



Financial Accounting  
Standards Board

**To:** Board Members  
**From:** Statement 140 Team (Sperry, ext. 445)  
**Subject:** Minutes of the January 28, 2009 Board Meeting: Redeliberation of Proposed Amendments to Statement 140  
**Date:** February 10, 2009  
**cc:** FASB: Golden, Bielstein, Lott, Proestakes, Stoklosa, Donoghue, Mayer, Hood, Barker, Maroney, Roberge, Lusniak, Nickell, Inzano, Mathys, Burnap, Schonefeld, Sperry, C. Smith, Chookaszian, Posta, Gabriele, Sutay, Glotzer, Mechanick, Cropsey, Wilkins, Allen, Klimek, FASB Intranet; IASB: Leisenring, Kusi-Yeboah, Teixeira, Mueller, Francis

*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, Interpretation, or FASB Staff Position.*

Topic: Redeliberation of Proposed Amendments to Statement 140

Basis for Discussion: Board Memorandum Nos. 111, 112, and 113

Length of Discussion: 8:30 to 10:30 a.m.

Attendance:

Board members present: Herz, Linsmeier (Phone), Seidman, Siegel, and L. Smith

Board members absent: None

Other participants: None

Staff in charge of topic: Donoghue, Barker, Mayer, Sperry, and Schonefeld

Other staff at Board table: Golden, Proestakes, and C. Smith

## Summary of Decisions Reached

The Board redeliberated significant issues raised in comments received on FASB proposed Statement, *Accounting for Transfers of Financial Assets*, and decided to limit the circumstances in which a transfer of a portion of a financial asset is eligible for derecognition. The Board affirmed the definition of participating interest with the following changes:

1. Remove the proposed exception to participating interests for transfers of portions of equity instruments, derivative financial instruments, and hybrid financial instruments with an embedded derivative that is not clearly and closely related, as described in FASB Statement No.133, *Accounting for Derivative Instruments and Hedging Activities*.
2. Exclude from the determination of proportional cash flows the cash flows related to (a) the origination of financial assets (b) effectuating the transfer of the financial assets and (c) servicing the financial assets.
3. Clarify that third-party guarantees should not be considered in the evaluation of whether the participating interest definition is met.
4. Clarify that set-off rights of the borrower, in the event of bankruptcy or receivership of the transferor, do not preclude meeting the definition of a participating interest.
5. Clarify that a financial instrument that is legally a single contract is considered an individual financial asset. For example, a loan transferred to a special-purpose entity before securitization should be considered an individual financial asset. In addition, a beneficial interest (in the loan) issued after the securitization process has been completed should be considered an individual financial asset.
6. Clarify that transfers of portions of a financial asset that do not individually qualify for sale accounting because they do not meet the participating interest definition, but result in the transferor transferring all of the interests in the original financial asset, should be derecognized when all portions of the financial asset have been transferred.

The Board also decided not to provide an exception to the definition of a participating interest for transfers where the transferor retains a non-pro-rata senior interest in the financial asset.

The Board decided to retain the existing language in paragraph 9(b) of FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, but to remove the notion of a qualifying special-purpose entity. The Board decided to require look-through provisions to consider the abilities of the beneficial interest holders to pledge or exchange their beneficial interests when the transferee entity is a special-purpose entity involved in a securitization or asset-backed financing arrangement.

Objectives of Meeting:

The purpose of this meeting was to redeliberate whether the proposed Statement should limit when it is appropriate to derecognize a portion of a transferred financial asset. Because the Board decided that the proposed Statement should limit when it is appropriate to derecognize a transferred portion of a financial asset, the staff asked the Board to redeliberate the approach to defining the unit of account (participating interest) that is eligible for derecognition. The Board also was asked to decide (1) whether the ability of a transferee to use the asset it receives should be a deciding factor for derecognition by a transferor and (2) whether to permit that ability to be restricted in a securitization or an asset-backed financing arrangement.

Matters Discussed and Decisions Reached:

**Issue 1: Whether the Proposed Statement Should Limit When it is Appropriate to Derecognize a Transfer of A Portion of a Financial Asset**

1. Mr. Mayer stated that there are two views on this issue. Mr. Mayer stated View A states that the proposed Statement should limit when a transfer of a portion of a financial asset is eligible for derecognition, while View B states that the proposed Statement should not limit when a transfer of a portion of a financial asset is eligible for derecognition.

