

## TRANSFERS OF FINANCIAL ASSETS COMMENT LETTER SUMMARY

### OVERVIEW

- The 60-day comment period for the proposed FASB Statement, *Accounting for Transfers of Financial Assets*, ended on November 14, 2008. As of December 5, 2008, comment letters were received from 48 respondents.

### Respondent Profile

Type of Respondent	Number
<b>Public Accounting</b>	
Big 4 Accounting Firm	4
Non-Big 4 Accounting Firm	2
Total Public Accounting	6
<b>Preparer</b>	
Financial	21
Nonfinancial	3
Industry Organization	8
Total Preparer	32
<b>User</b>	
Investor/Analyst	1
Total User	1
<b>Other</b>	
Academic	2
Consulting	1
Regulator	2
Other	4
Total Other	9
<b>TOTAL</b>	<b>48</b>

- The respondents categorized as industry organizations represent multiple preparer constituents. The respondents categorized as other were two

academics, a consulting firm, two individual accountants, one CPA state society, one state banking regulator, AcSEC, and a joint letter from the federal banking regulators.

## COMMENT LETTER SUMMARY

### Convergence

3. The Board previously decided to proceed with the project to amend FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, as a short-term solution to improve financial reporting in a timely manner. The Board expressed its intent to work with the IASB to develop a long-term converged solution for derecognition. Many respondents requested that the Board reconsider this decision. These respondents stated that the Board should abandon its current project to amend Statement 140 and work with the IASB to develop a converged model to address derecognition. For example:

- Cigna (Letter #18) stated, “Rather than finalizing an amendment to SFAS 140 as proposed, we believe it would be most beneficial for preparers and users of financial statements if the FASB worked together with the IASB to develop a single derecognition model with a coordinated plan of transition. This would avoid potential successive changes in accounting standards as reporting by U.S. companies converge with international standards.”
- LNR Property Holdings (Letter #29) stated, “With the continued increasing emphasis on convergence towards International Financial Reporting Standards ("IFRS"), we do not believe that a significant change to a new derecognition model, especially one that diverges from the current international model, is justified at this time.”
- ACLI (Letter #35) stated, “We do not believe that this guidance provides the improvement necessary to require two changes, one with the implementation of the proposed guidance and another for the implementation of the converged guidance.”
- The Federal Regulatory Agencies (Letter #48) stated, “However, taking additional time at this stage to develop a long-term, converged approach would permit a thorough consideration of all alternative approaches and promote greater consistency on an international basis. We believe that the FASB’s proposed improved disclosures will provide additional transparency during the time necessary to work jointly with the IASB on a converged approach.” [Footnote reference omitted.]

4. However, financial statement users generally supported the Board's plan to proceed with its issuance of the proposed amendments to Statement 140.
  - CFA Institute (Letter #46) stated, "While we agree that any changes to FAS 140 should be ultimately aligned with current efforts of the International Accounting Standards Board (IASB) to amend international accounting for transfers of financial assets, we nonetheless strongly urge the Board to reject pleas to shelve the ED until a converged standard is developed. The Board has expended considerable time and resources to develop a new standard and it is quite evident that immediate improvements are vital to provide investors and the capital markets with information about these significant exposures."

### **Other Recommended Accounting Approaches**

#### **No-Continuing-Involvement Model**

5. Statement 140, as amended, permits a transferor to derecognize financial assets in a transfer in which the transferor maintains continuing involvement, as long as the criteria in paragraph 9 of Statement 140, as amended, are met. Most respondents agreed with that determination. These respondents did not believe a no-continuing-involvement model would properly report transfers in a manner that would be consistent with the economics of many transfers. Additionally, some of these respondents noted that a no-continuing-involvement model would need an exception for servicing. For example:
  - Mortgage Bankers Association (Letter #2) stated, "A no continuing involvement model would be unjustifiable because it would produce inaccurate financial reporting results for the vast majority of transfers of assets in which transferors retain the right and obligation to service the transferred assets."
  - PricewaterhouseCoopers (Letter #15) stated, "We agree with the Board's decision to not support a no-continuing-involvement model. Such a model would be inconsistent with the overall economics of many financial asset transfers. Additionally, a no-continuing-involvement model is inconsistent with the fundamental financial components approach that was the basis for FAS 140 and its predecessor...."
6. However, a few respondents stated that a no-continuing-involvement model should be reconsidered. For example:
  - Donald Gorton (Letter #40) stated, "I believe the no-continuing-involvement alternative (there were 3 alternatives presented by the staff for the Board's consideration) merits further consideration. While the

Board's vote against the proposal, on April 7, 2008, was in fact 4-3, the reasons advanced were neither convincing nor compelling.”

- CFA Institute (Letter #46) stated, “We support de-recognizing assets only when control has been surrendered, and associated financial benefits and risk exposures have ceased, and to derecognize liabilities only when they have been extinguished. To that end we urge the Board to adopt a *no-continuing involvement* model for transferred assets to qualify for derecognition accompanied by robust disclosures. This model would be the least complex approach that would also eliminate financial engineering opportunities.”
7. Additionally, one respondent proposed an alternative model for the long-term project on derecognition.
- New York State Banking Department (Letter #21) stated, “We believe a better long-term solution would be to prohibit sales accounting if any recourse is retained by the seller. This basic concept, with minimal exceptions, was used by bank regulators until 1997, when regulatory accounting was changed to comply with GAAP.”

#### **Linked Presentation**

8. One respondent recommended that the Board consider linked presentation on the face of the balance sheet for certain structures where additional consolidation could be misleading:
- JP Morgan (Letter #41) stated, “The elimination of QSPEs coupled with the proposed changes in the FIN 46(R) Exposure Draft will result in more transactions being consolidated, under US GAAP. In certain structures we believe that this additional consolidation could be misleading for users as ‘over consolidation’ can result in a lack of transparency and misinformation to the same extent as ‘under consolidation’. Therefore, we believe that a linked presentation model would be appropriate for certain consolidated vehicles.”

JP Morgan suggested that the following factors be considered in determining whether linked presentation is appropriate:

- Whether the reporting entity has the ability to control the assets within the vehicle for its own benefit
- Whether the reporting entity has the right or obligation to regain control of the assets within the vehicle
- Whether the assets are isolated for the benefit of the third party beneficial interest holders
- Whether the reporting entity has any obligation to repay the beneficial interest holders in the event that the specific assets provide insufficient funds to repay financing provided by beneficial interest holders.

## Financial Components Approach

9. A few respondents noted that some of the requirements for derecognition are inconsistent with the financial components approach in Statement 140. For example:
- CMSA, MBA, and RER (Letter #6) stated, “We do not see how the division of a financial asset into a senior and junior portion through the use of the participation structure and sale of the junior or riskier portion of the financial asset can, in any sense, be construed as a secured borrowing by the transferor. Such a characterization is inconsistent with the financial component approach of FASB Statement No. 140.”
  - LNR Property Holdings, Ltd. (Letter #29) noted, “Consistent with the fundamental financial components approach which formed the basis of FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (“FAS 140”), we believe that the FASB should included individual asset classes and any other financial instruments recognized for accounting purposes in its guidance of what constitutes an ‘individual financial asset.’”
10. Several respondents disagreed with the participating interest concept and stated that meeting the requirements of paragraph 9 would adequately determine whether a portion of a financial asset should be accounted for as a sale or accounted for as a secured borrowing. Those respondents felt that the participating interest concept should be eliminated. For example:
- Citigroup (Letter #8) stated, “We believe the application of the requirements in paragraph 9 to all transfers of financial assets, including transfers of a portion of a financial asset, should be conceptually consistent and should not result in two economically identical transactions being accounted for differently.”
  - Discover Financial (Letter #31) stated, “We suggest the determination of whether a transaction involves the transfer or a portion of a financial asset or the entire financial asset should be based on a consideration of the legal characterization of the transfer. In particular, a transfer of ‘all right, title and interest’ in a financial asset should always be treated as a transfer of that financial asset in its entirety, whether or not the transferor has equity or other interests in the transferee.”
  - United Western Bancorp (Letter #34) stated, “We believe a transfer of a financial asset between a willing buyer and a willing seller should stand on its own merits.”
  - AICPA AcSEC (Letter #44) stated, “We are not aware of any abuses in practice related to transfers of a portion of an asset and this new guidance makes the standard much more difficult to apply, would significantly change practice and would result in accounting that doesn't make sense.”

