

Letter of Comment No: 11  
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Date Received:

August 22, 2005

Mr. Lawrence Smith  
Director of Technical Application and Implementation Activities  
Financial Accounting Standards Board  
401 Merritt 7  
P O Box 5116  
Norwalk, Connecticut 06856-5116

Re: File Reference No. FSP FAS 140-c – Proposed FSP No. FAS 140-c, “Clarification of the Application of Paragraphs 40(b) and 40(c) of FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*” (FAS 140)

Dear Mr. Smith:

Bank of America Corporation appreciates the opportunity to comment on the proposed Financial Accounting Standards Board (“FASB”) Staff Position identified above (the “FSP”). Bank of America Corporation provides a diverse range of financial services and products throughout the United States and in selected international markets, and is the second largest U.S. bank in terms of total assets. We routinely securitize assets for liquidity, alternative funding, and risk management purposes and we also structure securitization vehicles for our customers.

We support the Board’s decision to clarify the impact of unexpected events on the determination as to whether a qualifying special purpose entity (QSPE) complies with the requirements of paragraphs 40(b) and 40(c) of FAS 140. We agree that unexpected events occurring subsequent to inception should not impair the qualified status of a QSPE assuming that, at inception, an adequate analysis had been performed of events that were expected to impact the amount of beneficial interests held by third parties. However, we believe that it is not appropriate to incorporate the projected levels of normal market-making activities when it is done for the purposes of providing market liquidity in the development of an analysis of expected events. If this interpretation of paragraph 40(b) is adopted, we are concerned that it will have a disruptive impact on new and existing securitization transactions over the next year until the proposed amendment to FAS 140 is issued. In addition, we believe that the transition provisions are unclear with regard to application of the FSP to existing QSPEs. Our comments and observations are set forth below for your consideration.

#### **Application of Paragraph 40(b) to Secondary Market-making Activities**

When drafting FAS 140, the Board was concerned about potential abuses that might arise when transferors retained the benefits of derivatives held in QSPEs because they were not required to reflect the variability associated with changes in market value of those retained interests in the income statement. As noted in paragraph 187 of FAS 140, respondents to

the FAS 140 Exposure Draft “were concerned whether allowing a qualifying SPE to enter into a derivative instrument avoids accounting requirements under FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*, and whether a large derivative instrument could be put into or entered into by a qualifying SPE that held only a small amount of other financial assets.” As a result of these concerns, the Board decided to limit the notional amount of derivative instruments that a QSPE could enter into and decided that the derivative should pertain only to beneficial interests held by third parties other than the transferor, its affiliates, or its agents. These restrictions were not perceived as harsh or punitive because, as the Board noted, “if the transferor wanted to enter into derivative instruments pertaining to the beneficial interests it holds, it could accomplish that by entering into such derivative instruments on its own behalf, which would be accounted for under Statement 133.”

The Board’s concerns about potential abuse should not extend to secondary market-making activities that a transferor might enter into subsequent to inception for the following reasons:

- The securities acquired due to market-making activities are usually held for a short-term and acquired on a limited basis primarily to provide liquidity to investors who buy and sell these securities. We believe that paragraph 40(b) has been interpreted to apply to beneficial interests held longer-term and not for positions taken for a short duration used to provide liquidity to investors of such beneficial interests. Given the intent and nature of normal market-making activity, we don’t believe that such activity should be considered in analyzing expected events. The cost of such analyses and market disruption far outweighs any potential benefit from improved accounting. Conversely, activities that are expected to be inconsistent with the nature of secondary trading such as holding large positions for longer lengths of time should be considered in meeting the requirements of 40(b) and 40(c) of FAS 140.
- Securities acquired as the result of secondary market-making activity are classified as trading assets and marked to market through income. Therefore, to the extent that the transferor acquires securities as the result of market-making activities, the change in fair value of the beneficial interests (including any embedded derivatives) will be included in income. This accounting treatment which is similar to the treatment that would be achieved from holding derivative instruments that pertain to the beneficial interests that are held by the transferor should address the Board concerns about abusive practices.

Therefore, given the Board’s stated reasons for limiting the notional amount of securities, we believe that paragraph 40(b) should not apply to secondary market-making activities.

## **Disruptive Impact of Proposed Interpretation**

Rating agencies rely on the protection provided by passive derivatives such as interest rate caps and swaps as well as the liquidity provided by the market makers when assigning ratings to securities. If that protection were to be reduced, it might be difficult or impossible to achieve the same rating without obtaining another, more expensive and perhaps less transparent, form of enhancement.

## **Proposed Amendments of FAS 140 and FAS 133**

The proposed amendments of FAS 140 and FAS 133, which were issued as exposure drafts on August 11, 2005, would require that a transferor's beneficial interests be recorded initially at fair value rather than allocated cost and analyzed to determine if they contain embedded derivatives that are not clearly and closely related to the host contract. The transferor would then have the option of bifurcating the embedded derivatives and accounting for them at fair value or accounting for the entire retained position at fair value, in either case with changes in fair value recorded currently in income. As a result of these changes, the proposed amendment to FAS 140 would eliminate the requirement that the notional amount of derivatives held in a QSPE be limited to beneficial interests held by third parties, replacing it with the requirement that the notional amount of derivatives not exceed the total amount of beneficial interests issued. If the proposed amendments are adopted as written, a QSPE will no longer have to distinguish between interests held by the transferor and interests held by unaffiliated third parties in determining the maximum notional amount of derivatives.

Given that these changes are expected to be effective within the next nine months, there would seem to be little value in adopting a more restrictive interpretation of FAS 140 at this time.

## **Clarification of Transition Guidance**

Lastly, we believe that the transition guidance should be clarified with respect to its application to existing QSPEs. One might conclude that it is the intent of the Board to require a re-evaluation of the analysis performed at inception of existing QSPEs to determine whether the previously conducted analysis was sufficiently robust and included all necessary factors, including the impact of market-making activities. Many companies may not have previously factored market-making activities into their analysis since they interpreted the guidance to not require the consideration of market-making activities solely provided for the purposes of providing market liquidity. It is unclear from the current transition guidance in the FSP whether the lack of consideration of market-making activities by the transferor would cause the QSPE to be at risk of losing its qualified status. We believe that this result would be inappropriate and unduly punitive especially if such companies engaged in limited and normal market-making activities and given the fact that the guidance in this regard has not been clear. We therefore recommend that the

transition guidance be clarified and that existing structures be grandfathered to avoid disruption in the marketplace.

We appreciate the opportunity to express our views in this letter. If you have any questions, please feel free to contact me at 704-388-8433.

Sincerely,

Randall J. Shearer  
Senior Vice President  
Accounting Policy