2. **Staff Recommendation:** The staff recommended View A, stating that it believes that the segregation of an entire financial asset in an entity that is not controlled by a transferor is a significant factor to be considered for derecognition. The staff also stated that limiting a portion of a financial asset that is eligible for derecognition to proportionate, pari passu portions will reduce concerns about the practice issues that have arisen in the application of the isolation criteria in paragraph 9(a) of Statement 140, particularly transfers involving pools of financial assets that may meet the legal tests but leave significant risks with the transferor. Additionally, the staff stated in its recommendation that View A will reduce structuring opportunities for transactions that must be evaluated under both Statement 140 and Interpretation 46(R). Without providing guidance on portions that are eligible for derecognition, the staff stated that it believes that more transfers will result in derecognition than under Statement 140. In addition, the staff stated that limiting portions that are eligible for derecognition is consistent with IAS 39, which provides unit of account guidance.
3. **Board Vote:** The Board voted to support the staff's recommendation. **Ms. Seidman did not agree with the Board decision.**
4. **Board Comments:** Ms. Donoghue explained that by not limiting when a transfer of a portion of a financial asset is eligible for derecognition, a situation can arise in which a portion of the asset is transferred but the transferor has custody of the entire asset, has retained the primary risks and rewards of the entire asset, and services the entire asset but may not be required to consolidate under the proposed provisions of Interpretation 46(R). The reason this may occur is because the portion not transferred may not be considered as a variable interest in the current Interpretation 46(R) model. In this case, servicing would be performed at the transferor level, and risks and rewards, as well as powers, may not be evaluated as part of Interpretation 46(R). In order to avoid such a situation, rules would need to be put into Interpretation 46(R) to evaluate activities associated with assets not transferred as activities of the SPE. Further, Ms. Donoghue explained that similar structuring would be possible even if a limitation is placed on when a transfer of a portion of a

financial asset is eligible for derecognition. However, she stated that she was not as concerned about such a situation because the portion transferred and the portion retained have the same characteristics (that is, they have the same risks and priorities). Because the assets are essentially the same in nature, there is less concern over the lack of symmetry between the portions in an Interpretation 46(R) analysis. Also, limiting the definition of a portion of a financial asset subject to derecognition would address weaknesses and inconsistencies in practice concerning isolation analysis.

5. Ms. Seidman stated that she believes part of the analysis brought forth by the staff is based on a presumption that when two parties have different economic risks in a contract, one of the parties has incentive not to perform. She disagreed with this notion and explained that when you have a contract, the differences in risks are going to be reflected in the pricing of the two pieces of the asset and the subordinated entity cannot walk away and not give the entity holding the senior position the cash flows owed to it.
6. Mr. Golden stated that he thinks the two views stem from what is considered to be the asset. He stated that if the legal asset is viewed as the original asset, it makes sense to require pro-rata proportionate transfers only. Whereas, if the individual cash flows are viewed as the original asset, then subordination would be viewed as acceptable.
7. Mr. L. Smith stated that he recognizes that the staff proposal intends to address the structuring opportunities that might exist, but noted at the same time that structuring opportunities still exist with the staff's proposal because the proposal allows transfer accounting and step-up in basis when the transferor creates an SPE, transfers the whole asset to the SPE, and then the transferor takes back a pro-rata portion in the form of a beneficial interest. Yet, the economics are the same as if a pro-rata participation was transacted. However, Mr. L. Smith stated that he was more concerned with the alternative to the staff's recommendation, which would allow a company to transfer a non-pro-rata portion and ignore the portion of the

asset retained for the purposes of Interpretation 46(R) analysis. Ms. Seidman stated that she agrees that the portion retained is not a variable interest, but she thinks that a portion not transferred would be considered in a holistic view to determine who is running the SPE. Ms. Donoghue added that the staff will bring measurement back to the Board and will consider Mr. L. Smith's concern about "step-up."