## Qualifying SPEs

11. The proposed amendment to Statement 140 would eliminate the concept of a qualifying SPE. The removal of this concept would require that all SPEs be evaluated using the same consolidation framework. Many respondents supported the removal of the qualifying SPE concept. For example:

- KPMG (Letter #5) stated, “We believe the elimination of the QSPE concept in Statement 140 is an improvement in financial reporting that will reduce complexity and will result in a more objectives-based standard related to the transfer of financial assets.”
- Bank of America (Letter #45) stated, “While the Board has struggled with conceptual issues surrounding the activities of qualifying special-purpose entities (QSPEs), practitioners also struggle as they attempt to comply with the complex rules. We support the proposed changes to FAS 140 which will move the U.S. closer to international convergence while eliminating the existing practice issues including those related to QSPEs.”
- The CFA Institute (Letter #46) stated, “We agree that QSPEs should be eliminated and that these entities should be evaluated for consolidation. We agree with the Board's findings that the range of financial assets being securitized and the complexity of securitizations structures have resulted in QSPE criteria being stretched in some cases significantly beyond the intent and requirements of Statement No. 140.”
- Some respondents disagreed with removing the qualifying SPE concept. One of these respondents suggested that the concept would be sufficiently improved if the Board were to clarify the proper degree of servicing discretion permitted by a servicer of a qualifying SPE and otherwise retain the qualifying SPE concept.
- Capital One (Letter #10) stated, “This approach... has worked especially well for traditional securitization transactions, including those involving credit-card receivables and auto-loan receivables and most mortgage loans...The proposed changes to FAS 140 and FIN 46(R) are, we believe, too broad and may result in the consolidation of numerous qualifying special purpose entities (QSPEs) that previously received off balance sheet accounting, including such securitizations where the transferor retains only a portion of the benefits and risks associated with ownership of the receivables.

However, we agree that FAS 140 should be amended to clarify the proper degree of servicing discretion that can be exercised under this accounting standard, considering there have been instances where some issuers may have stretched the activities of a QSPE beyond those initially contemplated.”

12. Some respondents believe that the elimination of the concept of a qualifying SPE would result in overconsolidation of assets and liabilities. For example:

- The American Council of Life Insurers (Letter #35) stated, “While we conceptually agree with the elimination of the QSPE, we are very concerned about the impact of its elimination and the consolidation consequences based on the proposed guidance. The extent of QSPEs that certain entities may be required to consolidate based on the qualitative approach provided by the proposed guidance could result in financial statements with significant gross ups of assets and liabilities for entities that are not significant to the operations of the company. While certain high profile entities that qualified as QSPEs have created financial liabilities for entities, we still believe that the vast majority of the QSPEs should not require consolidation.”
  - Marriott International (Letter #4) stated, “We are particularly concerned that consolidation of QSPEs could be misleading to the users of financial statements because the financial statements would include assets to which transferors have only limited rights (i.e. residual interests) and liabilities for which the transferor has no obligations, thus failing to meet the definitions of these financial statement components as provided for within FASB Statement of Financial Accounting Concepts No. 6, *Elements of Financial Statements* (“CON 6”). For example, if a QSPE was consolidated after securitization, the consolidating enterprise would record all the assets and liabilities of the QSPE, even though the consolidating enterprise has no rights to the probable future economic benefits, other than for any participating interests held, and no obligation to settle liabilities as they come due.”
13. Some respondents agreed that qualifying SPE concept was flawed, but felt that the removal of the qualifying SPE concept would only be effective if significant improvements were made to the proposed amendments to FASB Interpretation No. 46 (revised December 2003), *Consolidation of Variable Interest Entities*. For example:
- Mortgage Bankers Association (Letter #2) stated, “MBA believes the prescriptive nature of the QSPE concept has fostered a ‘check-the-box’ approach to accounting for financial asset transfers (e.g., Is this servicer activity permitted? Is this activity entirely specified in the governing documents?), which, over time, has misdirected attention from judgments about ownership of cash flows to concerns about activities designed to preserve and protect the cash flows. Consequently, MBA supports this change to FAS 140 *provided* the change is accompanied by significant improvements to the FIN 46(R) Proposed Statement....”
  - Deloitte (Letter #12) stated, “Although the implementation issues related to whether an SPE is considered a qualifying SPE are eliminated by the proposed Statement, financial statement preparers will need to address new issues as part of the consolidation evaluation under the proposed amendments to Interpretation 46(R). For example, the subjective criteria for determining whether an SPE is a qualifying SPE will be removed and replaced by equally subjective criteria for determining who ‘has the power to direct matters that most impact the activities of the entity.’ For entities

whose activities are prescribed by a trust agreement and servicing guide, it may be difficult to determine who ‘has the power to direct matters that most impact the activities of the entity.’ We agree with the Board’s decision to eliminate the concept of a qualifying SPE provided that there are significant improvements made to the proposed modifications to Interpretation 46(R).”

- LNR Property Holdings (Letter #29) stated, “While the elimination of the concept of a QSPE is not troubling in and of itself, we believe that significant improvements must be made to the current exposure draft of FIN 46(R) in order for these standards to be jointly operational. The introduction of the highly subjective determination of who ‘has the power to direct matters that most impact the activities of the entity” by the current FIN 46(R) exposure draft is one which is certain to create confusion and inconsistency amongst preparers.’

14. One respondent recommended that the Board conduct a study of the effects of removing the qualifying SPE concept to better determine the potential impact to capital markets. Mortgage Bankers Association (Letter #2) stated that the study should “assess the costs/benefits to businesses of changing their systems and procedures to comply with potentially three different accounting models (i.e. the FAS 140 and FIN 46(R) model, the FAS 140 and FIN 46(R) Proposed Statements model, and ultimately a GAAP/IAS convergence model) for financial asset transfers within a relatively short period of time; determine if newly consolidated information would provide users with more useful information than would be provided through enhanced disclosures; consider the extent to which the Proposed Statements, as drafted, would discourage securitization transactions and thereby reduce the availability of credit and increase interest rates.”

15. Some respondents felt that the basis for conclusions did not adequately explain the reasons for the removal of the qualifying SPE concept. Other respondents were concerned that certain language inappropriately chastised preparers and auditors for the language oversimplified a complex issue and would falsely lead individuals to interpret past events. For example:

- AICPA AcSEC (Letter #44) stated that they “object to the language in the Basis for Conclusions (paragraphs A17, A18 and A26) that criticizes preparers and auditors for so-called abuse in the application of FASB

Statement 140 to QSPEs and argues that the Board was not aware of these issues.

