

MINUTES



To: Board Members
From: Transfers Project Team
Subject: Minutes of the July 26, 2006 Board Meeting (Transfers of Financial Assets) **Date:** August 1, 2006
cc: Bielstein, MacDonald, Smith, Leisenring, Project Team, Carney, Allen, Sutay, Gabriele, Polley, FASB Intranet

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: Transfers of Financial Assets—Redeliberations

Basis for Discussion: Memorandum 63, dated July 12, 2006

Length of Discussion: 8:00 a.m. to 8:30 a.m

Attendance:

Board members present: Herz, Batavick, Crooch, Linsmeier, Seidman, Trott

Board members absent: Young

Staff in charge of topic: Donoghue

Other staff at Board table: L. Smith, Barker, Lusniak, Jacobs, Arveseth, Detling

Outside participants: Leisenring (IASB)

Summary of Decisions Reached:

The Board continued redeliberations on the August 2005 revised Exposure Draft, *Accounting for Transfers of Financial Assets*, and discussed whether to (1) redeliberate three decisions made during the transfers project, (2) combine discussions and decisions related to the servicer discretion project with the transfers project, and (3) redeliberate the limitations on a qualified special purpose entity's (QSPE) ability to hold passive derivative financial instruments. The Board made the following decisions:

1. To proceed with redeliberations on the proposed guidance related to rollovers of beneficial interests.
2. To address issues pertaining to the permitted activities of a QSPE jointly by combining discussions and decisions related to servicer discretion (currently a separate project on the Board's agenda) with the transfers project.
3. To redeliberate the issues of initial measurement of interests that continue to be held by the transferor and passive derivative financial instruments held by a QSPE that pertain to a transferor's beneficial interests. This decision reversed the previous decision made at the June 7, 2006 meeting to delete consideration of these issues.
4. To defer making a decision regarding participating interests (paragraph 8(a)) and transferability requirements (paragraph 9(b)) until completion of redeliberations on the permitted activities of a QSPE and the effects of continuing involvements on isolation.

Objective of Meeting:

The objectives of this meeting were to:

1. Determine whether to redeliberate three open issues (rollovers of beneficial interests, participating interests, and transferability requirements) related to the transfers project.
2. Determine whether to address all of the issues related to the permitted activities of a QSPE jointly by combining discussions and decisions related to the transfers and servicer discretion projects.
3. Reconsider the Board's prior decision to drop consideration of a QSPE's ability to hold passive derivative instruments that pertain to a transferor's beneficial interest.

The objectives of the meeting were met.

Matters Discussed and Decisions Reached:

1. Ms. Donoghue began the discussion by explaining that at the June 7, 2006 Board meeting, the Board deferred making decisions on whether to redeliberate three issues related to the revised Exposure Draft. She stated that the staff would ask the Board whether it wants to redeliberate those remaining issues. In addition, Ms. Donoghue stated that the staff would ask the Board whether it wants (a) to address all of the issues related to the permitted activities of a QSPE together, including the issues on servicer discretion and the limits on derivatives that may be held by a QSPE and (b) to reconsider its June 7, 2006 decision to delete consideration of a QSPE's ability to hold passive derivative financial instruments that pertain to a transferor's beneficial interests.

Rollovers of Beneficial Interests

2. Ms. Donoghue stated that the first open issue that needed to be addressed regarded rollovers of beneficial interests. She asked the Board whether it wanted to:

- a. Reaffirm its decisions on the issue without modification?
- b. Remove the issue from the scope of this project?
- c. Discuss the issue further in redeliberations?

3. Ms. Donoghue then stated that the staff recommended that the Board redeliberate the proposed guidance on rollovers of beneficial interests and determine whether to:

- a. Disallow rollovers.
- b. Clarify the meaning of "more-than-trivial incremental benefit."
- c. Provide examples of acceptable and unacceptable combinations of involvements by a single party.
- d. Clarify the guidance for beneficial interests issued by a master trust.
- e. Consider other alternatives.

The Board agreed to redeliberate the issue on rollovers of beneficial interests.

4. Mr. Herz and Ms. Seidman stated that the Board should address practice issues to stabilize practice in the short term, and that fundamental changes should be made as part of a reconsideration of the model underlying FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. Ms. Seidman further noted that rollovers of beneficial interests is the original practice issue that led the FASB to begin the transfers project and it is still not adequately addressed. She stated that the Board should address the issue in a principles-based approach within the confines that a QSPE's activities be significantly limited and entirely specified. She stated that the staff has already formulated some alternatives regarding how to address permitted activities of QSPEs that could be applied to resolve the issue of rollovers as well.

