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July 31, 2003

Letter of Comment No: 57
File Reference: 1200-001
Date Received: 8/5/03

Mr. Lawrence Smith
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Financial Accounting Standards Board
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File Reference No. 1200-001

Dear Mr. Smith:

Citigroup is pleased to have the opportunity to provide comments on the Board's Exposure Draft, *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" or the "Proposal"). As a significant participant in the securitization markets, we use hundreds of qualifying special-purpose entities ("QSPEs") with hundreds of billions of dollars in assets. We find that applying current generally accepted accounting principles to securitization transactions produces financial statements that make sense to investors and borrowers. Moreover, the capital markets work extremely well with the current rules, facilitating capital flows between investors and borrowers. Therefore, we do not share the Board's view that there is a pervasive accounting problem that needs to be fixed with this far-reaching Exposure Draft. We urge the Board not to move forward with this project. Alternatively, if the Board is concerned, for example, that commercial paper conduit administrators could utilize the QSPE structure to avoid consolidation under FASB Interpretation No. 46, *Consolidation of Variable Interest Entities* ("FIN 46"), the Board could issue a FASB Staff Position that prohibits conduit administrators from QSPE qualification.

We believe that the Board's moving forward with this Proposal will add another layer of rules to a standard that already contains numerous rules and is contrary to the Board's stated intention of moving toward principle-based accounting standards and away from rules-based standards. Moreover, these rules depart from and undermine the financial components approach, which is the underlying fundamental principle of Statement of Financial Accounting Standards No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, a replacement of FASB Statement No. 125* ("FAS 140") and move toward a risks and rewards approach. Such a significant change in direction should not be undertaken without due process.

The Exposure Draft's provisions will have a significant impact on existing qualifying special-purpose entities (QSPEs), particularly master trusts used for credit card receivable

securitizations, and will adversely affect their status as QSPEs. The grandfathering transition provisions in the Proposal will not work for master trusts, since it is inevitable that new beneficial interests will be offered to investors as the seller's interest increases as a result of the commitment to transfer to the trust new receivables arising on designated customer accounts. In addition, master trusts are established with the understanding that new customer accounts will be designated to the trust from time to time adding to the pool of receivables supporting the trust's beneficial interests. Master trusts frequently have a portion of their issuances in a commercial paper program. Thus, the restrictions on reissuing beneficial interests will apply to them. Master trusts may also enter into passive derivatives with the transferor. Thus, the derivative restrictions will apply to them. The transferor may be one of the liquidity providers to the master trust. In addition, the transferor may be a party to other contracts that could result in cash or other assets being transferred to the trust and used to make payments to beneficial interest holders, violating provisions of the Exposure Draft. Even immaterial involvements in these contracts would disqualify the QSPE. Restucturing master trusts and other QSPEs to comply with the proposed rules will take considerable time to accomplish because of these trusts' complexity and because a vote of the beneficial interest holders may be required to approve amendments to the trust documents. As the Board is aware, conducting a vote of beneficial interest holders of a master trust can be a very complex, time-consuming, and costly matter.

The Proposal prohibits the transferor from entering into derivatives and liquidity facilities, financial guarantees, and other commitments that result in delivery of cash or other assets to the QSPE needed to make promised payments to beneficial interest holders. We disagree with theses proposed restrictions and discuss our reasons in the detailed comments below. However, these prohibitions are absolute; that is, there is no criterion that would accept immaterial involvements with these instruments. We think this needs to be revised if the Board continues to include these restrictions in the final standard, since immaterial involvements cannot possibly give rise to a transferor's retaining effective control over the assets transferred.

We do not understand the Board's rush to issue and implement this Proposal, which will certainly have an extensive impact on the financial services industry. We believe FASB should take the time to carefully study the effects of its proposals and consider the comments received from its constituents. The Board states that it is concerned that the issuance of FIN 46 provided an incentive to convert certain entities to QSPEs in order to avoid consolidation. However, we are not aware that organizers of any entities subject to FIN 46 have chosen to convert them into QSPEs, largely because the existing restrictions are too cumbersome. Additional restrictions are simply unnecessary to prevent the abuses that concern the Board. The effective date for implementing FIN 46 has come and gone. There is time for the Board to deliberate this proposal with due care to ensure that the final standard is worthy of issuance.