[T]he record will show that the Board had every opportunity to obtain an in-depth knowledge of structures widely considered to be QSPEs. We recommend that such language be deleted from the Basis for Conclusions, because it is incorrect, inappropriate, and misstates what actually occurred.”

- Huron Consulting Group (Letter #43) stated that they “recommend the Board revise its comments in paragraphs A18, A23 and A26 of the Basis for Conclusions. The FASB has long been aware of the first two practice issues cited as raising questions about whether companies were applying Statement 140 correctly. The EITF attempted to address questions about rollovers of beneficial interests in Issue No. 02-12, "Permitted Activities of a Qualifying Special-Purpose Entity in Issuing Beneficial Interests under FASB Statement No. 140," but was unable to reach a consensus. Further, the FASB addressed a number of servicer discretion issues in the Staff Implementation Guidance on Statement 140, indicating an awareness of the extent to which there were practice issues. Finally, we believe the credit crisis raised new issues around servicer discretion, mostly because of pressure on servicers to modify loans on which borrowers were likely to default in an attempt to help those borrowers avoid foreclosure.”

## **Participating Interests**

### **Scope**

16. One respondent requested that the Board clarify whether the term *individual financial asset* refers to the residual interest held by the entity or to the securitized assets underlying the residual interest.
  - KPMG (Letter #5) stated, “We believe that the guidance related to participating interests should apply to the financial assets that are recognized for accounting purposes. For example, a beneficial interest in a securitization is a financial instrument that should be eligible to be a participating interest even though it represents a share of the assets underlying the beneficial interest. Depending on the final guidance provided in the amendment to FIN 46(R), this could be a significant issue as many holders of residual interests may transfer a portion of their residual interest so that they do not hold a majority of the expected losses of a variable interest entity if the quantitative primary beneficiary test is retained in FIN 46(R).”
17. Some respondents did not understand why the definition of a participating interest could not include equity, derivatives, or hybrid financial instruments.

Those respondents requested that the Board reconsider and better explain the limitation. For example:

- KPMG (Letter #5) stated, “As many securitized instruments have characteristics of both debt and equity, the Board should clarify whether it intends for interests in securitizations to be excluded from the scope of instruments that may meet the definition of a participating interest. For example, would a ‘seller’s interest’ in a credit card securitization trust (which is in the form of a debt security) meet the definition of a participating interest, whereas a residual interest in a trust that has certain characteristics of an equity instrument would not meet the definition of a participating interest?”
- Citigroup (Letter #8) stated that they “do not see the conceptual merit in excluding a transfer of equity instruments, derivative Instruments, and hybrid financial instruments from classification as a participating interest when they would otherwise meet the requirements to be classified as a participating interest. Those limitations had some merit when the Board originally considered this concept in connection with QSPEs, which could only hold passive financial assets, but with the elimination of QSPEs, it seems to be a restriction without a justifiable purpose. Moreover, we see no reason to treat the transfer of a pari passu interest in a hybrid debt instrument any different from the transfer of a debt instrument that does not contain a bifurcated embedded derivative.”

#### **Proportionate Ownership Shares**

18. The definition of a participating interest requires that all cash flows received from the asset be divided among the participating interest holders in proportion to the share of ownership. Some respondents were concerned that a requirement in which the distribution be pro rata over the life of the loan would preclude some participations that would otherwise meet the requirements. For example:

- Deloitte (Letter #12) stated, “As proposed, the requirement that the ‘transferor's ownership shares must remain pro rata over the **life of the original asset**’ (emphasis added) could be interpreted to require that all cash flows over the life of the original asset need to be divided proportionately, even when the participating interest was sold after the origination date of the financial asset. In addition, this would allow the originating lender in a bank participation loan to exclude origination fees (e.g., documentation fees, title fees) that are received before the sale of the participating interest when the originating lender identifies the cash flows that are divided among the participating interests. The language in the proposed Statement appears to indicate that these fees would not be excluded from the allocated cash flows, which would result in most

participating loan agreements (when the originator receives originating fees before the sale of the participating interests) to fail sale accounting.”

- McGladrey & Pullen (letter #47) stated, “We would ask that the FASB consider eliminating or clarifying the requirement in paragraph 8B(b) that the transferor's ownership shares must remain in exactly the same pro rata position as the original date through the life of the financial asset. In standard loan participation agreements, it is not uncommon for the transferor's proportionate interest to vary over the life of the original financial asset.”

### **Cash Flows to Be Included in the Determination of Participating Interest Cash Flows Are Proportionate**

19. The definition of a participating interest also allows cash flows allocated to a servicer to be excluded from the determination of whether the cash flows of the participation are allocated according to the proportionate ownership of the participating interests. Some respondents felt that additional types of fees should be excluded from the determination. For example:

- Freddie Mac (Letter #7) stated, “We believe that this limitation should be expanded to other cash flows, such as guarantor fees, trustee fees, and other fees necessary to complete the transaction, so long as the remaining cash flows are divided among the participating interests as described in paragraph 8B of the proposed Statement.”
- Credit Suisse (Letter #16) stated, “Although servicing fees are explicitly excluded from the determination of whether cash flows are equally divided among all participants, other fees such as syndicating, structuring, arranging, underwriting or agency fees are not explicitly excluded. We recommend the Board amend paragraph 8(b) to indicate whether such fees will compromise the ability of a financial asset to meet the proposed definition of participating interests.”
- JPMorgan (Letter #41) stated, “We ask that the FASB treat these fees similar to the fees allocated to the servicer and exclude origination and other fees earned by the transferor in the determination of whether the cash flows of the loan are divided among the participating interests in proportion to the share of ownership, as these fees are compensation for services performed.”

20. Some respondents commented that cash flows that represented origination fees or the gain or loss on the participation should be excluded from the determination of whether participation cash flows are proportionate to ownership. For example:

- Deloitte (Letter #12) stated, “Because a participating interest in an asset may be sold after the purchase or origination of the asset, often the interest rate passed through for the portion of the asset sold is based on the market rate at the time of sale and differs from the contractual coupon on the financial asset. Generally, this difference is attributable to changes in market interest rates between the origination of the financial asset and the sale of the participating interest. For example, if an entity originates a loan with a contractual coupon of 8 percent but subsequently sells a portion of that loan, in a declining interest rate environment, for a 6 percent coupon, the retained 2 percent coupon is effectively the transferor's gain on sale of the portion of the loan sold. However, because cash flows equal to 8 percent are received on the portion of the loan sold, it is unclear whether an allocation of cash flows equal to only a 6 percent coupon to participating interests would meet the requirement in paragraph 8B(b). Under the proposed Statement, the transferor would need to (1) sell the participating interest at either a discount or a premium or (2) build (reduce) the excess interest into (from) the servicing fee. However, the issuance of participating interests at discounts or premiums will introduce significant prepayment risks associated with these investments, which may make them less attractive to market participants.”
  - Excel National Bank (Letter #19) stated, “We agree with several of the earlier comment letters which suggested that origination fees and cash flows received that represent the transferor's gain or loss on the sale of a portion of a financial asset should be excluded from the requirements of paragraph 8B(b) of the Proposed Statement.”
21. One respondent recommended that the exclusion of servicing fees should be limited to those fees that are (a) not subordinate to the proportionate cash flows and (b) not significantly above or significantly below adequate compensation.
- The respondent, PricewaterhouseCoopers (Letter #15), stated, “Consider an arrangement where the cash flows allocated to the servicer are subordinate to the transferor's and the transferee's participating interests. We believe that such subordination alters the rights to the cash flows of the underlying assets and as a result such an allocation should not meet the definition of a participating interest. Additionally, the servicing fee could be structured in a manner that subordinates the cash flows of the underlying asset while still meeting the definition of a participating interest. Consider a fact pattern where the servicer is allocated cash flows significantly in excess of adequate compensation and in a manner that is senior to the participating interests. This could result in the servicer subordinating cash flows allocated to the participating interest holder.”