8. Mr. Leisenring stated that if the transferor keeps a 20% pro-rata portion, that portion has nothing to do with the transferee entity; however, he said if the portion is non-pro-rata, then it effectively represents a credit enhancement and should be considered a variable interest in the entity. Mr. L. Smith added that when the transferor sells a proportionate pro-rata portion, it no longer has that portion, so it can account for the transfer as a sale and if the transferor sells something other than pro-rata, then it is creating a completely different asset.
9. Mr. Herz stated that he would like the components model if accounting were currently in a complete fair value world. He stated that if companies are slicing and dicing assets, fair value is the conceptually better approach, as the company would just report what it has at fair value. He stated that he agrees with the staff recommendation because the "stickiness model" better fits the current accounting model. Mr. Golden stated that the financial instruments project will handle the macro problems associated with transfers of financial assets, while the staff's proposal offers guidance that works well in the short term.
10. Ms. Seidman stated that she supports View B partly because of the new recognition model being considered with the IASB. She stated that she does not think that a patch will sufficiently address the structuring opportunities. She said that she thinks paragraph 9(a) of Statement 140 is a valid principle that has been tested in the court system. Ms. Seidman also expressed concern with the relationship between partial sales, participating interests, and the difference between allocation based on relative FV and new basis in a mixed attribute model. She recommended that the Board choose View B, concentrate on eliminating qualifying SPEs, and rely on Interpretation 46(R).

11. Mr. Siegel stated that he is unsure whether an overarching principle can be attained for limiting structuring opportunities but that in the narrow question of whether or not to limit when a transfer of a portion of a financial asset qualifies for derecognition, he supports View A.
12. Mr. Linsmeier said that he is in favor of View A until a components approach that involves reporting all components at fair value can be considered. He said that he views the current Statement 140 model under View A as a whole asset approach with a very limited ability to view portions as whole assets. He explained that under the model, the transferor must transfer the whole asset in order to derecognize, and the only exception is the circumstance where the transferor has a participating interest and the asset transferred is as complete as the portion kept because there are no changes in risk and the asset is fully pro-rata and proportionate. Mr. Linsmeier said that under the proposal in View A, two items are bought separately and the transferor could transfer all of the portions at the same time and remain in the same position before and after the transfer. He feels that it is a miscommunication to call this model a financial components approach.

**Issue 2: What Criteria Should be Used to Define a Portion of a Financial Asset Eligible for Derecognition**

13. Mr. Mayer stated that there are two views when evaluating what criteria should be used to define a portion of a financial asset eligible for derecognition. He stated that View A utilizes the participating interest definition in the proposed statement with certain modifications. He stated that if View A is chosen by the Board, there are several potential modifications that will be discussed in Issue 3. Mr. Mayer stated that the other alternative, View B, utilizes the IASB definition of a portion that is eligible for derecognition.
14. **Staff Recommendation:** The staff recommended View A. The staff noted that the Board has previously considered and rejected View B because of concerns that the IASB definition of a portion would result in subordination of cash flows in certain cases. The staff noted that the IAS 39 unit of account guidance is currently

being reviewed by the IASB and may change significantly because of practice issues.

15. **Board Vote:** The Board voted to support the staff’s recommendation. **All Board members agreed.**
16. **Board Comments:** The Board noted that it is unclear as to which direction the IASB will be moving with IAS 39 and that it would therefore not make sense to consider View B.

### **Issue 3A: Equity, Derivative, and Hybrid Financial Instruments**

17. Mr. Mayer asked the Board whether paragraph 8B(a) of the participating interest definition should explicitly prohibit transfers of equity instruments, derivative financial instruments, or hybrid financial instruments with an embedded derivative that is not clearly and closely related, as described in Statement 133.
18. **Staff Recommendation:** Mr. Mayer stated that the staff recommends that paragraph 8B(a) of the proposed amendments to Statement 140 should not explicitly prohibit transfers of equity instruments, derivative financial instruments, or hybrid financial instruments with an embedded derivative that is not clearly and closely related, as described in Statement 133. Mr. Mayer noted that the staff believes that the participating interest definition adequately captures when it is appropriate for these items to be considered for derecognition. Mr. Mayer stated that as a result of this recommendation, paragraph 8B(a) of Statement 140 will be modified to state the following: “It represents a proportionate ownership interest in an entire individual financial asset.” The remaining language would be eliminated from the final standard.
19. **Board Vote:** The Board voted to support the staff’s recommendation. **All Board members agreed.**
20. **Board Comments:** Mr. Herz noted that he agrees with the staff recommendation but does not like the idea of companies creating multi-step processes where they are

creating one instrument out of another and going through Statement 140 analysis each time. Ms. Donoghue noted that the original language was included in the participating interest definition to be consistent with the limitations on the assets that could be held by a qualifying SPE.

