



Letter of Comment No: 40
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July 31, 2003

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

RE: File Reference 1200-001 - Proposed Statement of Financial Accounting Standards,
*Qualifying Special-Purpose Entities and Isolation of Transferred Assets, an amendment of
FASB Statement No. 140*

Dear Mr. Smith:

Wachovia Corporation is pleased to comment on the Proposed Statement of Financial Accounting Standards, *Qualifying Special-Purpose Entities and Isolation of Transferred Assets, an amendment of FASB Statement No. 140* (the Exposure Draft). While we support the Board's efforts to clarify the permitted activities of a qualifying Special-Purpose Entity (SPE), we disagree with many of the proposed amendments to Statement 140 in the Exposure Draft. We believe that the Board is inappropriately trying to reconcile the risk and reward control model for consolidation in FASB Interpretation No. 46, *Consolidation of Variable Interest Entities*, (Interpretation 46) with the passive activities of a qualifying SPE in Statement 140. In paragraph A2 of Appendix A of the Exposure Draft, the Board notes its concern that the exception in Interpretation 46 may lead to increased use of qualifying SPEs. Qualifying SPEs are a concept that generally accepted accounting principles in the United States have held since January 1997 and one that the Board continued to support in April 2001 with the issuance of Statement 140.

We strongly suggest, and would fully support, the Board not moving forward with this Exposure Draft and instead committing to developing more robust sale and consolidation models than are currently in place under Statements 94 and 140, ARB 51 and Interpretation 46. It seems to us that the Board is attempting to patch some of the shortcomings of Interpretation 46, while not addressing others. We do not believe it is appropriate to single out and amend on a piecemeal basis the requirements of a concept (qualifying SPEs) that was founded on passivity, not risks and rewards.

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The accompanying Appendix to this letter details our specific comments on the Exposure Draft.

We would be pleased to address any questions you may have regarding the comments in this letter or to discuss our position in more detail at your convenience. I can be reached at 704-383-1293 or by email at lynn.rogers@wachovia.com.

Sincerely,

B. Lynn Rogers
Senior Vice President
Director of Accounting Policy

cc: David M. Julian, Senior Vice President and Controller

APPENDIX

Paragraph 3

We believe the proposed revision to paragraph 9(a) should be clarified to be consistent with question 20 in the FASB Q&A on SFAS 140. Question 20 provides that a transfer from one subsidiary of a common parent to another subsidiary of a common parent can be treated as a sale if the requirements of paragraph 9 of SFAS 140 have been met, “including the condition on isolation of the transferred assets.” The revised paragraph 9(a) would require isolation “beyond the reach of the powers of a bankruptcy trustee ... for the transferor or any consolidated affiliate of the transferor that is not a special-purpose corporation or other entity designed to make remote the possibility that it would enter bankruptcy ...” This implies that the only time intercompany transfers can be treated as sales is if a bankruptcy-remote special-purpose corporation is the transferee. This is how this amendment is reported in the summary at the beginning of the Exposure Draft, which states “assets transferred to any entity ... may not be derecognized unless they are isolated from all members of the consolidated group that includes the transferor, except for certain bankruptcy-remote entities.” It is a normal part of the management of a diverse financial institution to have transfers of financial assets between legal entities, most of which are not special-purpose corporations. We believe it is appropriate to apply sales accounting in the stand-alone financial statements of a subsidiary if a transfer of financial assets to another subsidiary in the consolidated group meets the requirements of paragraph 9 of SFAS 140 and the transferor does not consolidate the transferee in its financial statements.

Paragraph 4(c)(1)

We suggest the Board clarify in its amendment to paragraph 35(c)(1) what is intended by the term “equity instruments.” It is unclear whether the instrument in question needs to qualify as an equity security under Statement 115, *Accounting for Certain Investments in Debt and Equity Securities*, whether it should be accounted for as equity of the issuer under the guidance of Statement 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities or Equity*, or other standards, or whether it has another intended meaning.

Paragraph 4(c)(2)

We disagree with the amendments to paragraph 35(c)(2), restricting the ability of the transferor and its affiliates or agents from being the counterparty to any derivative instruments. We understand the basis for such amendment, as described in paragraph A12 of Appendix A of the Exposure Draft, is that the Board believes that risk transference from the qualifying SPE to the transferor through a derivative instrument allows the transferor to change its financial statements without significantly changing its economic position. We disagree that this basis should justify such an amendment, since this is not always the intended purpose of the transaction. In many transactions, the transferor is already hedging any risk related to the collateral before it is transferred.

Derivatives that facilitate a matching of the interest rate characteristics of assets and liabilities in a transaction, regardless of who the counterparty is, should not preclude that structure from being a qualifying SPE. Statement 140 already requires that the derivative provide a level of risk offset at the qualifying SPE level and we do not understand why prudent risk mitigation practices at this level should be affected by who the counterparty is. Examples of matching in qualifying SPEs may include interest rate swaps that align fixed rate collateral with variable rate beneficial

interests, basis swaps that align prime-based collateral with LIBOR-based beneficial interests, or currency swaps that align U.S. dollar-denominated collateral with Euro-denominated beneficial interests.

We suggest that the restriction on the transferor being a counterparty to derivative instruments in paragraph 4(c)(2) be worded as follows.

- (2) Passive derivative financial instruments that, if entered into with a transferor, its affiliates or agents, would, by itself, make that party the primary beneficiary of the qualifying SPE if Interpretation 46 were applicable.

We believe this type of amendment will address the Board's concern about reconciling certain aspects of Interpretation 46 with the requirements of a qualifying SPE without unnecessarily changing basic risk-mitigating, passive and non-controlling activities of a qualifying SPE.