## Priority and Recourse

22. Paragraph 8B(c) requires that the rights of each participating interest holder have the same priority and that the participating interest holders have no recourse, other than standard representations and warranties, to the transferor. Several respondents requested that the Board clarify what effect third-party guarantees would have on this analysis. For example:
- KPMG (Letter #5) stated that “the proposed Statement does not address the effect of third-party guarantees (including SBA loans) and interest-only and principal-only allocations. The Board should clarify the effect of guarantees and specific allocations (such as interest- or principal-only) in determining whether an ownership interest is proportionate.”
  - Excel National Bank (Letter #19) stated, “We believe that if the participations of SBA 7(a) guaranteed portions fail to meet sales treatment under the new requirements of paragraph 8B of the Proposed Statement, many lenders will abandon the guaranty programs.”
  - The Clearing House Association (Letter #24) stated that they “are concerned that paragraph 8B(c) could preclude accounting sale treatment for many loan participations that contain standard protection provisions such as the servicer obligation to protect the rights of the contracts or not acting in gross negligence, willful misconduct or bad faith in addition to other ongoing contractual obligations of the transferor that may be providing other services or making certain covenants in the loan participation agreement. In addition, there may be certain issues regarding recourse to the transferor and/or other participating interest holders under set-off sharing provisions. We urge that the FASB clarify that breaches of on-going obligations would not preclude such interests from meeting the criteria set forth in paragraph 8B(c).”
23. Some respondents expressed concern that the participating interest concept was an overreaction by the Board. One respondent, Community State Bank (Letter #1), noted that the Board should “allow true sale/participations to continue while changing the rules for Special Purpose Entities (SPE) that were the primary cause of the current problems....”
24. Some respondents were concerned that the proposed accounting for common transactions would have a negative effect of the accounting for these types of transactions. Respondents specifically mentioned potential negative effects on LIFO participations of revolving lines of credit and SBA loans. For example:
- Temecula Valley Bank (Letter #28) stated that After the guaranteed portion of a SBA 7(a) loan is participated, the Buyer has a full faith and

credit guarantee by the United States. Therefore, the Buyer generally receives a yield on the guaranteed portion that is substantially lower than the borrower's note rate. Would the difference between the note rate and the Buyer's guaranteed portion cause the transaction to fail the requirements of paragraph SB (b) of the proposed Statement?"

- Excel National Bank (Letter #19) stated, "We believe that if the participations of SBA 7(a) guaranteed portions fail to meet sales treatment under the new requirements of paragraph 8B of the Proposed Statement, many lenders will abandon the guaranty programs. The result of lenders abandoning the SBA programs will reduce the credit available to small businesses. Providing credit to small businesses is critical to our economy."
- National Associate of Government Guaranteed Lenders (Letter #38) stated, "As originators of SBA 7(a) loans, our members have communicated to NAGGL their strong concern about the Amendment to FASB No. 140 currently under consideration. The concern revolves around the negative impact the Proposed Statement will have on participating interests, and the result that the proposed accounting treatment may not be consistent with the underlying economics of the transaction."
- The Federal Regulatory Agencies (Letter #48) stated, "Therefore, we urge the FASB to clarify that when a loan partially guaranteed by a U.S. Government agency is divided into guaranteed and unguaranteed portions, the transfer of the guaranteed portion would be eligible for sale accounting without having to structure an SPE that is not consolidated under the new requirements of FIN 46(R), which would avoid a potentially significant disruption to the credit availability initiatives administered by the SBA and other U.S. Government agencies."

25. One respondent noted that accounting for certain transfers of financial assets as secured borrowings under the proposed Statement would give rise to a fair value measurement issue.

- Specifically, the Federal Home Loan Bank of Chicago (Letter #20) noted, "If the transfer by the [Participating Financial Institution] PFIs accounted for as a secured borrowing, the PFIs will have a mortgage asset that they do not control and for which they do not have market risk. We believe this creates a fair value measurement issue. Specifically, would representational faithfulness exist if a PFI were to carry these loans at fair value when they do not have control over them to sell them and they do not have market risk for them?"

26. Some respondents were concerned that the right of offset would preclude a portion from meeting the definition of a participating interest due to the inherent priority of the offset amounts. For example:

- KPMG (Letter #5) stated that they “understand that set-off rights between the borrower and the transferor could create seniority for a transferor’s interest in a participation that would cause the arrangement to not meet the definition of a participating interest under paragraph 8B(c) of Statement 140, as added by the proposed Statement.

We understand that these types of set-off rights are common and in many instances exist as a matter of law. We do not believe that the Board intended for such set-off rights to preclude a transferred portion of a financial asset from meeting the definition of a participating interest. Therefore, we suggest that this issue be explicitly addressed in the proposed Statement.”

- The Clearing House Association (Letter #24) stated that “there may be certain issues regarding recourse to the transferor and/or other participating interest holders under set-off sharing provisions. We urge that the FASB clarify that breaches of on-going obligations would not preclude such interests from meeting the criteria set forth in paragraph 8B(c).”

#### **Right to Pledge or Exchange the Entire Financial Asset**

27. Paragraph 8B(d) provides that a participating interest in an individual financial asset constitutes a participating interest only if no party has the right to pledge or exchange the entire financial asset. For example:

- LSTA (Letter #11) believes that an entity should have the right to pledge or assign the entire financial asset if (a) it is 100 percent of participating interests or (b) the participating interest holders collectively decide to assign the financial asset.
- JPMorgan Chase (Letter #41) stated, “Under current LSTA master loan participation agreements, the transferor is permitted to assign the underlying loan with the consent of the participants. We believe that as long as the participating interest holders agree to the transfer or assignment of the loan, this should not disqualify a loan participation from being accounted for as a sale.”

#### **Other**

##### **Two-class Participations**

28. One respondent stated that a two-class participation, in which all interests in the underlying asset have been transferred, should be accounted for as a sale.

- Citigroup (Letter #8) further stated, “If the concept of participating interests is retained in the final Statement, it is not clear why two-class participations should not meet sale requirements if all cash flows are passed through to participants and participants in each class are pari passu with the participants in their respective classes. For example, if an entity

originates a loan and transfers a senior 80% undivided interest in the loan to a third party (Party A) and shortly thereafter transfers the junior 20% undivided interest in the loan to another third party (Party B), the proposed Statement reads to require that the parties (the originator, Party A, and Party B) each account for the transactions as a secured borrowing or secured lending, notwithstanding the fact that the originator has no continuing economic interest in the asset and notwithstanding the fact that Party A and Party B may have no knowledge of the involvement or form of the other participation. Is it the Board's intention that each transfer be considered a secured borrowing or secured lending or should the transfers be collectively evaluated and considered a sale once the originator no longer has a continuing economic interest in the asset?"

