



Letter of Comment No: 9
File Reference: FSPFAS140C
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: 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:

PricewaterhouseCoopers LLP appreciates the opportunity to respond to 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* (the "proposed FSP"). We note that the Board is addressing issues related to qualifying special-purpose entities (QSPEs) in its agenda projects to amend FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (FAS 140). We recommend that the Board consider including in the scope of those projects the issue addressed by the proposed FSP, which is described in paragraph 8 of the proposal. We believe this would enable the Board and its staff to take advantage of the expected time frame for completing those projects to research the feasibility of certain aspects of the guidance in the proposed FSP, which we believe will be important to ensure that such guidance operational. As a practical matter, we question the need to issue the proposed FSP in view of the fact that the agenda projects are well underway and could accommodate the need for guidance, and because the final standards resulting from those projects will likely supersede aspects of the proposed FSP, giving it a rather short shelf-life.

The comments that follow are provided to convey certain of the operational issues we believe exist with the guidance in the proposed FSP, which we think would need to be addressed whether the guidance is issued in an FSP or as part of the agenda projects.

We understand that the fundamental principle of paragraphs 40(b) and 40(c) of FAS 140 is that, at issuance, the transferor should perform a robust comparison of the beneficial interests expected to be held by outside parties and the notional amount of any derivatives held by a

special-purpose entity (SPE) over time. The beneficial interests expected to be held by outside parties over time are estimated using assumptions and other modeling techniques, over a variety of scenarios, for certain factors that impact the amount of beneficial interests held by outside parties, including, but not limited to, prepayment speeds. If the other requirements of paragraph 35 of FAS 140 are met, the SPE would become qualified if the expected beneficial interests held by outside parties is initially, and is expected to be over time, equal to or greater than the notional amount of any derivatives held by the SPE. We believe that the proposed FSP is consistent with that principle. However, we believe the following operational issues need to be addressed.

Impact of Transferor Market-Making and Trading Activities

Paragraph 10 of the proposed FSP requires that the model comparing the amount of beneficial interests expected to be held by outside parties and the notional amount of any derivatives held by an SPE include an estimate of purchases of beneficial interests through market-making or trading activities. We understand that, in practice, that estimate would be very subjective. Historical data of the market-making and trading activities of the transferor, while available, may not be representative of a current securitization, as each asset class and securitization structure (i.e., the duration of the position, notional amounts, and seniority) is different. The needs of investors would also change the need for market-making and trading activities. Such measures would be very difficult, if not impossible, to reliably predict. Accordingly, we are concerned about the operability of this provision. Unless the Board can resolve this issue, for example, by working with industry experts to identify the indicators that a transferor might reasonably be able to use to estimate its market-making or trading activities, we recommend that this provision be deleted from any final guidance that is issued.

We have a similar concern in situations in which the transferor purchases interests of a qualified SPE (QSPE) to hold as an investment. We believe that such holdings would have the same affect as market-making and trading activities (i.e., the purchase of interests to be held for investment by the transferor could cause the notional amount of the derivative entered into to be more than the beneficial interests held by outside parties). However, it would seem that the same difficulties would exist in estimating interests to be held for investment by the transferor as would exist in estimating market-making and trading activities. Accordingly, our recommendation above also applies in these situations.

It is also unclear whether the purchase and sale of the same position that occurs multiple times should be considered to be an individual trade or whether a cumulative value should be determined for all of the trades (similar to the issues of “tainting” through the purchase and sale of treasury stock subsequent to a “pooling of interest” transaction). If guidance on market-making and trading activities is issued, we recommend that this aspect be clarified.

Interaction with Interpretation 46

Paragraph 4(d) of FASB Interpretation No. 46(R), *Consolidation of Variable Interest Entities, an interpretation of ARB No. 51 (FIN 46(R))*, exempts an investor that has a variable interest

in a QSPE from consolidating the QSPE unless it has the unilateral ability to cause the entity to liquidate or no longer be a QSPE (i.e., no longer meet the conditions in paragraph 25 or 35 of FAS 140). The investor must, among other things, determine whether the entity still meets the QSPE requirements of FAS 140 to qualify for the exemption at each reporting date, which would include whether the notional amount of any derivative held by the QSPE exceeds the amount of beneficial interests held by third parties.

We believe the proposed FSP would require the investor to estimate a transferor's market-making and trading activities in determining whether the entity meets the requirements of a QSPE. However, we believe an investor in such an entity would not have the information needed to make such an evaluation. Therefore, we recommend that any final guidance explicitly state that a nontransferor investor is not required to make such an estimate in order to qualify for the paragraph 4(d) exemption from FIN 46(R). If the Board decides to require such an estimate by the nontransferor investor, we recommend that it do so after having satisfied itself that such an estimate can reasonably be made. The requirement also could be subject to a "reasonable efforts" threshold in recognition of the fact that it may not be practicable for nontransferor investors to obtain the information needed to make the estimate.

Other Considerations

Paragraph 11 of the proposed FSP discusses that paragraph 35(b) of FAS 140 must be followed in order to "rebalance" the derivative amount in the QSPE. We believe that this guidance is widely understood and is an unnecessary reminder that is outside the scope of the FSP. We believe that the inclusion of the paragraph in the FSP could be interpreted to mean that rebalancing of a QSPE is required if actual prepayment speeds and market-making and trading activities were different than those used in the comprehensive analysis prepared at the time of transfer. Therefore, we recommend that paragraph 11 of the proposed FSP be removed.

We agree that the guidance should be applied prospectively to the evaluation of the qualified status of new SPEs. However, we believe the transition guidance for existing structures should be clarified. It is unclear whether the FSP should be applied only to new derivatives in existing structures, or whether the qualified status of an existing structure must be re-analyzed based on the guidance. We believe that existing QSPEs should not be re-analyzed because in some circumstances it may not be practicable, and the cost of performing such an analysis is likely to exceed any potential benefits as gathering the relevant information is likely to be difficult, if not impossible.

Additionally, if the Board continues to require estimation of a transferor's future market-making and trading activities as part of its comprehensive analysis, and the final guidance is issued in the form of a FSP, we recommend that the effective date of the FSP be delayed to allow companies enough time to gather relevant information and develop models that will produce reliable estimates.



We appreciate the opportunity to express our views on the Proposed FSP. If you have any questions regarding our comments, please contact Tom Barbieri (973-236-7227) or Gerard O'Callaghan (973-236-7817).

Sincerely,

PricewaterhouseCoopers LLP