

MINUTES



To: Board Members

From: Statement 140 Amendment Team
(Stell, ext. 211)

Subject: Minutes of the August 28, 2003 FASB Open Roundtable Discussion on Qualifying Special-Purpose Entities **Date:** September 8, 2003

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

Topic: Qualifying Special-Purpose Entities:
Comments on the Exposure Draft

Basis for Discussion: The Exposure Draft, *Qualifying Special-Purpose Entities and Isolation of Transferred Assets*, and comment letters of participants

Length of Discussion: 9:00 a.m. to 12:00 and
1:30 p.m. to 3:45 p.m.

Attendance:

| | |
|-----------------------------|--|
| Board members present: | Herz, Trott, Schipper, Batavick, Crooch, Seidman, and Schieneman |
| Board members absent: | None |
| Staff in charge of topic: | Lott |
| Other staff at Board table: | Smith, Bullen, Lusniak, and Stell |
| Outside participants: | Refer to the attachment |

Summary for ACTION ALERT:

The Board held a roundtable discussion with various constituents to discuss issues relating to the proposed amendment, *Qualifying Special-Purpose Entities and Isolation of Transferred Assets*. The purpose of the public roundtable was to provide information to assist the Board in its redeliberations of the provisions in the proposed amendment. Board members and constituents expressed their views but no decisions were reached.

Matters Discussed and Decisions Reached:

The following text summarizes participant responses to questions posed by Board members at the public roundtable. However, this summary does not include quotes from that meeting.

1. Paragraph 9(a)—Legal Isolation of Transferred Assets from Affiliates and Agents of the Transferor

Participants questioned which affiliates of the transferor are intended to be covered by this requirement. A majority of participants believe that the transferred assets must be legally isolated from the transferor and members of its consolidated group (narrow view), while other participants believe that the transferred assets must be legally isolated from the transferor and any affiliate, whether such affiliates are consolidated by the transferor or not (broad view). A number of participants stated that the wording in the summary and basis for conclusions appears to reflect the broad view, while the wording in the standards section appears to reflect the narrow view.

2. Paragraphs 9(b) and 80-84—Transferee’s Control of Assets and Two-Step Transfers

a. The requirement to use a qualifying SPE in a two-step transfer, whether or not it is a securitization

One Board member stated that if the second transferee in a two-step transfer does not have the right to sell or pledge the transferred assets **and** issues beneficial interests, then the transferee in the second step must be a qualifying special-purpose entity (SPE). Several participants indicated that they did not believe that requirement was necessary and asked the Board to clarify what perceived abuses it is intended to address.

b. Differentiating between beneficial interests in a SPE and undivided interests in assets of a SPE

This issue is important because paragraph 9(b) requires that a transferee be able to sell or pledge the transferred assets or portions thereof. Undivided interests would be considered portions of the assets but beneficial interests would not. Therefore, an entity that issues undivided interests no longer holds the portion of the transferred assets represented by the undivided interests. Issuance of undivided interests demonstrates that the SPE can sell or pledge the transferred assets, and the condition in paragraph 9(b) is met. However, beneficial interests are considered interests in the transferee entity that do not demonstrate the transferee’s ability to sell or pledge the assets and, in fact, normally precludes the transferee from selling or pledging the transferred assets. In that case, the transferee must be a qualifying SPE to satisfy the criteria in paragraph 9(b).

Participants provided a variety of views. The participants did not agree on a precise definition of the term *undivided interest*. Two Board members (Trott & Schipper) suggested that the distinction between undivided interests and beneficial interests might be the presence or absence of subordination, and opined that undivided interests are often associated with pro rata cash flows. Some participants agreed, but one participant (Kravitt) stated that undivided interests could be subordinated to one another.

One Board member (Seidman) suggested that beneficial interests and undivided interests differ in that an undivided interest does not give its holders rights to receive any cash flows other than those that existed in the original assets, whereas beneficial interests may introduce different cash flows as a result of credit enhancement and diversification. Still others argued that a beneficial interest is a broader term than undivided interest and that the terms of the contract determine which type of interest is issued.

The participants concluded their discussion on these issues without identifying the factors that distinguish undivided interests from beneficial interests. Some participants agreed to help the FASB develop a definition of those terms to help constituents distinguish between the two types of interests.

3. Paragraph 35(c)(1)—Prohibition of Equity Securities

a. Definition of equity securities

b. Equity securities received in collection efforts

c. Short-term investment in money market funds of cash collected

A majority of participants stated that *equity security* should be defined in accordance with FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. Several participants requested that the Board not prohibit short-term investments in money market funds, equity securities received as the result of collection efforts, and equity-form beneficial interests issued by other SPEs.

4. Paragraphs 35(c)(2) and 35(e)—Transferor Support Obligations

a. Representations and warranties

b. Master trust arrangements

c. Difference between credit guarantees and subordinated beneficial interests

d. Total return swaps and other derivatives

Most roundtable participants stated that standard representations and warranties by a transferor should not be prohibited if they relate only to the quality of the

assets at the time of the initial transfer. Other participants suggested that the Board specify what *standard* representations and warranties are.