#### **Differences between Transfers of a Portion of a Financial Asset and an Entire Financial Asset**

29. Some respondents felt that the participating interest concept would result in inconsistent accounting for economically similar transactions. For example:

- PricewaterhouseCoopers (Letter #15) stated, "The participating interest definition may not always result in accounting that reflects the economics of a transaction. Consider a factoring arrangement whereby a portion of a \$100 financial asset (a trade receivable) is legally transferred to a transferee and such portion represents a right to the first \$90 of cash flows from the trade receivable (i.e., the portion not sold is subordinate). Under paragraph 8B(c), such a transfer of a portion of a trade receivable would not qualify as a participating interest because of the subordination feature. However, the same economics could be achieved by transferring the entire \$100 financial asset, with the transferor accepting a receivable from the transferee, where the obligation for the transferee to pay depends on the performance of the trade receivable (i.e., the transferee is required to pay amounts collected from the trade receivable in excess of \$90). In essence, the transferor accepts a non-recourse collateral-dependent receivable from the transferee. The economic substance of the two transactions is the same, but they may result in different accounting."
- Cigna (Letter #18) stated, "In [an] arms-length transaction, a third-party buyer will pay fair value for a senior interest that will earn a market rate of interest commensurate with the level of risk associated with the asset.

However, the new conditions in paragraph 8 of the proposed amendment would require such a transaction to be treated as a secured borrowing under paragraph 12, while a similar transaction where the participating interest holder's share in cash flows on a pro rata basis may be accounted for as a sale. This will create inconsistent accounting and recognition of assets and liabilities when the seller in both transactions no longer has the right to cash flows from the asset sold, nor the obligation to return the funds received. It is not clear to us why derecognition of the portion transferred in a senior/junior arrangement would be prohibited."

- Nationwide Insurance (Letter #36) stated, “Any type of transaction should be subjected to the same sales ‘tests’, otherwise inconsistency can result. For example, consider a loan participation deal where there is a senior tranche and a junior subordinated tranche of ownership. If an entity sells 98% of this asset and retains 2% (the junior tranche) which is subordinated in terms of receiving principal and interest, the Proposed Standard would require secured borrowing accounting. If the same asset is purchased by another company through an off-balance sheet special purpose vehicle and they acquire the 98% bond and the original transferor purchases the junior 2% bond, then sale accounting is achieved. Economically, the results are the same; however, the Proposed Standard causes inconsistent accounting treatment.”

## **Interrelation of Consolidation and Derecognition Analyses**

### **Accounting for Transfers within a Consolidated Group and for Standalone Financial Reporting**

30. The proposed amendment to Statement 140 requires that the transferor consider arrangements by both itself and its consolidated affiliates to evaluate isolation and effective control. Many respondents were concerned that this guidance would preclude sale accounting for transfers between a parent and a subsidiary, or transfers between subsidiaries even on an entity’s standalone financial statements. For example:

- AICPA AcSEC (Letter #44) stated, “We also would suggest that the FASB clarify the accounting for a transfer from a parent to a subsidiary. Presumably, the parent would not account for the transfer as a sale; since the parent has control over the subsidiary, it would be deemed to have effective control over the transferred financial assets. Therefore, it appears that such transfers would never be eligible for sale accounting. If symmetrical accounting for both the parent and subsidiary is achieved, the subsidiary could never account for the assets it received in the transfer in its standalone financial statements.”
- KPMG (Letter #5) stated, “Given that the accounting in Statement 140 is symmetrical for the transferor (the parent) and the transferee (the subsidiary), the fact that the parent could not derecognize the transferred assets (either due to the guidance in paragraph 9(a) and/or paragraph 9(c)) means that the subsidiary could not recognize those assets in its separate financial statements. The Board should consider revising paragraph 9 to permit parent to subsidiary transfers to be accounted for as sales and purchases of the transferred assets by the parent and subsidiary, respectively.”
- McGladrey & Pullen (Letter #47) stated, “We also would suggest the FASB clarifies the accounting by a subsidiary in a transfer of financial assets from the parent when the transfer does not meet sale accounting.

Presumably, the parent would not account for the transfer as a sale. Since the parent has control over the subsidiary, it would be deemed to have effective control over the transferred financial assets. Therefore, it appears that such transfers would never be eligible for sale accounting. If symmetrical accounting for both the parent and subsidiary is achieved, the subsidiary could never account for the assets it received in the transfer in its standalone financial statements.”

### **Order of Application of Statement 140 and Interpretation 46(R)**

31. The proposed amendment to Statement 140 does not require that a specific order is followed while an entity evaluates derecognition and consolidation accounting. Some respondents felt that the proposed amendment to Statement 140 implied a certain order in which an analysis should be performed. Other respondents asked the Board to clarify in what order the analyses should be performed. For example:

- Citigroup (Letter #8) stated, “The proposed Statement implies that consolidation guidance should be applied before derecognition guidance. However, this is not explicitly stated. If this was the Board's intent, this should be clarified. We would observe that such a requirement would prohibit a transfer from a parent to a subsidiary from being recognized as a sale on the stand-alone financial statements of the parent. Is this what the Board intended? We believe that the more logical approach would be to first analyze the transfer under the amended FAS 140 and then analyze the consolidation of the transferee entity, since that follows the order of the business activity.”
- Bank of America (Letter #45) stated, “In many circumstances, these results would have no impact, as a sale between consolidated affiliates is eliminated in consolidation. However, the interaction between the sale accounting analysis and the consolidation analysis for a VIE under FIN 46(R) creates a logical circularity because the consolidation analysis may be dependent upon the sale accounting analysis.

Consider, for example, the transfer of mortgage loans to a VIE that holds no other assets. If the transfer is accounted for as a sale and the transferor has a variable interest in the VIE, the transferor may be the primary beneficiary. However, if the transfer is accounted for as a secured borrowing, the VIE holds a receivable from the transferor. As this receivable is a creator of variability, the transferor no longer has a variable interest in the VIE and therefore cannot be the primary beneficiary.

Thus, if a tentative sale accounting conclusion leads the transferor to consolidate the VIE, the sale accounting conclusion cannot survive, since consolidation renders sale treatment impossible. Yet, in the absence

of sale treatment the VIE would not be consolidated, which would make sale accounting possible.

To prevent this outcome, we recommend that paragraph 9 be modified such that the transferee is not considered a consolidated affiliate for purposes of performing the sale accounting analysts. As previously noted, this will not affect the presentation in consolidated financial statements, as the impact of the transfer, including any gain on sale, will be eliminated in consolidation. It merely eliminates a logical circularity in applying these two interrelated standards.”

### **Legal Isolation**

32. Respondents to the Exposure Draft were generally supportive of the changes to the isolation guidance. However, some respondents asked that the Board expand the implementation guidance to include more examples about how to apply it in additional jurisdictions such as the United Kingdom and institutions subject to receivership under various banking regulatory regimes in the United States. A few asked that the implementation guidance mirror the auditing guidance in AU Section 9336, “Using the Work of a Specialist: Auditing Interpretations of Section 336.” A few also asked for a more expansive discussion in the implementation guidance on how to do a legal analysis in various specific situations.
33. A couple of respondents asked that the Board to discuss the impact of setoff rights on isolation in the standard rather than in the basis for conclusions. For example:
  - KPMG (Letter #5) stated that “the Board should address how an attorney should identify and analyze arrangements or agreements contemplated at the date of transfer but not yet entered into as of that date for purposes of the legal isolation analysis.”
  - Deloitte (Letter #12) stated, “We also believe that the Board should consider including some of the information in the Background Information and Basis for Conclusions section, such as the discussion on set-off rights in paragraph A14, in the standard section of the final Statement....”

