

MINUTES



To: Board Members

From: Statement 140 Amendment Team
(Gagon, Ext. 322)

Subject: Minutes of the February 11, 2004 Board Meeting **Date:** February 18, 2004

cc: Bielstein, Smith, Petrone, Leisenring, Project Team, Mahoney, Thompson, Vincent, Sutay, Gabriele, Swift, Polley, FASB Intranet (e-mail)

Topic: Qualifying Special-Purpose Entities:
Legal Isolation Criteria and
Transfers of Undivided Interests

Basis for Discussion: Board memorandum 25
dated February 6, 2004

Length of Discussion: 9:35 a.m. to 11:10 a.m.

Attendance:

Board members present:	Herz, Trott, Schipper, Batavick, Crooch, Seidman, and Schieneman
Board members absent:	None
Staff in charge of topic:	Donoghue
Other staff at Board table:	Lott, Smith, Lusniak, Stell and Gagon
Outside participants:	Leisenring (IASB)

Summary of Decisions Reached:

The Board discussed issues related to the legal isolation criteria set forth in paragraph 9(a) of FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. The Board also considered issues related to transfers of undivided interests in financial assets and discussed alternatives to the Board's decision that the proposed amendment to Statement 140 require that transfers of undivided interests in portions of financial assets be accomplished using a qualifying special-purpose entity (SPE) in order to receive sale accounting treatment.

The Board tentatively agreed that further guidance and clarification was needed about the criteria set forth in paragraph 9(a) of Statement 140. Specifically, the Board directed the staff to enhance guidance in paragraphs 104–106 on loan participations, provide further detail about the right of setoff in bankruptcy or receivership, clarify that depositors of a financial institution are considered creditors of that institution in the event of bankruptcy or receivership, and discuss additional implementation guidance with the Public Company Accounting Oversight Board (PCAOB).

Additionally, the Board addressed whether or not to require that transfers of undivided interests in portions of financial assets be accomplished using a qualifying SPE in order to receive sale accounting treatment. The Board deferred a decision on that issue and agreed to reconsider it at the March 10, 2004 Board meeting.

Matters Discussed and Decisions Reached:

Legal Isolation Criteria

The Board discussed issues related to the legal isolation criteria set forth in paragraph 9(a) of Statement 140. The discussion focused on conversations between the staff, attorneys, and the Federal Deposit Insurance Company (FDIC) concerning the right of setoff in the case of bankruptcy or receivership. Many different views were provided to the staff as to whether portions of an asset

can be legally isolated from creditors of an entity without the use of a bankruptcy remote entity.

One area of concern is the guidance provided in paragraphs 104–106 concerning transactions such as loan participations. Paragraphs 104–106 indicate that loan participations can meet the criteria of paragraph 9(b), but those paragraphs do not excuse participations from having to meet the other criteria in paragraphs 9(a) and 9(c). However, in practice, many institutions are applying paragraph 106 to a loan participation transaction without a thorough analysis of the requirements of paragraphs 9(a) and 9(c). The Board unanimously agreed that there is confusion with the discussion of loan participations in paragraphs 104–106 and directed the staff to revise those paragraphs to clarify that all requirements of paragraph 9 must be met for a loan participation to be accounted for as a sale of financial assets, not just paragraph 9(b).

The Board also discussed the impact of the right of a debtor that is also a depositor of the same financial institution to set off its deposit against its loan in the event the institution goes into bankruptcy or receivership. Board members indicated that the borrower's ability to satisfy a loan payable (including the part that has been transferred) with its funds on deposit without any of those funds being passed along to the participating bank suggests that the transferred portion is not beyond the reach of the transferor.

Ms. Seidman noted that current auditing literature is vague on the issue of legal isolation, which could be contributing to some of the confusion in applying the provisions in paragraph 9(a). Therefore, she recommended, and the Board agreed, that either the Board or the staff contact the PCAOB to discuss additional implementation guidance concerning the matter of legal isolation.

Transfers of Undivided Interests

The Board discussed whether or not to require that transfers of undivided interests in portions of financial assets be accomplished using a qualifying SPE

in order to receive sale accounting treatment. Two alternatives were discussed with respect to this issue.

The first would clarify that a transfer of any portion of a financial asset must utilize a qualifying SPE in order to receive sale accounting treatment. This alternative would leave the language that is currently in the revised Exposure Draft largely unchanged with respect to this issue. However, there would be additional guidance about how to consider the right of setoff in assessing legal isolation.

The second would revise the current language in Statement 140 to clarify that a transfer of a portion of a financial asset must meet all of the criteria contained in paragraph 9 in order to receive sale accounting treatment, with particular attention being given to the requirements of paragraphs 9(a) and 9(b). The Board members who supported this approach observed that most transfers of financial assets would be unlikely to qualify for sale accounting treatment unless a qualifying SPE is used; however, they believe that if an institution were able to meet all of the criteria in paragraph 9, a qualifying SPE should not be required in order to qualify for sale accounting treatment.

Ms. Schipper and Messrs. Crooch and Trott supported the first alternative. Ms. Seidman and Messrs. Batavick, Herz, and Schieneman supported the second alternative. However, the Board deferred a decision on that issue and agreed to reconsider it at the March 10, 2004 Board meeting.

Follow-up Items:

None.

General Announcements:

None.