5. Mr. Trott stated that rollovers of beneficial interests fall into the category of permitted activities of a QSPE. He also stated that the notion that the permitted activities of a QSPE be significantly limited and entirely specified as expressed in Statement 140 has proven not to work for rollovers and many other issues concerning the permitted activities of a QSPE. He explained that the way to address the practice issues related to permitted activities of a QSPE is to determine the types of assets that a QSPE can hold. He noted that Statement 140 was originally developed such that a QSPE could only hold and divide up passive financial assets. Currently, however, QSPEs are doing more than that—they are acting as businesses (making business decisions) by buying assets and reissuing assets repeatedly rather than acting simply as collection and distribution agents. Mr. Trott noted that a review of the types of assets that a QSPE could hold may require that the Board develop a new model that would relate the types of assets a QSPE could hold to the beneficial interests. He also noted that changes in this area could mean that entities involved in rollovers of beneficial interests would be considered for consolidation under other current guidance such as in FASB Interpretation No. 46 (revised December 2003), *Consolidation of Variable Interest Entities*.

6. Mr. Batavick stated that there was a need to address permitted activities of a QSPE including rollovers. He stated that rollovers should be discussed in the

context of the permitted activities of a QSPE and that hopefully a model would be developed to address all of the permitted activities of a QSPE.

Combining the Transfers and Servicer Discretion Projects

7. Ms. Donoghue continued the discussion by asking the Board whether it wished to address issues pertaining to the permitted activities of a QSPE by combining the transfers project with the servicer discretion project (currently a separate project on the Board's agenda). She noted that the following issues in the transfers and servicer discretion projects involve the permitted activities of a QSPE:

- a. Rollovers of beneficial interests.
- b. Equity investments in a QSPE.
- c. Servicer discretion in:
 - (1) Waiving a due-on-sale provision
 - (2) Substituting collateral with respect to a loan held by a QSPE
 - (3) Connection with the potential foreclosure and sale of real estate temporarily held by a QSPE.
- d. Limitations on derivatives in a QSPE

She recommended that the Board address these issues jointly for efficiency and to ensure that consistent guidance is provided for those related issues. The Board agreed with the staff recommendation.

Limits on a QSPE's Ability to Hold Passive Derivatives and Initial Measurement of a Transferor's Interests

8. In response to comment letters received from constituents, Ms. Donoghue asked the Board if it wished to reconsider the decision it made at the June 7, 2006 Board meeting to drop consideration of the limits on a QSPE's ability to hold passive derivative financial instruments that pertain to a transferor's beneficial interests. She recommended that the Board reverse its prior decision and discuss the issue further in redeliberations.

9. The Board decided to redeliberate the issue of a QSPE's ability to hold passive derivative financial instruments. In conjunction with that decision, Mr. Herz asked the Board to address whether it should redeliberate the issue of initial measurement of interests that continue to be held by the transferor.

10. Mr. Trott stated that there is a strong link between initial measurement and limitations on passive derivatives. He stated that it is inconsistent to address the limitations on derivatives in a QSPE without consideration of the initial measurement of beneficial interests that continue to be held by the transferor.

11. Ms. Seidman stated that the issue of a QSPE's ability to hold passive derivatives should be discussed in the context of permitted activities of a QSPE. She opposed further consideration of issues related to measurement of retained interests. She stated that there were two reasons that led the Board to its prior decision on this issue:

- a. If the measurement attribute for initial measurement were changed to fair value and the interests are new, the transferor's interest should not be treated differently than a third party's interest.
- b. The possibility that an issuer could put derivatives in a QSPE and not account for them has been significantly limited by FASB Statement No. 155, *Accounting for Certain Hybrid Financial Instruments*, which requires that an issuer look for embedded derivatives.

Mr. Batavick agreed with Ms. Seidman and stated that a discussion of the measurement issue was unnecessary.

12. The Board decided to redeliberate the measurement of interests that continue to be held by a transferor. Four Board members (Mr. Trott, Mr. Herz, Mr. Linsmeier, and Mr. Crooch) supported redeliberating the measurement issue and two Board members (Ms. Seidman and Mr. Batavick) supported deleting the issue from further consideration.

Participating Interests and Transferability Requirements

13. Ms. Donoghue then asked the Board whether it wished to defer decisions regarding participating interests (paragraph 8(a)) and transferability requirements (paragraph 9(b)). She recommended that decisions on these two issues be

deferred until the Board had completed its redeliberations on (a) the permitted activities of a QSPE and (b) the effects of continuing involvements on isolation. The Board agreed with the staff recommendation.

Follow-up Items:

None.

General Announcements:

Mr. Herz announced that the Board will change the order of the agenda for today's meeting by moving the discussion on the proposed FASB Staff Position on FASB Statement No. 123 (revised 2004), *Share-Based Payment*, to immediately follow the conclusion of the discussion of the transfers project and to precede discussion on the pensions project.