### **Effective Control**

#### **Differences in the Description of Control in Statement 140 and Interpretation 46(R)**

34. The concept of effective control, as described in the amendments to Statement 140, was inconsistent with the definition of a *controlling financial interest* in

the amendments to Interpretation 46(R). Some respondents commented that it was inappropriate to require a transferor to consolidate assets in accordance with Interpretation 46(R) if the transferor accounted for the transfer as a sale because it determined that it did not maintain control of those assets after applying Statement 140. Others questioned whether the differences in the definitions of control could lead to any unintended consequences or result in implementation issues. For example:

- LNR Property Holdings (Letter #29) stated, “It would be contradictory to conclude on the one hand that a transfer of financial assets to a securitization vehicle met the criteria for sale treatment by FAS 140, but on the other hand required consolidation of those same assets by FIN 46(R). As such, we believe that the two standards ultimately issued by the FASB with regards to both derecognition and consolidation principles should be consistent and ultimately based on the overriding concept of a controlling financial interest.”
- Freddie Mac (Letter #7) stated, “The concepts of control in the proposed Statement differ significantly from the concepts of control in the Proposed Amendments to Interpretation 46(R). As a result, it is quite possible that securitization transactions will meet the criteria for a sale under the proposed Statement, yet will be consolidated by the transferor under Proposed Amendments to Interpretation 46(R). We believe this will result in confusion for users of the financial statements, given the differing definitions of control and the different conclusions about control (i.e., that the transferor has surrendered control over the transferred assets, yet has power and control and should thus consolidate). This result presents new irreconcilable differences in the accounting literature that we believe will create additional issues in the future that will need to be addressed.”
- Grant Thornton (Letter #13) stated, “We are concerned that differences between effective control over an asset and a controlling financial interest in an entity could provide a structuring opportunity to account for similar economic events differently depending on whether the transaction involves the asset itself or an entity created to hold the asset.”

## **Effective Control**

### **Paragraph 9(c)(3)**

35. The majority of the respondents’ comments on effective control were related to paragraph 9(c)(3) in the Statement 140 amendments. Most of those comments stated that paragraph 9(c)(3), as currently drafted, is not clear, is not operational, or is overly subjective. For example:

- Mortgage Bankers Association (Letter #2) stated, “The MBA finds it difficult to assert that the transferee gets the primary benefit of such a restriction in most securitizations, because the transferee is primarily a conduit for the transferor to maximize its proceeds on its transferred loans.”
- CMSA, MBA, and RER (Letter #6) stated, “If a transfer of a financial asset occurs between parties free to contract, a benefit to the transferee should be assumed. Otherwise, the transferee would not purchase the financial asset.”
- Fannie Mae (Letter #9) stated, “We have discussed this principle with specialists in the securitization industry and have not been able to reach a clear consensus as to how it should be applied to our securitization program.

[W]e believe that the basic principle could be interpreted differently for even the simplest securitization structures....

[I]t would be reasonable to argue that any restriction that increases the marketability of the certificates is primarily for the benefit of Fannie Mae.”

- Ernst & Young (Letter #17) stated that “one could assert that the [beneficial interest holders] pay the transferor for any benefit they are receiving as it is considered in determining the fair value of the [beneficial interests] they purchase.”
- GR Solutions (Letter #39) stated, “To be able to sell their ownership interest, the transferee entity articles of incorporation, partnership agreement, or trust document strictly limit the transfer of the assets contributed to the entity. Without the restriction, there is nothing to securitize - no market whatsoever. So which entity is ‘primarily benefited’ - the transferor or the transferee?”
- Huron Consulting Group (Letter #43) stated, “We believe constraints will, in many cases, benefit both the transferor and the transferee and we are not sure how a transferor should determine whether the constraint is primarily for its benefit or is primarily for the transferee's benefit. The discussion in paragraphs 54A and 54B implies that the provision prohibiting the transferee from pledging or exchanging the transferred financial assets either benefits the transferor or benefits the transferee, but not both. We are concerned with the inevitable second-guessing, years after the fact, of a company's conclusion that a constraint was primarily for the benefit of the transferee.”

36. In addition to concerns about the operability of paragraph 9(c)(3), some respondents questioned the relevance of including paragraph 9(c)(3) in the determination of whether a transferor maintains effective control over transferred financial assets. These respondents did not think that the presence

of a constraint should prohibit a transferor from derecognizing the financial asset. For example:

- CMSA, MBA, and RER (Letter #6) stated, “While we recognize that some restrictions may be indicative of retaining control, the mere presence of such a restriction should not automatically cause the transferor to have ‘effective control’ of the transferred asset.”
- The Clearing House Association (Letter #24) stated that “it should not be relevant whether the transferee can sell or pledge, as long as we have determined that the transferor cannot regain control.”

37. Respondents proposed several alternative amendments to address these concerns. The most common alternative suggested was to delete paragraph 9(c)(3) in its entirety. Some of the other alternatives include:

- Allow the transferor to look through an SPE and determine whether the beneficial interest holders have any restrictions on their ability to pledge or exchange their investments in an SPE.
- Remove the term *primarily*.
- Permit a constraint on the transferee, provided that the benefit to the transferor is trivial, with consideration given to the type of asset being transferred.
- Base the effective control test on whether the transferor primarily benefits from the constraints.

#### **Ability to Bid on an Asset**

38. Many respondents expressed concern about the guidance in paragraph 53 and the guidance on partial sales in question 50 of the FASB Special Report, *A Guide to Implementation of Statement 140 on Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, which discusses whether a transferor maintains effective control by maintaining a residual interest if it has the ability to repurchase the transferred financial assets. Several respondents agreed that effective control was maintained if the transferor held 100 percent of the residual interest. However, these respondents questioned whether the transferor would be determined to maintain effective control if the transferor maintained only a portion of the residual interest. For example:

- Citigroup (Letter #8) stated, “As an example, assume that a reporting enterprise transfers a \$1,000,000 financial asset that will mature in 2020 to a newly established SPE that issues a senior \$900,000 interest and a

subordinate \$ 100,000 interest....The reporting enterprise retains \$100 of the subordinate interest. We understand that the reporting enterprise is assumed to maintain effective control, because it holds a piece of the residual interest and will therefore willingly outbid other parties. Assuming that the financial asset is worth \$1,000,000 in 2015 and that the reporting enterprise overbids by paying \$1,001,000, the reporting enterprise will receive an asset worth \$1,000,000 and \$101 from the redemption of its subordinate interest by the SPE. While \$ 1 of the \$1,000 excess was recovered by the reporting enterprise through its partial ownership of the subordinate interest, the reporting enterprise lost \$999 of the excess to the other residual holders; that is to say, from an economic perspective the reporting enterprise paid \$1,000,999 to third parties for an asset that is worth \$1,000,000.”

- Ernst & Young (Letter #17) stated, “It is not clear whether the Board believes there is any level of ownership a transferor can hold in the residual interest of the transferee that would not lead to a conclusion that the transferor has not surrendered control of the transferred assets. Any amount of residual interest held by the transferor would result in the ability to bid higher than another bidder that did not hold a residual interest. If greater than 50% of the residual interest were held, the majority of any excess would be reclaimed. However, if less than 50% of the residual interest were held by the transferor, the majority of the proceeds in excess of fair value would be remitted to the third party residual holders.”
- Merrill Lynch (Letter #27) stated, “It is our view that from an economic perspective the transferor would only be willing to pay an excess above fair value if it was able to recover substantially all of that excess through its residual interest, and it is only in this case that the transferor has the ability to choose whether to buy the assets without regard to the economics. If the transferor is not able to recover substantially all of the excess through its residual interest, the transferor will be subject to the same economic considerations as any other purchaser and therefore should not be deemed to effectively control the transferred assets.”

