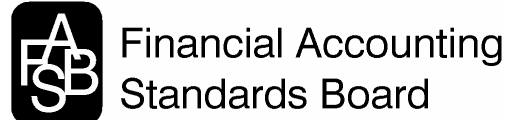


MINUTES



To: Board Members

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

Subject: Minutes of the August 11, 2004 Board Meeting **Date:** August 13, 2004

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

The Board meeting minutes are provided for the information and convenience of constituents who want to follow the Board's deliberations. All of the conclusions reported are tentative and may be changed at future Board meetings. Decisions become final only after a formal written ballot to issue a final Statement or Interpretation.

Topic: The Effect of Setoff Rights on Isolation

Basis for Discussion: Memorandum 33
dated August 5, 2004

Length of Discussion: 9:20 a.m. to 10:20 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, Lusniak, and Gagon

Outside participants: Leisenring (IASB)

Summary of Decisions Reached

The Board continued its discussion on the impact of setoff rights on the isolation requirement in FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, but did not make any decisions. The Board will consider a proposal that would define the isolation requirement in paragraphs 9(a) and 27 in a manner consistent with a legal true sale opinion and provide implementation guidance that would describe the characteristics of a true sale for portions of financial assets, for example, loan participations.

Objective of the Board Meeting

The objectives of the meeting were to (a) discuss the alternative approaches to consider the impact of setoff rights in accounting for transfers of financial assets and (b) decide whether to adopt one of the alternative approaches in the amendment to Statement 140. The first objective was met. The second objective was not met. Setoff rights will be discussed further at a future Board meeting.

Matters Discussed and Decisions Reached:

Ms. Donoghue began the meeting by discussing the effect of adopting each of the following alternatives that consider the impact of setoff rights on the isolation requirement under Approach 2 as discussed at the last Board meeting (refer to July 27, 2004 Board meeting minutes):

- **Alternative A**—Require that the existence of setoff rights by either the transferor or obligor be remote.
- **Alternative B**—Require that the transferor waive its setoff rights.
- **Alternative C**—Require that the risk that setoff rights would be exercised by the transferor or the obligor be remote.
- **Alternative D**—Require that setoff rights be evaluated like a conditional call that does not disqualify the transfer from being accounted for as a sale until the condition is met.

Ms. Donoghue stated that the staff recommends that the Board adopt a modified Approach 2 that deems that a financial asset has been isolated from a transferor if a transaction meets the criteria for a true sale at law and the entity to which the assets were transferred would not be substantively consolidated with the transferor by a receiver or bankruptcy court without the addition of any of the requirements described in Alternatives A–D. The staff made its recommendation for the following reasons:

- The exceptions proposed in Alternative A are inconsistent with the FASB’s announced objective of principles-based standards and would create an uneven playing field.
- A requirement for the transferor to relinquish setoff rights as proposed in Alternative B would benefit neither the transferor nor the transferee since the transferee cannot exercise setoff on its on behalf in most cases. In a well constructed transaction the transferor would be acting on behalf of all of the transferee owners of the asset in which case, the exercise of setoff would not indicate a measure of control that benefits only the transferor.
- Accounting for these transactions as conditional calls as described in Alternative D would lead to transfers being accounted for as sales and later reversed based on certain criteria. This could cause undue volatility when even a minor default such as a late payment could cause assets to be recognized on the balance sheet, only to have the assets be derecognized from the balance sheet in a short period of time.

Mr. Trott stated that he believes that if the Board accepts the staff’s recommendation, additional implementation guidance should be provided for loan participations and possibly other one-step transfers of undivided interests. He believes that the implementation guidance for these transactions should include the seven characteristics of a “true participation” as described on page 10 of the Cleary, Gottlieb, Steen & Hamilton comment letter (letter 27) dated June 14, 2004. In addition, he believes that the implementation guidance should state that the transfer documents must require that the participant’s share of any benefits realized by the transferor from the exercise of its setoff rights must be passed along to the transferee.

Certain Board members agreed with Mr. Trott’s suggestions because implementation guidance would improve the comparability of financial

statements. Some Board members expressed concern that attorneys do not all use the same criteria to render true sale opinions and would like to minimize the variations in accounting treatment that could result simply due to the individual attorney selected to perform the true sale analysis. Those Board members believe that additional implementation guidance would establish a benchmark that both accountants and attorneys could understand.

Ms. Seidman stated that she supports the staff's recommendation for the reasons mentioned in the July 27, 2004 Board meeting minutes. She stated that she would support providing implementation guidance to improve comparability, facilitate implementation, and improve financial reporting. However, she would not be comfortable adding a requirement that the benefits of setoff must be passed through to the transferee because she believes that requirement is based on a risk and rewards approach that is inconsistent with an isolation principle based upon control. She stated she would be willing to explore that option further.

Mr. Herz stated that he initially supported the staff recommendation but would be willing to explore Mr. Trott's proposal to add implementation guidance. He agreed with Ms. Seidman's remarks and stated that if the characteristics described in prior meetings of a true participation are included in the implementation guidance, he would clarify that the Board understands that those are the characteristics that would apply to transactions in U.S. jurisdictions; however, characteristics of a true participation might be different in other jurisdictions, such as those outside of the United States.

The Board did not make any decisions on this issue pending further consideration of a proposal that would define the isolation requirement in paragraphs 9(a) and 27 in a manner consistent with a legal true sale opinion and provide implementation guidance that would describe the characteristics of a true sale for portions of financial assets, for example, loan participations.

Follow-up Items:

The Board directed the staff to provide further analysis of the proposal to provide implementation guidance using the characteristics identified for a true participation as detailed in the Cleary, Gottlieb, Steen & Hamilton comment letter and the additional requirement that transfer agreements state that the benefits from a transferor setoff must be passed through to the transferee on a pro rata basis. In addition, the staff will explore whether the guidance should be provided as an example or should be articulated as a requirement that could be applied to all transactions.

General Announcements:

None.