

MINUTES



To: Board Members

From: Statement 140 Amendment Team—
QSPEs (Kapko, Ext. 317)

Subject: Minutes of the January 19, 2005 Board Meeting **Date:** January 25, 2005

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

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

Topic: Proposed Accounting for Transfers of Portions of Financial Assets

Basis for Discussion: Memorandums 37 and 38 dated December 27, 2004

Length of Discussion: 1:00 p.m. to 1:40 p.m.

Attendance:

Board members present:	Herz, Trott, Schipper, Batavick, Crooch, Young, and Seidman
Board members absent:	None
Staff in charge of topic:	Donoghue
Other staff at Board table:	L.Smith, Lott, Lusniak, Kapko, and Bergstrom
Outside participants:	None

Summary of Decisions Reached

The Board decided to adopt a proposed approach that would define the circumstances for which isolation could be achieved for transfers of portions of financial assets without using a qualifying special-purpose entity (QSPE). The approach would require that a QSPE be used for all transfers of portions of financial assets unless each interest, including any retained interest, has equal rights to the cash flows from the underlying assets, no interest is subordinate to any other interest, and there is no recourse to the transferor or any other interest holder. The approach would also clarify that paragraph 9(b) would need to be applied to each step in a series of transfers.

Objectives of the Board Meeting

The objectives of the meeting were for the Board to reach agreement on an approach that would define (1) the circumstances for which isolation could be achieved for transfers of portions of financial assets without using a QSPE and (2) how to evaluate a transfer of a portion of a financial asset when there is an intermediate transfer or series of transfers under paragraph 9(b) of FASB No. Statement 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. The objectives of the meeting were met.

Matters Discussed and Decisions Reached:

The following paragraphs summarize the Board's views on the major issues discussed at the meeting. The views and matters presented in these minutes may not be in the specific order in which they were discussed at the meeting.

1. Ms. Donoghue opened the meeting by explaining the approach and the reasoning behind the approach. She noted that the Board has three keys issues relating to the amendment to Statement 140 that still need to be addressed.

They are:

- a. Whether or not to require the use of a QSPE to achieve sale accounting for a portion of a financial asset

- b. Whether or not the isolation requirement in paragraph 9(a) can be achieved based solely on a legal analysis of whether the assets had been placed beyond the reach of the transferor and its creditors
- c. How to apply paragraph 9(b) to transactions involving intermediate entities.

2. Ms Donoghue stated that the staff's proposed approach addresses all three issues and that she is asking the Board to decide whether the approach should be included in the Exposure Draft of the amendment to Statement 140. The approach would require that a QSPE be used for all transfers of portions of financial assets unless each interest, including any retained interest, has equal rights to the cash flows from the underlying assets, no interest is subordinate to any other interest, and there is no recourse to the transferor or any other interest holder. This approach would also clarify that paragraph 9(b) needs to be applied to each step in a series of transfers.

3. Four Board members (Crooch, Schipper, Trott, and Young) support the proposed approach. Three Board members (Batavick, Herz, and Seidman) do not support the proposed approach.

Arguments for Adopting the Proposed Approach

4. Mr. Trott stated that the proposed approach will bring clarity to Statement 140 and answers the questions of when a QSPE should be used and what a transferred asset is. Although the approach recognizes the role of legal analysis in determining when isolation has been achieved, it clarifies that isolation is an accounting determination. Mr. Trott further stated that a legal determination of isolation is necessary but not sufficient to determine if the asset should be derecognized. He stated that the transfer to a bankruptcy remote entity (BRE) is a step that may be necessary to achieve isolation and sale accounting, but it is not sufficient and a transaction that "purports to be a sale" should not necessarily result in derecognition.

5. Ms. Schipper stated that she was in favor of the proposed approach because she believes that it will improve comparability and consistency of financial statements.

6. Mr. Young stated that he has considered all of the alternatives and is leaning towards the perspective of the market place and investors. He indicated that investors do not want to become legal experts or to second guess attorneys. They just want to make sure a sale is a sale. He also noted that investors place a high value on including a QSPE in transactions, and that is why he favors requiring a QSPE in the circumstances proposed by the staff. He supports the staff's proposed approach.

7. Mr. Crooch stated that he believes it is important for accounting purposes to draw a clear line between a collateralized borrowing and a sale. He noted that the accounting is crucial to providing a clear picture of the transaction, and it has become increasingly important in the past 10 to 15 years. He supports the staff's proposal because it gives an unambiguous line to determine when a QSPE is needed. He emphasized that this is an accounting decision and not a legal decision.

Arguments Against Adopting the Proposed Approach

8. Ms. Seidman stated that as she has approached this set of issues, she has tried to be consistent with the stated objectives of the financial components approach, which are (1) to be consistent with the way participants in the financial markets deal with financial assets, including the separation of components, and (2) to reflect the economic consequences of contractual provisions underlying financial assets and liabilities (paragraph 141 of Statement 140). She stated that a contract alone can transfer an ownership right to some or all of the cashflows and those transactions should be accounted for as sales (assuming paragraphs 9(b) and 9(c) are met).

9. Ms. Seidman further stated that in its discussions on participations, the Board learned the attributes of a contract that would be likely to qualify a

transaction as a true sale at law. She suggested that the Board require those attributes for all partial sales that do not segregate the assets in a legal entity. The most important attribute is that a transferor would be obliged to carry out the terms of the contract in the best interest of the transferee(s). Ms. Seidman stated that this new requirement, when added to the previous Board decisions to strengthen the guidance on isolation, would add rigor to the isolation condition for sales of portions of financial assets without imposing the complexity and cost of requiring a QSPE.

10. With respect to BREs, she stated that they are poorly defined and currently have a “special status” under Statement 140. She proposed to add a requirement that all legal entities used to effect a transfer be evaluated as potential transferees under paragraph 9(b). A BRE should be required to meet the same restrictive conditions as a QSPE to qualify as a sale (and the Board would need to clarify that a pledge or sale of the assets concurrent with the issuance of new interests would be permitted). Otherwise, the BRE would be evaluated as the transferee for the purposes of applying paragraphs 9(a) and 9(b).

11. Mr. Batavick believes that a well executed contract should be enough. He indicated that he believes that market participants are knowledgeable enough to determine whether the contract is well executed or not and stated that the staff’s proposal would add complexity and unnecessary costs.

12. Mr. Herz stated that he does not support the staff proposal because it will dramatically change the framework of Statement 140. He believes it changes the basic model that distinguishes a sale from a borrowing, and he is very troubled by the consequences of this proposal. He stated that a QSPE should be required only when the transferee cannot sell or pledge the asset it receives. He also said that he did not view this as a question of when to use a QSPE. Mr. Herz stated that he agreed more with Ms. Seidman’s proposal. He stated that he is concerned with the effects of the staff proposal on interest-only and principal-

only transfers. Mr. Herz stated that this issue will be re-exposed so constituents who feel strongly about this will get a chance to give their comments.

Follow-up Items:

Ms. Donoghue stated that the staff will be coming back to the Board to readdress transition issues. Mr. Lott also indicated that he would be issuing a memorandum that would address the similarities between setoff and other types of dilutive rights and provide a recommendation to the Board on how setoff should be addressed in Statement 140 as previously discussed at the October 27, 2004 Board Meeting.

General Announcements:

None.