## **Other Comments**

39. Some respondents also requested that the Board reconsider other aspects of the guidance on effective control. One respondent recommended that the Board should reconsider its decision that a transferor’s right of first refusal on the occurrence of a bona fide offer to the transferee by a third party presumptively would not cause the transferor to maintain effective control of the transferred financial asset.

- Grant Thornton (Letter #13) stated, “We believe that such a provision would likely constrain the transferee in many circumstances as it would

create a disincentive to third parties to undertake the effort to make a bona fide offer for the financial assets.”

40. Another respondent requested that paragraph 9(c)(4) be deleted because it was not necessary with the existence of paragraphs 9(a) and 9(c)(1).
- CMSA, MBA, and RER (Letter #6) stated, “We believe that a price ‘that is so favorable to the transferee that it is probable that the transferee will require the transferor to repurchase the transferred financial assets’ would also ‘obligate the transferor to repurchase’ and would be taken into consideration in determining if legal isolation has occurred.”

### **Guaranteed Mortgage Securitizations**

41. The Board decided to remove the special provisions in Statement 140 and in FASB Statement No. 65, *Accounting for Certain Mortgage Banking Activities*, for guaranteed mortgage securitizations that require them to be treated the same way as any other transfer of financial assets. Most respondents either did not comment on these changes or agreed with them. However, some respondents believe that some or all of the special provisions should be retained.
- Federal Home Loan Bank (Letter #20) stated, “We can appreciate the Board's concern for income manipulation with respect to the current accounting for guaranteed mortgage securitizations - that is, the ability to shift from a loan carried at amortized cost to an investment security carried at fair value. However, we still believe that a guaranteed mortgage securitization still transforms the loans into an investment security— that is, such securitized loans would meet the definition of a security pursuant to FAS 115, paragraph 137.”
  - BB&T (Letter #22) stated, “We believe the existing special provisions should be continued that allow mortgage-backed securities that continue to be held by a transferor in a guaranteed mortgage securitization in which the SPE meets all conditions for being a qualifying SPE be classified in the financial statements of the transferor as securities that are subsequently measured under Statement 115. Such loans carry a substantive guarantee by a third party of exposure to credit risk and do not have the same characteristics of other loans.”
  - Federal Banking Regulators (Letter #48) stated, “Many financial institutions undertake these securitizations primarily for liquidity purposes. If a given pool of residential mortgages has been converted to security form in advance, it will be much easier to sell in a timely manner than the individual, seasoned whole loans underlying the securities. The guarantee also promotes liquidity. Retaining the underlying mortgage loans on the financial institution’s books raises significant questions about how the institution would account for the sale of part of the securities

backed by the mortgage loans. It also raises questions about whether and how to determine an appropriate allowance for loan losses relative to the securitized mortgage loan pool.”

42. Additionally, one respondent who believes that the special provisions should be retained noted that the current project was intended to provide a quick fix to address current market distress and stated that guaranteed mortgage securitizations did not present concerns for which a critical quick fix was necessary.
43. Other respondents who agreed with the removal of the special provisions believed that a guaranteed mortgage securitization would and should still achieve sale accounting in most cases. However, these respondents stated that paragraph 9(c)(3) of Statement 140, as currently drafted, may prohibit sale accounting because the transferor would benefit from the restriction placed on the transferred financial assets.
44. The removal of the special provisions for guaranteed mortgage securitizations would require the transferor to continue to carry the transferred financial assets as loans, rather than securities, until the transfer is accounted for as a sale. Additionally, several respondents noted that the amendments to Interpretation 46(R) would require the guarantor in a guaranteed mortgage securitization transaction to consolidate the trust involved in the transfer. Accordingly, some respondents questioned how the removal of the special provisions for guaranteed mortgage securitization would interact with the amendments to Interpretation 46(R). For example:
  - Deloitte (Letter #12) stated, “If the transferor takes back all of the beneficial interests, it is unclear whether it would need to record the debt securities and a liability to the trust for all of the beneficial interests on the basis of the amendments to paragraph 12 of the proposed Statement. If so, the trust, which, on the basis of Example 5 in the proposed amendments to Interpretation 46(R), would be consolidated by the guarantor, would record a receivable from the transferor equal to the transferor's liability. If the transferor subsequently sells the beneficial interests, the trust would need to reclassify the receivable from the transferor to mortgage loans. We do not believe that it is feasible for the nontransferor entity that must consolidate the trust to prepare its financial statements based on actions, taken by the transferor, that it may not be aware of.”

- AICPA AcSEC (Letter #44) stated, “Specifically, if the transferor retains 100 percent of the beneficial interests, but the transferee consolidates the GMS trust holding the loans, would both the transferor and transferee reflect the loans in their financial statements? We believe the Board needs to clarify which asset it intends that the third-party guarantor to recognize - the loans or a receivable from the transferor in its consolidated financial statements.”

### **Measurement of Beneficial Interests**

45. Some respondents were supportive of measuring all beneficial interests at fair value. One respondent, The Clearing House Association (Letter #24), noted, “Current guidance is a hybrid model that requires transferors to distinguish between interests that continue to be held (which must be recognized at allocated carrying value) and interests, including servicing assets, which are proceeds from a sale (which must be measured at fair value). Consequently, The Clearing House supports the proposed change in measurement.” The respondent noted that measuring all assets obtained and all liabilities incurred from a sale at fair value would simplify the accounting for transfers that are sale.
46. Other respondents were not supportive of measuring all beneficial interests at fair value. For example:
  - AICPA AcSEC (Letter #44) stated, “We are concerned that this requirement could lead to abuse in practice and would not meet the objective of improved financial reporting and transparency. For example, under the proposed standard, a transferor could choose to transfer assets to an SPE shortly before a reporting period ends in order to get sale accounting for the assets and to recognize a gain in the financial statements while retaining a very large portion of the interests issued by the SPE.”
  - Federal Banking Regulators (Letter #48) stated, “We disagree with the FASB’s conclusion that a transferor’s beneficial interest should be treated as a new asset, thereby triggering initial fair value measurement. In our view, such a conclusion is not consistent with the substance of the arrangement and would reduce the transparency of the sale transaction.  
We are concerned that the proposed remeasurement of retained beneficial interests at fair value introduces discretionary timing of gains and losses on entire assets for what may be a transfer of a small portion of the original assets.”

## Disclosure

47. Most respondents were generally supportive of the enhanced disclosures. Many respondents reiterated their views regarding the disclosures previously exposed during the comment period for proposed FASB Staff Position (FSP) FAS 140-e and FIN 46(R)-e, *Disclosures by Public Entities (Enterprises) about Transfers of Financial Assets and Interests in Variable Interest Entities*.
48. Some respondents expressed concern that removing the example disclosures from Statement 140 would result in inconsistent implementation of the amended standard. For example:
- Deloitte (Letter #12) stated, “The amendments proposed by the Board will result in the elimination of the example disclosures in Statement 140. We believe that on the basis of the number of additional disclosures proposed, the Board should consider expanding the examples that are already in Statement 140 rather than eliminating the example disclosures. This would assist with financial statement preparation.”
  - Some respondents expressed concern that removing footnote 10 would result in too many disclosures for servicing arrangements. For example:
    - Mortgage Bankers Association (Letter #2) stated, “MBA believes the focus of a transferor's disclosures when their only continuing involvement in transferred assets is servicing should be the risks associated with the servicing assets and liabilities. As that information would be disclosed under subparagraphs 17.e, f, and g, of the Proposed Statement, the additional disclosures that would be required under subparagraph 17.h6 regarding the status of transferred assets would greatly expand the amount of information that would be required to be disclosed for little, if any, additional benefit to users. MBA recommends therefore that the Board reinsert footnote 10 which provides an exception from the disclosure requirements in subparagraph 17.h.(6) for securitized assets that an entity continues to service but with which it has no continuing involvement other than servicing. At the least, the Board should allow servicers to disclose much less information about transferred assets for which servicers have no other continuing involvement beyond the servicing.”
  - JPMorgan (Letter #41) stated, “JPMorgan Chase does not believe it would be relevant or meaningful to add deals for which we act as servicer but do not have any other continuing involvement to the managed asset disclosures. Our involvement with these deals is recorded as part of mortgage servicing right assets and is therefore subject to the sensitivity analysis or stress test disclosures required under paragraph 17.i.4. Including these deals in the managed asset disclosure would gross up the

amounts of total principal outstanding, delinquencies, and credit losses, for no apparent benefit. We urge the FASB to keep footnote 10 in place.”