**Issue 3b-1: Excluding Cash Flows for Services Performed From the Determination Of Whether Cash Flows Are Proportionate**

21. **Staff Recommendation:** The staff recommended that the second sentence of the participating interest definition in paragraph 8B(b) of Statement 140 indicate that the determination of proportionate cash flows shall exclude cash flows allocated to a transferor as compensation for services performed, if any, provided that such cash flows (a) are not subordinate to the proportionate cash flows and (b) are not significantly above or below adequate compensation for the services rendered.
22. **Board Vote:** The Board voted to exclude from the determination of proportional cash flows the cash flows related to (a) the origination of financial assets (b) effectuating the transfer of the financial assets and (c) servicing the financial assets.  
**All Board members agreed.**
23. **Board Comments:** Ms. Seidman stated that she felt that the language should be crafted to limit the servicing to customary servicing of assets, not for any type of service performed.
24. Mr. Linsmeier stated that he was uncomfortable about allowing unspecified types of servicing due to his concern that fees may be structured into participation agreements that would violate the intent of the participating interest definition. He noted that the types of fees the Board would seek to exclude would be fees relating to services performed to effectuate the transfer of a financial asset.
25. Ms. Seidman stated that not all fees were paid to facilitate the transfer, but that other services, like fees for liquidity arrangements, were related to services performed over the life of the participation. Ms. Donoghue stated that the activities were related to administrative activities and that fees may or may not be separated

for specific services. Mr. Mayer noted that the staff's intent is to create a principle for the types of fees that would be permitted. Mr. Mayer gave examples of the types of fees the staff was attempting to cover in its principle.

26. Mr. Linsmeier stated that those fees mentioned by Mr. Mayer would be for services performed to effectuate the transfer or financial assets. The staff noted that some fees would not be to facilitate the transfer, such as a guarantee fee.
27. Mr. L. Smith asked how special servicer fees would fit into the proposed exclusion. He noted that in many real estate deals, the special servicer has a particular obligation. He also noted that he would view special servicing fees as similar to guarantee fees in nature. Ms. Donoghue stated that she believed that incremental fees are compensation for incremental services performed, or to compensate for fees paid to a third party, whether that be special servicing, appraisal, or other services, and should be excluded to enable the transferor to recoup cash flows for services performed.
28. Mr. Linsmeier inquired whether a special servicer would be included in the servicing activities currently excluded. Mr. Golden replied that a special servicer performs a different function than a normal servicer. He noted that a normal servicer collects cash flows and pays them out to the entitled parties, while a special servicer would step in and perform more functions, such as workouts. He agreed with Mr. L. Smith that the special servicing fee would be more akin to a guarantee fee in that the special servicer is there to facilitate the return of principal.
29. Mr. Golden clarified that a special servicing fee is paid by all participants, but that one of the participants happens to receive the entire fee because they are paying for or performing the service. Ms. Seidman noted that the borrower is in effect paying the fee and that the servicer keeps the fee and passes out the remaining cash flows net of the fee for service performed or paid to a third party for their performance. Mr. Golden stated that the participants that receive less cash are in effect agreeing to pay the other participant to perform the service rather than perform the service

activity themselves. Mr. Golden noted that the special servicer is there to help recoup principal and may look like a guarantor, but is not actually a guarantor.

30. Mr. Golden stated that the issue that needs to be addressed in drafting is to determine when an activity is an eligible service, which would be excluded, and when an activity is a disguised service but really creates subordination.
31. Mr. Herz stated that the Board has previously had this conversation in determining whether a fee is a fee for a service or whether a fee is really a variable interest in an entity. He noted that the same notion may apply to this circumstance. Ms. Seidman noted that this principle would have to be applied in a different way. Mr. Herz agreed but thought that the staff could look to the prior guidance for aid in drafting the proposed guidance.
32. Mr. Golden gave an example of a guarantee fee, where the transferor is provided a guarantee and asked whether the Board agreed that a fee paid to the guarantor should be excluded because the fee is paid for a service performed. Mr. Herz agreed that the fee would be excluded as long as the costs were proportionately shared by the participants. Mr. Seidman noted that in the instance where the transferor provides a guarantee, the portion would not meet the other requirements to be classified as a participating interest.
33. Mr. Linsmeier expressed concern about providing guidance that would then be overridden by other guidance within the participating interest definition.
34. Mr. Herz asked whether Mr. Linsmeier felt that there should be a natural set of services that relate to a participating interest and that any new services introduced would be a problem. Mr. Linsmeier responded that any new services that changed the priority of cash flows or created recourse other than standard representations and warranties would preclude a portion from meeting the definition of a participating interest.
35. Mr. Herz asked under what view servicing would not be allowed for participating interests. Ms. Seidman stated that the intent of the Board is to define the parameters

when cash flows may be excluded. Mr. Golden stated that the Board decision should be whether to expand the exclusion beyond servicing to include other services performed.

