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Mr. Lawrence W. Smith
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Financial Accounting Standards Board
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Proposed FASB Staff Position No. FAS 140-c, "Clarification of the Application of Paragraphs 40(b) and 40(c) of FASB Statement No. 140"

Dear Mr. Smith:

Deloitte & Touche LLP is pleased to comment on the proposed FASB Staff Position No. FAS 140-c, "Clarification of the Application of Paragraphs 40(b) and 40(c) of FASB Statement No. 140" ("proposed FSP").

The proposed FSP indicates that compliance with the requirements of paragraph 40(b) and 40(c) of FASB Statement No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, involving a comparison of derivative financial instruments held by a potential qualifying special-purpose entity (SPE) and issued or sold beneficial interests needs to be assessed only upon issuance of beneficial interests or replacement of the derivative financial instruments. The proposed FSP describes application of this guidance to two situations: (a) when future prepayments are expected and (b) when future purchases of beneficial interests are anticipated as part of market-making activities. We support the guidance regarding consideration of expected future prepayments in the assessment. However, we believe the guidance regarding market-making activities misses the objective and we question the need for this restriction. Finally, we believe the transition guidance needs further clarification. The basis for our views is discussed below.

Market-Making Activities

One of the objectives of paragraph 40 of Statement 140 is to prevent transferors from avoiding the accounting requirements of FASB Statement No. 133, Accounting for Derivative Instruments and Hedging Activities, by packaging derivatives in securitization trusts. Paragraph 40(b) and 40(c) of Statement 140 were designed to ensure that any derivative held by a qualifying SPE pertained only to beneficial interests held by parties other than the transferor, or its affiliates or agents. The requirements of paragraph 10 of the proposed FSP (i.e., a comprehensive analysis that anticipates the level of market-making activity) will not achieve the aforementioned objective.

If the original financial asset transfer meets the criteria in paragraph 9 of Statement 140 to be accounted for as a sale, then it is impossible to prevent beneficial interests repurchased by the transferor or its affiliates or agents from obtaining the benefits of a derivative held by the qualifying SPE. The effects of a derivative financial instrument held by a qualifying SPE must be

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passed through to all issued beneficial interests, including those that have been repurchased by the transferor. The terms of the beneficial interests would not permit the issuer to discriminate against certain beneficial interests (e.g., by denying those interests the benefit of the derivative) based solely on the identity of the interest holder. Therefore, the proposed provision in paragraph 10 that requires a transferor to reduce the notional amount of a derivative held by a qualifying SPE by the amount of beneficial interests that are anticipated to be repurchased through market-making activities would not prevent the transferor's repurchased beneficial interests from realizing their proportionate share of the benefit provided by the derivative.

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In addition, the proposed provision seems unnecessary for many market makers because they intend to resell the beneficial interests in the near term and therefore account for any repurchased interests as trading securities (i.e., mark to market in earnings). For these entities, all changes in the fair value of the beneficial interests are reflected in the income statement, which achieves the same accounting result as if those interests' proportionate share of the underlying derivative had been recorded separately on the transferor's books in accordance with Statement 133. Because there is no circumvention of the requirements of Statement 133, there does not appear to be a need for the additional guidance in this FSP for market making activities.

Conceptually, it also may be argued that repurchasing beneficial interests should not trigger a reassessment of whether the SPE maintains its qualifying status. In order for a transfer of a financial asset to qualify as a sale under Statement 140, the transferor must give up control of the financial asset and the transferee must obtain the benefits of owning the asset. Accordingly, once a transferor transfers its asset to a qualifying SPE in a transfer that meets the Statement 140 sale criteria, and the qualifying SPE issues those interests to independent third parties, the transferor has no assurance that it will be able to repurchase any of those issued beneficial interests. From the transferor's perspective, if it is able to repurchase beneficial interests, then the repurchased beneficial interests are new assets; therefore, it appears reasonable that they should be treated similarly to beneficial interests held by unrelated third parties.

For these reasons, the FASB staff should consider the following alternatives, which are consistent with the anti-abuse provisions of paragraph 40 of Statement 140. One alternative is to require that all repurchased beneficial interests are classified as trading securities under FASB Statement No. 115, Accounting for Investments in Certain Debt and Equity Securities, which would ensure that the transferor accounts for its proportionate share of the underlying derivative in a manner consistent with Statement 133. Alternatively, entities that carry all of their assets and liabilities at fair value should be excluded from the scope of the proposed FSP.

Consistency With Proposed Amendments to Statement 140 and Potential Implementation Costs

We recognize that this proposed FSP is in response to inquiries received by the FASB staff regarding the proper application of the requirements in paragraph 40(b) and 40(c) of Statement 140. However, the guidance in the proposed FSP related to market-making activities is inconsistent with the recently released Exposure Draft, Accounting for Transfers of Financial Assets, which will amend Statement 140. The proposed amendment would revise paragraph 40(b) of Statement 140 to allow a qualifying SPE to hold passive derivative financial instruments with a notional amount that pertains to all beneficial interests issued or sold (including those issued or sold to the transferor).

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Since the guidance in this proposed FSP will serve only as interim guidance, we encourage the Board to carefully weigh the benefits provided by the new guidance against the potentially significant implementation costs that could be incurred if the proposed guidance requires system or process modifications, or causes the disqualification of existing qualifying SPEs. The proposed FSP also may affect parties not affiliated with the transferor as the disqualification of existing qualifying SPEs may cause all non-transferor beneficial interest holders in disqualified SPEs to assess whether they would have to consolidate the SPE in accordance with FASB Interpretation No. 46(R), Consolidation of Variable Interest Entities, since they no longer would be eligible for the Interpretation 46(R) scope exception.

Transition

Paragraph 12 of the proposed FSP states that the guidance applies prospectively to the evaluation of the qualified status of new and existing SPEs after the date the proposed FSP is finalized. It is unclear how this transition guidance applies to existing SPEs. In addition, if the guidance must be applied immediately upon the issuance of a final FSP to existing SPEs it is unclear how such transition reconciles with the notion that the requirements of paragraph 40(b) and 40(c) need only be met when beneficial interests are issued by the qualifying SPE or when passive derivative financial instruments are replaced (see paragraph 9 of the proposed FSP). If this is an inception-only test, then the new guidance should be applied to existing qualifying SPEs only when new beneficial interests are issued or when a passive derivative financial instrument is replaced (i.e., the FASB staff should consider making the transition provisions truly prospective). If the transition is not truly prospective, the transition provisions should be clarified with respect to how the guidance should be applied to existing qualifying SPEs.

Deloitte & Touche LLP appreciates the opportunity to comment on the proposed FSP. If you have any questions concerning our comments, please contact Robert Uhl at (203) 761-3705.

Yours truly,

Deloitte & Touche LLP

cc: James A. Johnson