



August 11, 2005

Mr. Lawrence Smith, EITF Chairman
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856 – 5116

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

Re: FSP FAS 140 – c, “Clarification of the Application of Paragraphs 40(b) and 40(c) of FASB Statement No. 140”

Dear Mr. Smith:

Citigroup appreciates the opportunity to comment on the proposed FSP FAS 140-c, *Clarification of the Application of Paragraphs 40(b) and 40(c) of FASB Statement No. 140*. We thank the Board for its willingness to promptly address the concerns of constituents regarding events that could disqualify a qualifying special purpose entity (QSPE) and the potential limitations on secondary market activities that would arise from a strict interpretation of the language of paragraphs 40(b) and (c).

We support the Board’s conclusion that unexpected subsequent events, such as a differing pattern of prepayment of assets of the QSPE, which was not expected in a thorough analysis of the future prepayment scenarios when the beneficial interests of the qualifying SPE were issued, would not impair the qualified status of the QSPE. We also support the Board’s intent to amend FAS 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (FAS 140), to allow QSPEs to hold passive derivative financial instruments that relate to all beneficial instruments issued by the QSPE and not just those held by third-party investors. We believe the restrictions currently imposed by paragraphs 40(b) and 40(c) will no longer be necessary when the Board addresses the issues around bifurcation of beneficial interests.

However, the proposed guidance in paragraph 10, which is intended to be the solution for secondary market activities offered by the Board, may be confusing to constituents. This FSP introduces a new requirement to perform a “comprehensive” analysis of expected secondary market-making activities.¹ The Board’s recent deliberations led us to expect that the FSP would explicitly state that secondary market activities need not be contemplated continuously or subsequently after an initial issuance.

We do not believe that secondary market-making and trading activities constitute “repurchases” of beneficial interests as contemplated in Statement 140. Once a beneficial interest has initially been sold to third-party investors (without any repurchase commitments

¹ We would suggest using a term other than “comprehensive” throughout the FSP to describe the required analysis because a “comprehensive” analysis may connote contemplating both expected and unexpected events. We believe the intent of the analysis is to focus only on reasonably expected events, and the requirement should be to perform a “thorough” or “careful” analysis of those expected events and scenarios.

or conditions that would require that transfer to be accounted for as a secured borrowing), that beneficial interest retains its character as a third-party interest. The volume of beneficial interests owned in typical market-making and trading activities does not approach the limitation set by paragraph 36 of FAS 140, and we fail to see the necessity for, or the benefit of, incorporating that concept in this FSP. We understand that distinguishing secondary market-making and trading activities from substantive repurchases of assets for investment purposes requires professional judgment. We do not believe that practice issues or abusive interpretations have arisen from making this distinction, and do not believe that the Board needs to provide detailed guidance on that judgment.

If a “comprehensive” analysis of expected market-making and trading activities estimated that up to 2% of issued beneficial interests could be held in inventory for short periods of time, some could infer that derivative notional amounts could not exceed 98% of the notional amount of beneficial interests, even though at many (even most) points in time, 100% of the beneficial interests would be held by third parties. Using a derivative contract with a 98% notional amount would alter the economics of all the beneficial interests by passing on 2% of the related risks to investors who are not interested in being exposed to this risk. Furthermore, rating agencies may be unwilling to accept a reduced notional amount for the derivative, because it adversely alters the economics of the transaction to each third-party investor. Such a solution is simply not commercially viable and is not consistent with current market practices.

The proposed FSP clearly acknowledges that the Board’s primary reason for originally including the limitations in paragraphs 40(b) and 40(c) in FAS 140 was to prevent constituents from circumventing the requirements of FAS 133, *Accounting for Derivative Instruments and Hedging Activities*. It is important to note that beneficial interests purchased in market-making and trading activities are recorded at fair value and are marked to market through income. Thus, these activities do not raise any of the issues regarding circumvention of Statement 133 through QSPEs that created the need for paragraphs 40(b) and 40(c).

We believe that the additional restrictions introduced in paragraph 10 of the proposed FSP are unnecessary—imposing an analysis of market-making activities that is not contemplated in practice today. These additional restrictions are not directionally consistent with the Board’s intent to allow the notional amount of a derivative to equal the total notional amount of beneficial interests, including those held by a transferor, its affiliates and agents, in paragraphs 40(b) and 40(c) in the upcoming amendments to Statement 140. We recommend that the FSP be revised to state explicitly (as in paragraph 9 for unexpected prepayments) that secondary market-making and trading activities do not impair the qualified status of a QSPE and need not be considered in determining the qualifying status of an SPE subsequent to the initial issuance of beneficial interests to third-party investors. We believe the Board need not attempt to specifically define secondary market-making and trading activities, as those activities are readily apparent in practice and distinguishable from other investing activities.

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Further, the transition provisions of the proposed FSP are problematic. If the guidance in paragraph 10 is finalized as written, many existing QSPEs would not be in compliance, unless their governing transaction documents were amended in order to provide for the necessary "rebalancing" of the QSPEs in the event that the level of secondary market purchases reach a certain magnitude. Those amendments to the governing documents would likely be costly and presumably would no longer be necessary upon the forthcoming amendment of FAS 140. We believe the Board need not attempt to specifically define secondary market-making and trading activities, as those activities are readily apparent in practice and distinguishable from other investing activities. We therefore ask the Board to reconsider the language in paragraph 10 of the proposed FSP with respect to market-making and trading activities and possibly delete its problematic language.

We thank the Board for its consideration and would welcome the opportunity to further discuss this matter with the Board members and their staff. Please do not hesitate to contact me at (212) 559 - 7721.

Sincerely,



Robert Traficanti
Vice President and Deputy Controller