Paragraph 5(e)

We disagree with the amendments to paragraph 5(e) because holding the types of interests referred to in the proposed paragraph would not necessarily make a transferor the primary beneficiary of a variable interest entity under Interpretation 46. In an attempt to reconcile the requirements of a qualifying SPE with the consolidation requirements of Interpretation 46, we suggest that paragraph 5(e) be written as follows:

- e. It may not enter into an agreement...with a transferor, its affiliates or its agents that, if that party were subject to Interpretation 46, would, by itself, make that party the primary beneficiary under Interpretation 46.

Further, it is unclear to us what the purpose is of the following the phrase: "... any other derivative instruments that may require delivering additional financial assets." It seems that the proposed amendments in paragraph 4(c)(2) of the Exposure Draft already address this point.

Paragraph 5(f)

We suggest that the Board clarify the intent and meaning of "the ability to reissue" beneficial interests because it is unclear to us how this prohibition on reissuance reconciles with either paragraph 35(b) or paragraph 44(c) of Statement 140.

Paragraph 35(b) gives the beneficial interest holder the right to change the activities of the qualifying SPE provided any potential changes are specified in the documents that established the qualifying SPE. If the beneficial interest holders vote to amend the terms of their beneficial interests, such an amendment would presumably be accounted for as either an extinguishment of debt under EITF Issue 96-19 or Statement 140, or a modification under EITF Issue 96-19. Would such an activity be a reissuance under the Exposure Draft or does a qualifying SPE have the ability to reissue only when the original beneficial interests mature and new beneficial interests are issued to the same or different investors? Moreover, paragraph 44(c) permits beneficial interest holders to put their beneficial interests back to a qualifying SPE in exchange for new beneficial interests. Does this provision in a beneficial interest give the qualifying SPE the ability to reissue?

Paragraph 5(f)(1)

We suggest that this restriction be removed. We disagree with the restriction on a single party providing more than half of the commitments. Such commitments do not impact the passive nature of the qualifying SPE, nor would they necessarily lead to that party being the primary beneficiary of the structure under Interpretation 46. For example, certain commitments, such as a wrap on a AAA tranche that is 80% of all beneficial interests issued, would not lead that party to be the primary beneficiary of the structure under Interpretation 46, except in the unlikely case where no single party held a majority of the variable interests that are exposed to expected losses and the gross fees paid to the wrap provider were a majority of the residual returns of the structure.

We are unclear why the restrictions on commitments are based on the “fair value” of the commitment relative to all commitments. Because commitments often compensate the counterparty for losses in cash flows and because our understanding of the Board’s intent behind the Exposure Draft is to prevent any potential abuses of the use of qualifying SPEs because of the issuance of Interpretation 46, we believe the more appropriate measure is the variability to expected losses or residual returns of the cash flows of the structure.

If the Board believes that paragraph 5(f)(1) should remain, we suggest the following:

- (1) No party (including affiliates or agents) enters into a commitment (or commitments) to deliver additional cash or other assets to fulfill the SPE's obligations to BIHs if that commitment (or those commitments) would, by itself (or themselves), cause that party to be the primary beneficiary of the structure under Interpretation 46.

Paragraph 11

We disagree with the amendment to paragraph 83, requiring that the second step in a “two-step” transfer must be a qualifying SPE.

It is our understanding that transferring beneficial interests in assets and transferring the assets themselves are legally considered the same transaction. If a transfer of beneficial interests in specific assets is documented to give the beneficial interest holder the right to pledge or exchange the beneficial interests it received, the requirements in paragraph 9(b) should be considered met.

We do not believe transfers economically and legally recognized as sales should be recorded as anything other than sales for accounting purposes. To prohibit such transactions to be derecognized just to possibly prohibit abuses of other proposed amendments seems contrary to the entire basis of Statement 140. We recommend the amendment be removed.

If the amendment to paragraph 83 is retained, we believe the Board needs to reconcile the guidance in the amendment to paragraph 83 and the basis for conclusion discussed in paragraph A15 of Appendix A of the Exposure Draft. We understand the basis for such amendment, as described in paragraph A15, that if the “two-step” transaction results in the issuance of beneficial interests in the transferred assets rather than the actual assets themselves then the transferee has not obtained the ability to pledge and repledge the actual assets because the transferee only holds beneficial interests in the assets. However, it does not seem clear that the amendment to paragraph 83 is reflective of the basis for the amendment in paragraph A15.

The amendment to paragraph 83 requires the second step in a “two-step” structure be a qualifying SPE in order to meet paragraph 9(b) that the transferee has the right to pledge or exchange assets. This would seem to prevent sale accounting and derecognition when the second step in a transfer is to an Interpretation 46 Variable Interest Entity (VIE). We believe the amendment is meant to only require a qualifying SPE as the second step in a “two-step” transaction when beneficial interests in the transferred assets are transferred and not the actual assets but this is unclear. We recommend that if the amendment to paragraph 83 is retained that more specific and clearer language from the basis in A15 be included in the actual amendment to paragraph 83.

Paragraphs 12 and 13

We believe the effective date and transition provisions of the Exposure Draft will not provide financial statement preparers with sufficient time to implement the standard. The provisions of the Exposure Draft will impact many existing structures and many structure formats that are actively used in the marketplace. Existing structures may well have the ability to revise features of the structure to meet the requirements of the Exposure Draft; however, the revisions may well require communication with and approval by a wide group of investors, along with legal document revisions. The time frame anticipated by the Exposure Draft does not provide adequate time to understand the implication of changes needed to comply with the amendment, make the necessary changes to structures and obtain the necessary approvals. We believe the effective date should be at least six months after the issuance date of the standard to provide adequate time for users to address these issues.