specialized accounting principles for those companies; a lessee's guarantee of the residual value of leased property in a capital lease; contingent rents; vendor rebates; and guarantees whose existence prevents the guarantor from recognizing a sale or the earnings from a sale. Paragraph 7 of FIN 45 excludes: product warranties; guarantees that are accounted for as derivatives; contingent consideration in a business combination;

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