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Letter of Comment No: 3
File Reference: FSPFAS140C
Date Received:

August 22, 2005

Mr. Lawrence Smith
Director-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. 140-c, "Clarification of the Application of Paragraphs 40(b) and 40(c) of FASB Statement 140" (the "Proposed FSP")

Dear Mr. Smith:

The Commercial Mortgage Securities Association ("CMSA") is pleased to comment on the Proposed FSP.

CMSA:

 Supports the issuance of Proposed FSP paragraph 9 (unanticipated prepayments), and

For the reasons indicated below, does not support the issuance of Proposed FSP paragraph 10 (market making activities¹) and recommends the paragraph be deleted from the Proposed FSP.

CMSA:

CMSA is an international trade organization dedicated to improving liquidity of commercial real estate debt securities ("CMBS") through access to the capital markets. Headquartered in New York City, CMSA has chapters in Canada, Europe, and Japan,

One of the possible results of paragraph 10 of the Proposed FSP is that an CMBS SPE that holds derivatives will not be a QSPE, unless the derivative's notional automatically reduces while, and to the extent that, a "transferor" (or its affiliates or agents) to the SPE holds beneficial interests (to which the derivative pertains) as a result of "normal" market making activities. Another possible result is that CMBS SPE derivative notionals will be reduced at CMSB SPE formation to the extent of anticipated transferor market making.

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and has expanded to more than 300 member firms since it was founded in 1994. CMSA's members include leading CMBS originators, issuers, investors and service providers, including the largest money-center banks, investment banks, insurance companies, money managers, specialty finance companies, loan servicers and rating agencies. More information on CMSA can be found at www.cmbs.org.

CMBS:

QSPE Status-

Most special purpose entities ("SPEs") that issue CMBS are designed to be Statement 140 qualifying SPEs ("QSPEs), resulting in:

1. The related "transferors" accounting for their transfers of commercial mortgage loans to the CMBS issuing SPEs as Statement 140 sales, and

2. CMBS investors being exempt from FIN 46(R)'s consolidation provisions with regard to CMBS SPEs.³

Derivatives-

Some CMBS SPEs enter into passive interest rate swaps and/or caps that reduce the SPE's interest rate risk resulting from the mismatch between fixed and floating coupons on the SPE's assets and beneficial interests.

These derivatives generally have notional amounts that protect (and therefore "pertain to") 100% of one or more classes of the SPE's CMBS and, as such, are not designed to distinguish between the portions of the CMBS class (a) held by the transferor (and its affiliates and agents) as a result of its market making activities and (b) held by other parties.

Market Making Activities-

An affiliate of one of the transferors of commercial loans to each CMBS SPE is frequently the lead underwriter for the initial offering of the SPE's CMBS. Investors expect (and it is therefore important to the efficient functioning of the CMBS market) the lead underwriter to make a market in the CMBS, so investors can (if they desire) sell their CMBS before maturity. The lead CMBS underwriter is generally in the best position to make a market in the CMBS, due to its unique knowledge of the CMBS SPE's assets and beneficial interests.

² There are usually several, independent transferors to a CMBS SPE.

³ If they do not qualify as QSPEs, most CMBS SPEs will be FIN 46 "Variable Interest Entities."

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Why CMSA Does Not Support Paragraph 10:

 Paragraph 10 is inconsistent with most CMBS market participants' (transferors' and investors') historical and current interpretation and application of paragraph 40 of Statement 140, by which most (if not all) CMBS participants treat "normal" transferor market making as having no impact on QSPE qualification under paragraph 40.

Accordingly, most (if not all) CMBS SPEs that own derivatives do not have provisions by which derivative notionals automatically change with transferor market making activities.

- 2. Paragraph 10 cannot be applied to existing CMBS SPEs by virtually all investors as:
 - Most CMBS SPEs have no provisions for gathering and/or disseminating market maker positions due to most market participants' current interpretation (described in (1)) of Statement 140's paragraph 40, and
 - b. Market makers are unlikely to voluntarily disclose their market making positions, as disclosure would likely adversely impact market making economics.
- 3. Paragraph 10 will likely require parties involved with CMBS SPEs desiring the SPEs to continue to be QSPEs to attempt to amend the SPEs' documents to either:
 - a. Prohibit transferor market making activities, or
 - b. Make changes so:
 - CMBS SPE derivatives automatically change (reduce, and then increase) to the extent of transferor market making purchases and sales of SPE CMBS, and
 - The CMBS SPE cash flow waterfall provides that cash flows from SPE derivatives are only distributed to third party beneficial interest holders.

It is unlikely that such amendments can (or will) be made, given:

- a. That prohibiting transferor market making would have an adverse impact on CMBS liquidity and secondary market prices,
- Likely Rating Agency objection (100% of a class of CMBS are rated, not just the portion held by parties other than the transferor, its affiliates and agents), and
- c. The impracticality of changing SPE documents in "widely held" transactions, given typical restrictions⁴ on changes to SPE activities and documents.

⁴ Amendments usually must be approved by at least a majority of third party CMBS holders.

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4. Paragraph 10 will result in inconsistencies in the QSPE status of "existing" and "newly formed" CMBS SPEs, in that:

a. Most existing SPEs that own derivatives will no longer be QSPEs pursuant

to the Proposed FSP,

- b. Most SPEs created after the effective date⁵ of the three recently released exposure drafts (the "Exposure Drafts") to amend SFAS 133 and SFAS 140 that own derivatives will be QSPEs, as the Exposure Drafts remove Statement 140 paragraph 40's restrictions on transferor ownership of beneficial interests that "pertain" to QSPE derivatives, and
- c. The Exposure Drafts' changes to paragraph 40 of Statement 140 will apply only to QSPEs formed after the Exposure Drafts' effective date.⁶
- Paragraph 10 unnecessarily complicates an already complicated area.

Other Comments:

If, contrary to CMSA's recommendation, the Proposed FSP is issued with the current paragraph 10, CMSA recommends that:

- 1. To minimize the time during which there are inconsistencies between "old" and "new" QSPEs, the Exposure Drafts' transition provisions is changed so the Exposure Drafts' paragraph 40 changes apply to QSPEs established before effectiveness of the Exposure Drafts.
- 2. The Proposed FSP clearly state:
 - It is to be applied prospectively, and
 - Restatement of previously issued financials is not required (or allowed) for SPEs previously considered QSPE that did not comply with Proposed FSP paragraph 10, and
- 3. The phrase "should anticipate a level of purchases of beneficial interests by the transfer, its affiliates, or agents" in paragraph 10 is changed so the reference to "purchases" is net of subsequent resales of purchased beneficial interests.

⁵ The effective date will likely be July 1, 2006, for calendar year end public companies.

If, contrary to CMSA's recommendation, paragraph 10 is not removed form the Proposed FSP, comparability between "old" and "new" QSPEs would be achieved if the Exposure Drafts' transition provisions are changed as described in Item (1) under "Other Comment."

⁷ CMSA will be submitting separate comment letters on the Exposure Drafts.

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CMSA would be pleased to discuss this letter with at your convenience you or to provide you with any additional information that may be of assistance to the Board. Please call Stacy Stathopoulos at (212) 509-1950.

Very truly yours,

Dottie Cunningham

Chief Executive Officer

Commercial Mortgage Securities Association