36. Mr. Linsmeier stated that he agrees with excluding services performed to effectuate the transfer. He also expressed concern over other fees, such as guarantee fees, that change the risks for some participants.
37. Mr. Siegel noted that Mr. Linsmeier's view is that there are fees paid to recoup for services performed in the past or at the inception of the participation, and that there may be forward-looking payments for future services—the latter of which troubled Mr. Linsmeier. Ms. Seidman stated that as long as the outcome is shared proportionately, she did not believe that the Board should be concerned. Mr. L. Smith and Mr. Linsmeier agreed.

**Issue 3b-2: Excluding Cash Flows That Represent the Gain or Loss At the Time Of Participation From the Determination Of Whether Cash Flows Are Proportionate**

38. **Staff Recommendation:** The staff recommended that all cash flows that represent the transferor's share of the contractual interest retained as the transferor's gain on sale due to changes in market interest rates shall be excluded from the determination of what is meant by proportionate cash flows. Mr. Mayer emphasized that the staff recommendation would allow a transferor to receive an interest-only (IO) strip as proceeds; however, it would not permit a transferor to transfer an IO strip and receive sale treatment.
39. **Board Vote:** The Board voted not to support the staff's recommendation. **Ms. Seidman did not agree with the Board decision.**
40. **Board Comments:** Mr. Linsmeier stated that the ability to obtain as proceeds an interest-only (IO) strip would change the risks by keeping more prepayment risk with the transferor and that he would not be comfortable with the proposed exclusion. Ms. Seidman noted that the prepayment risk is only retained by the

transferor for the portion representing the interest-only (IO) strip that represents proceeds..

41. Ms. Seidman stated that the exclusion would have to be limited to a gain or loss solely from changes in market interest rates. Mr. Linsmeier agreed and suggested that the exclusion of the IO should only be allowed for a gain.
42. Mr. Herz stated that he believed that there is an economic difference between receiving a cash premium up front and receiving an IO strip, since the transferor would retain a greater portion of prepayment risk with an IO and the transferee would retain a greater portion of prepayment with a premium. He noted that the conceptual basis of a participating interest was more consistent when the premium is paid up front.
43. Mr. Mayer stated that constituents indicated that in order for the transfer of a portion to meet the definition of a participating interest that the premium would have to be paid up front. He stated that constituents have indicated that less of these deals would occur if the transferee would be required to pay a premium for the loan rather than a reduction in interest because of the risk of prepayment.
44. Ms. Seidman noted that this type of transaction typically occurs when an instrument is participated after the inception of the underlying asset and is intended to allow participations to occur at market rates. Mr. Linsmeier replied that a premium would result in a market rate but changes the entity that holds the risk. Mr. Herz noted that this issue does not exist when the underlying asset is participated in the same day it is originated by the transferor.
45. Mr. Siegel stated that he believed the two transactions (the payment of a premium and the retention of an IO) were economically different transactions with different risks. Mr. L. Smith, Mr. Linsmeier, and Mr. Herz agreed.
46. Ms. Seidman stated that allowing the retention of an IO would undermine the concept of a participating interest definition. She noted that she felt that this

supported her view that the participating interest definition was flawed. However, Ms. Seidman decided to vote in favor of the staff's recommendation.