### **Effective Date and Transition**

78. Some respondents were concerned that the proposed effective date would not provide adequate time for regulated entities to consider important regulatory, rating agency, and other responses. Some respondents were concerned that adequate time would not be provided to meet the internal control requirements of the Sarbanes-Oxley Act. One respondent felt that this concern should not delay the issuance of the proposed guidance.

- Credit Suisse (Letter #16) stated that “it is our view that the Board's current course of action and timetable will not provide regulated entities with the ability to consider appropriate regulatory, rating agency and other responses to a final Standard. Regulated entities will face substantial challenges in explaining significant changes to their balance sheets to investors and lenders, with potentially little or no change to the economics of the transactions impacted by this guidance.”
- Bank of America (Letter #45) stated, “We also note that the proposed effective date of January 1, 2010 for calendar year preparers may not provide a sufficient amount of time to implement the new standards. Provisions of the new standards need to be fully vetted before accurate conclusions can be drawn. Also,...systems will need to be modified and controls must be established to ensure compliance with the requirements of the Sarbanes-Oxley Act...Additionally, given the turmoil in the current economic environment, we do not believe that now is the time to make the significant changes as proposed due to the potential impact that it may have on the securitization markets and availability of efficient funding for the many companies that rely upon the markets for such funding. Therefore, we recommend that implementation be delayed until January 1, 2011. This would also provide additional time to further eliminate practice differences with international standards.”
- New York State Banking Department (Letter #21) stated, “The Board should disregard arguments about the expected impact the proposal will have on regulatory capital since regulators have the ability to revise their capital requirements.”

### **Amendments to Other Authoritative Literature**

#### **General**

79. Most respondents who commented on the amendments to other authoritative literature stated that the amendments were consistent with the amendments to Statement 140. However, a couple of respondents stated that some of the

questions that were deleted in the FASB Special Report should be amended and retained. Specifically, most of the questions that respondents stated should be retained related to qualifying SPEs and determining fair value. For example:

- Freddie Mac (Letter #7) stated, “We believe that many of these questions should remain, with modifications to the new accounting guidance contained in the proposed Statement. For example, we believe that many of the questions related to QSPEs are still relevant, although they are now relevant in the context of whether the transferor has maintained effective control over the transferred assets, as opposed to whether an SPE is meets the criteria for a QSPE. We recommend that the Board revisit the proposed amendments in that light, and consider making further revisions.”
- PricewaterhouseCoopers (Letter #15) stated, “Certain of these Q&As would appear to remain relevant under the proposed FAS 140 amendment and provide useful guidance....”

#### **Partial Sales**

80. Some respondents also questioned the elimination of partial sales in the amendments to question 50 of the FASB Special Report. (See also related comments in paragraph 62 of this memorandum.) For example:

- Deloitte (Letter #12) stated, “For example, we do not believe that the Board has sufficiently weighed the effects of eliminating the concept of a sale of a portion of a financial asset....This could be achieved by the transfer of the financial asset and the retention of a call option when the transferred principal balances have been reduced to a predetermined amount for the portion that represents a financing transaction. We are concerned that the proposed accounting treatment may not mirror the underlying economics of the transaction.”
- JP Morgan (Letter #41) stated, “We believe that when a transferor transfers a group of financial assets in their entirety and retains a beneficial interest that has an embedded right to call the remaining assets back when a pool amortizes down to a specified percentage (for example, 1% for a typical commercial mortgage securitization) and such call option is determined not a clean-up call, the transferor’s ‘control’ is limited to the percentage of the portfolio which is subject to the call option (i.e., 1% of the transferred portfolio). The transferor has no effective control over the remaining portfolio that will be collected before the threshold has been met. As such, the transferor should report the portion of the portfolio that it does not have effective control over as a sale and the portion of the portfolio it has control over as a secured borrowing. We believe it would be misleading to report 100% of the transferred financial assets on the balance sheet of the transferor when the transferor only has the ability to ‘control’ a percentage of the portfolio.”

## Other

### Due Process

81. The proposed amendments to Statement 140 had a 60-day comment period; however, entities that participated in the roundtable meetings were required to submit their comments within 45 days. Some respondents stated that additional time was needed for companies to consider and respond to the Exposure Draft.

For example:

- Freddie Mac (Letter #7) stated, “The comment period for the proposed Statement is extremely short for proposed changes of this magnitude to a Standard that is very significant to the accounting and reporting for an entity such as Freddie Mac....Further, the 45-day comment period for the proposed Statement occurred right at the end of the third quarter financial reporting process, adding to the difficulty of a timely review. Lastly, many of the entities that are likely to be the most affected by the proposed Statement, the Proposed Amendments to Interpretation 46(R), and the Proposed FSP are financial services entities that are in the midst of dealing with very significant business issues resulting from the current market turmoil. In view of these factors, we believe that much more time is needed to properly assess the overarching impacts of the proposed Statement and believe that we could provide helpful additional comments if we were afforded a longer comment period.”
- BB&T (Letter #22) stated, “We do not believe the 60 day comment period was sufficient given the significant changes the amendment represents. The proposed changes will have a sweeping impact on existing and future securitizations, and could potentially have a significant adverse impact on financial institutions' capital ratios. Additional time would allow institutions and their regulators the chance to understand the ramifications of the amendment and to appropriately address any unintended consequences of the proposed amendment in their comments. In addition, the comment period came at a time when the current financial crisis was exploding and financial institutions were devoting the majority of their resources in addressing those immediate issues.”

### Costs

82. The Exposure Draft asked respondents what costs would be incurred to apply the amendments to Statement 140. Some of the costs mentioned by respondents were costs that would be incurred to increase the volume of disclosures, restructure agreements, and to develop new systems and processes. Many of these respondents questioned whether the costs were justified for a short-term improvement. For example:

- LNR Property Holdings (Letter #29) stated, “Making significant changes to our systems and processes pursuant to the proposed amendment would be costly, time consuming, and, considering the impending trend toward convergence to an entirely different model, largely inefficient.”

#### **Private Entity Requirements**

83. The Exposure Draft asked respondents whether they felt that any differing requirements should be applicable for nonpublic entities. Respondents generally felt that the requirements of the standard should apply equally to both public and private entities. For example:

- Grant Thornton (Letter #13) stated, “If the proposed statement is issued with a sufficient period of time before required adoption (for instance at least nine months), we do not believe that there should be differences in any application of the proposed amendments to Statement 140 for private companies.”
- AICPA AcSEC (Letter #44) stated, “We also believe that the recognition, measurement and disclosure requirements in this proposed standard should apply equally to both public and private companies.”