With respect to master trust arrangements, the roundtable participants raised several concerns. Many participants noted that some master trusts issue commercial paper, and they would be subject to the reissuance restrictions. Some participants stated that master trusts have to issue new interests that reduce the transferor's retained interest as well as the ability to add new accounts. Several participants noted that many master trusts hold derivatives in which the transferor is the counterparty and may not be able to replace them with similar contracts with third parties without the consent of the beneficial interest holders. Hence, these types of arrangements need to be grandfathered in the final Statement.

Participants also attempted to distinguish a credit guarantee from a subordinated beneficial interest. Several roundtable participants questioned how a passive guarantee could be construed as control and argued that the issue is not whether there is a guarantee but what the guarantee covers.

A majority of participants agreed that total return swaps (or a combination of instruments that effectively create a total return swap) should be prohibited but that other derivatives should be permitted as long as they are passive.

5. Paragraph 35(f)—Reissuance of Beneficial Interests

a. Definition of reissuance

b. Separation of decision-making authority from the ability to benefit through support commitments and subordinated beneficial interests

c. Limitation on concentration of support commitments in one provider

Some participants asked why reissuances are considered a problem by the Board if the reissuances do not affect the transferor's interest. Some participants asserted that in most commercial paper structures, the transferor's ability to choose a term for new issuances of commercial paper does not materially affect the residual interest. They noted that liquidity commitments are important but that whether the transferor has subordinated interests is not important unless its

interests are affected more than anyone else's. The participants suggested that the Board explain why issuing new beneficial interests to replace beneficial interests that have matured is considered control.

Several participants stated that subordinated beneficial interests held by the transferor are equivalent to a transferor's guarantee if the guarantee requires a cash collateral account or similar arrangement.

Many roundtable participants made comments about the limitations on the percentage of support commitments that could be provided by a single party. Some participants suggested that the Board treat "pure" liquidity different from credit support. They maintained that providing liquidity does not equate to control over the assets. Others urged the Board to explain why a combination of decision-making abilities and subordinated interests equals control. In addition, some participants also recommended that the Board explain why either a guarantee or a delivery of additional assets equates to control.

Most participants stated that the prohibition of beneficial interests other than the most senior is impractical. With many multinational structures, it may not be possible to find out if two different subsidiaries hold an interest that would cause the qualifying SPE to no longer qualify.

In addition, some participants asked the Board to consider requiring more comprehensive disclosures as an alternative. Others suggested that the Board consider the materiality of the effect of a transferor's decisions on any one party's interest instead. They urged the Board and staff to define *related parties* more specifically and to clarify the term *indirect* in paragraph 35.

6. Transition and Effective Date

Not many comments were raised about the transition provisions and effective date of the proposed Statement. However, one participant noted that they would have to incur significant costs to comply with the proposed standard. Several cited difficulties with the implementation of FASB Interpretation No. 46, *Consolidation of Variable Interest Entities*. Those participants asked the Board to

consider a transition period similar to that set forth in FASB Technical Bulletin No. 01-1, *Effective Date for Certain Financial Institutions of Certain Provisions of Statement 140 Related to the Isolation of Transferred Financial Assets*. Other participants noted that the Board should consider grandfathering any activities that were grandfathered under FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*.

7. Other Comments

a. IASB approach to “pass-through” entities

b. Matched presentation

Participants urged the Board to consider a requirement for matched presentation as an alternative to the proposal in the Exposure Draft. Some asked why the Board would make a significant change to Statement 140 now when it will probably need to be changed again in a few years for purposes of international convergence. Other participants suggested that the Board consider including in this project provisions that would permit mortgage servicing rights to be measured at fair value.

Follow-up Items:

None.

General Announcements:

None.

ATTACHMENT

FASB Public Roundtable Discussion on Qualifying Special-Purpose Entities Listing of Participants August 28, 2003

| <u>Speaker</u> | <u>Affiliation</u> | <u>Letter</u> |
|--------------------------------------|---|---------------|
| Chuck Maimbourg | American Bankers Association | 25 |
| Stephen Young | American Securitization Forum | 2 |
| Jason Kravitt | Bond Market Association | 2 |
| Tom Feil | Capital One Financial Corporation | 16 |
| Linda Bergen | Citigroup | 51 |
| Anna Glick | Commercial Mortgage Securities Association | 18 |
| Julie Roth | Credit Suisse Group | 21 |
| James Johnson | Deloitte & Touche LLP | 50 |
| Mike Joseph | Ernst & Young LLP | 48 |
| Jonathan Boyles | Fannie Mae | 32 |
| Frederick Feldkamp | Frederick Feldkamp | 22 |
| Terry Cooper | General Electric Co. | 46 |
| Linda Zukauckas | GMAC | 34 |
| Matt Schroeder | Goldman Sachs | 47 |
| Randy Shearer | Institute of Management Accountants | 12 |
| David Morris | J.P. Morgan Chase | 15 |
| Kurt Skonberg | Kaye Scholer LLP | 8 |
| David Britt | KPMG LLP | 36 |
| Kristine Smith | Lehman Brothers | 37 |
| Rob Hugi | Mayer, Brown, Rowe & Maw LLP | 11 |
| Vernon Wright | MBNA | 13 |
| J. Douglas Van Ness | Morgan Stanley & Co. | 4 |
| Woody Wallace | PricewaterhouseCoopers LLP | 49 |
| Eric Schuppenhauer and John James | SEC | |
| Stephen Howard | Toyota Financial Services/Motor Credit | 39 |