**Issue 3C: Whether Third-Party Guarantees Should Affect the Determination of Whether a Transferred Portion Meets the Definition of a Participating Interest**

47. **Staff Recommendation:** Mr. Mayer stated that the staff believes that third-party guarantees should not affect whether the participating interest definition is met. He stated that in the staff's view, a third-party guarantee represents a future arrangement to assume a participating interest in the event of default and does not result in recourse to the transferor. Mr. Mayer stated that upon default, there is no longer a third-party guarantee since the guarantor assumes the role of participating interest holder and there is no change in the rights and obligations of the transferor. Mr. Mayer stated that as a result, the staff recommends that the Board clarify that third party guarantees are considered a separate unit of account that should not be considered in the evaluation of whether the participating interest definition is met.
48. **Board Vote:** The Board voted to support the staff's recommendation. **All Board members agreed.**
49. **Board Comments:** Mr. Mayer explained that, conceptually, the issue involves a transferor who sets up a party to step into the transferee's position in the case of an event of default. Ms. Donoghue explained that this is a unit of account issue, and that the question is whether a guarantee on a loan is part of the loan or a separate financial asset.
50. Mr. Leisenring said it matters who paid for the guarantee, when was it instigated, and why it was instigated. He said that if a transferor has a loan and simultaneously makes the transferee, which is not reimbursed off the stream of cash flows, pay for it as a guarantee, then the participation is not proportionate on the loan. Mr. Leisenring noted that if one party pays upfront and the two parties have different yields, he does not think the participation is proportionate because the two

parties are not paying the same amount for the guarantee. Ms. Seidman noted that the fee may be passed on indirectly.

51. Mr. Golden noted that the two situations in which a guarantee causes an issue is when (a) the guarantee does not represent 100% of the loan or (b) the guarantee is greater than the amount transferred. He stated that the most common scenario involves a loan with a 90% guarantee where the transferor transfers the guaranteed portion and retains the 10% portion that is not guaranteed. He stated that if the transferor includes the guarantee in the transfer, the transfer is not pro-rata.
52. Mr. L. Smith stated that if the transferor obtains a loan on day one and participates it out on day five, the transferor would not have made the loan unless the SBA was behind it. He believed that the SBA guarantee should not be a separate unit of account. However, Mr. L. Smith agreed with Ms. Donoghue's earlier comment that a similar circumstance could occur with an interest rate swap associated with the transferred loan; however, such a swap would be accounted for as a separate unit of account. Mr. L. Smith was concerned that if there is an 80% or 90% guarantee and that guaranteed portion is participated, the principle of pro-rata may be violated.
53. Mr. Golden explained that in an SBA loan, the guarantee does not travel pro-rata because the transferor has to retain the unguaranteed portion. He stated that legally, the proceeds cannot be shared pro-rata.
54. Mr. Mayer noted that there is no recourse to the transferor and that the transferor will always share proportionately in the cash flows of the underlying asset. He stated that because of the SBA guarantee, the question becomes who is the participating interest holder that the transferor will share proportionately with. He stated that it will be either the original participating interest holder prior to default or a third party guarantor after default who has previously agreed to step in because of the guarantee.
55. Ms. Seidman indicated that she did not understand the point being made by others at the meeting who were stating that someone will step in. She explained that in a

normal loan participation, if the borrower defaults, both parties lose but that when one party happens to be guaranteed, that party is protected. Mr. Mayer indicated that the transferor is sharing equally in the losses on the underlying loan with that guarantor. Ms. Seidman clarified that the point being made by the staff is that both the transferor and the guarantor lose. As a result, she questioned whether we care that the guarantor loses.

56. Mr. Golden noted that a transferor would receive different accounting treatment depending on whether it first guarantees a loan and then sells it or if the transferee obtains a guarantee after the transfer. Ms. Seidman noted that the two scenarios mentioned by Mr. Golden are different in substance.
57. Mr. Herz stated that he agrees with the staff's recommendation. He conceded that the party that retains the unguaranteed portion is not participating proportionately with the party holding the guaranteed portion but noted that there is no recourse back to the transferor.
58. Ms. Seidman noted that this is a very common transaction that does not involve many practice issues.
59. Mr. L. Smith stated that he can support the staff recommendation by looking at the sale of the loan and the guarantee as two separate transactions.
60. Mr. Linsmeier stated that he thinks by accepting the staff recommendation, the same economics will result as in the discussion about the interest-only strip. He stated that if a transferor transfers loans with a guarantee that covers a larger portion than the retained portion, that guarantor will ask for more cash flow up front as compensation for the extra risk at the transfer.
61. Mr. Herz expressed concern that the staff's recommendation allows creation of synthetic tranches. He said he would feel better if at the time of the transfer, tranches could not be created by putting on a new guarantee, but was not sure if that would be operational.

62. As a result of this discussion, Ms. Seidman decided to change her vote on issue 3B-2 to agree with the staff's recommendation on that issue.

**Issue 3D: Whether Setoff Rights Should Preclude Meeting the Definition of a Participating Interest**

63. **Staff Recommendation:** Mr. Mayer stated that the staff does not believe that set-off rights should preclude meeting the definition of a participating interest, consistent with the basis for conclusions in the proposed Statement relating to set-off rights (paragraph A14) that states that “the Board ultimately decided that set-off rights would not be an impediment to meeting the isolation requirement.”
64. **Board Vote:** The Board voted to support the staff's recommendation. **All Board members agreed.**
65. **Board Comments:** Ms. Seidman noted that comment letters, when referring to this issue, were referring to agreements where the parties agree to share the benefits of a set-off proportionately with the participating interest. She stated that if the agreement achieves that effect, then the participation is proportionate.
66. Ms. Donoghue explained that the issue arises when a borrower exercises a right of set-off against the transferor. In most cases, exercising the set-off right would probably require that the transferee disproportionately receive any subsequent cash flows. To clarify, she said that if the borrower owes \$100 and it sets off an obligation for \$50, then the borrower would pay \$50. If the borrower and the transferee were sharing equally, then the whole \$50 could go to the transferee, which indicates that theoretically there is disproportionate sharing.
67. Mr. L. Smith stated that if there is set-off, then it needs to be shared with the participating interest holder. He said in Ms. Donoghue's example, the borrower effectively set off an obligation and therefore the transferor had to convey a disproportionate amount of cash to the beneficial interest holder but that the sharing is proportionate because both parties received the same benefits in the end. Ms. Donoghue explained that there are situations in which the participating interest

holder would not be made whole. In the event of bankruptcy of the transferor, the transferee would become a general creditor of the transferor. If the transferor does not have the cash to pay the transferee, it is not clear that the transferee would receive its pro rata share. Mr. Linsmeier pointed out that the transferor's bankruptcy would not be an issue at the time of the transfer and therefore would not be considered, so this situation would not be a problem.

### **Issue 3E: Individual Financial Asset**

68. **Staff Recommendation:** The staff recommended that the term *individual financial asset* should be clarified to indicate that a financial instrument that is legally a single contract is considered an individual financial asset. The staff recommended that a loan transferred to a special-purpose entity prior to securitization shall be considered the unit of account and that a beneficial interest issued after the securitization process has been completed shall be considered the unit of account.
69. **Board Vote:** The Board voted to support the staff's recommendation. **All Board members agreed.**
70. **Board Comments:** None.

### **Issue 3F: Retention of a Senior Interest**

71. **Staff Recommendation:** The staff recommended that the Board not permit a transferor to retain a senior interest since it would be inconsistent with the participating interest concept that requires the cash flows received from the asset be proportionate
72. **Board Vote:** The Board voted to support the staff's recommendation. **All Board members agreed.**
73. **Board Comments:** None.

### **Issue 3G: Multi-Class Participations**

74. **Staff Recommendation:** The staff recommended clarifying that transfers of portions that do not individually qualify for sale accounting, but result in the transferor transferring 100 percent of the interests, should be derecognized when all interests in the asset have been transferred.
75. **Board Vote:** The Board voted to support the staff's recommendation. **All Board members agreed.**
76. **Board Comments:** None.

#### **Issue 4: Effective Control**

77. Ms. Barker stated that the Board removed paragraph 9(b) in Statement 140 and inserted language about the transferee's ability to exchange or pledge the transferred assets into paragraph 9(c)(3) of the proposed standard. She stated that comments received on the exposure draft indicated that the change was not considered operational by many constituents.
78. **Staff Recommendation:** The staff recommended that the Board retain the existing language in paragraph 9(b) with modification for the removal of the qualified special-purpose entity. The staff recommended that look-through provisions be limited to special-purpose entities involved in securitization or asset-backed financing arrangements.
79. **Board Vote:** The Board voted to support the staff's recommendation. **All Board members agreed.**
80. **Board Comments:** Ms. Seidman stated that her initial concern was that the change from a qualifying special-purpose entity to a securitization or asset-backed financing arrangement would broaden the use of the look-through provision. She stated that this concern was lessened by the requirement that 9(a) and 9(c) be met for these transactions and that she would support the recommendation. Mr. Herz stated that he followed a similar process and had come to the same conclusion.