The Exposure Draft offers almost no transition time before becoming effective at the beginning of the first interim period after the amendment's issuance, essentially requiring immediate application. If a QSPE cannot be restructured to comply with the proposed

rules, an analysis of each QSPE must then take place under FIN 46. For a large institution, this could involve a review of hundreds of QSPEs, each of which must be individually evaluated. We believe this very limited transition period before effectiveness is unreasonable and unprecedented for a proposed standard of this magnitude. FASB's assertion that the costs of implementing the Proposal would be minimal are misguided, as the costs involved are likely to be substantial. Any costs incurred to conform existing QSPEs to the new standard's requirements are properly included in the cost analysis and will not be insignificant in this case, just as costs of modifying a company's computer systems and accounting procedures to comply with a new standard are part of the costs of implementing any new standard.

Many of the Exposure Draft's provisions would affect the existing guidance in FASB's *Guide to Implementation of Statement 140 on Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, Questions and Answers* ("FAS 140 Q&A"). It would be very helpful to see the proposed changes before the amendment is finalized to better understand what the Board is truly proposing in the current amendment.

The balance of this letter contains our detailed comments on the Exposure Draft.

Limitations on a Transferor's Involvement with a QSPE

The Exposure Draft creates a conflict between the criteria for sales of financial assets to entities that are QSPEs and all other entities. Under FAS 140, it is completely acceptable for transferors to obtain sales accounting treatment while entering into derivatives or retaining some recourse through guarantees, liquidity facilities, or other commitments, so long as such continuing involvements with the transferred assets do not violate the isolation standard in paragraph 9(a) or result in the transferor retaining effective control under paragraph 9(c). In accordance with the financial components approach, the transferor merely records any liabilities or assets resulting from its involvement with these instruments at fair value and takes them into account in calculating its gain or loss on the sales. In contrast, the Exposure Draft establishes a new standard for transfers to QSPEs by prohibiting the transferor's providing any of these commitments or derivatives, even in insignificant amounts that would never pose a concern under paragraphs 9(a) and 9(c) and even where the expected accounting losses under these arrangements would be de minimus. The Exposure Draft fails to justify setting this higher standard for achieving sales accounting for QSPEs or for departing from the financial components approach for transfers to QSPEs. We do not find any merit in establishing these new restrictions on a transferor.

Derivatives
We agree with FASB's prohibiting a QSPE from entering into a total return swap, because such swaps transfer economic risks from the transferee. However, this prohibition is unnecessary, since the existence of a total return swap would make it very unlikely that the transferor would meet the paragraph 9(a) requirement that the assets transferred be isolated from the transferor, even in bankruptcy or other receivership.

Accordingly, the transferor would not be able to treat the transfer as a sale and could not derecognize the asset, in which case there would be no benefit to the transferor in using a QSPE. We would be pleased to work with the Board to develop language to insure that a combination of several derivatives are not used to replicate the economics of a total return swap; however, the Proposal's total ban on a transferor's entering into a derivative contract with a QSPE is excessive.

We strongly disagree with the proposed prohibition of a QSPE's entering into any derivative with a transferor. FAS 140 already requires that every derivative in a QSPE must be passive; that is, the holder cannot have to make any decisions with respect to the derivative. In addition, FAS 140 requires that derivatives entered into by a QSPE can only relate to beneficial interests held by unrelated third parties. Accordingly, there is no way that the transferor can benefit economically from the QSPE other than through the pricing of the derivative set at inception. As the counterparty to such a derivative, it is hard to see how a transferor can exercise any control over the assets transferred or over the QSPE as all cash flows are preordained at inception of the contract. Furthermore, the very limited variability of passive derivatives, such as plain vanilla interest rate or currency swaps, would be unlikely to cause the transferor to be deemed the primary beneficiary of a variable interest entity (VIE) under FIN 46. Paragraph B6 of FIN 46 acknowledges this concept.

There has been a long history of generally accepted accounting principles' allowing a transferor to retain interest rate risk, recognizing that retention of interest rate risk is very different from retention of credit risk. At least as far back as 1983, Statement of Financial Accounting Standards No. 77, *Reporting by Transferors for Transfers of Receivables with Recourse* (FAS 77), allowed transferors to retain interest rate risk, stating "A transfer of receivables with recourse could qualify to be recognized as a sale even though the transfer price is subject to adjustment because of a floating interest rate provision." FAS 140 and its predecessor FAS 125 continued this practice and expanded it to allow retention of credit risk, currency risk, and other risks as long as the risks retained allowed the transferor to demonstrate that the assets had been isolated and that the risks retained did not result in retaining effective control over the assets transferred. Long-standing business practices developed to be consistent with these standards would now be disrupted despite the fact the transferor does not retain effective control through these arrangements.

The language in the Exposure Draft that precludes transferors from entering into derivatives with QSPEs can also be read to prohibit a transferor from holding removal of account provisions (ROAPs) and a transferor that is also the servicer from holding a cleanup call, since both are call options. While the paragraphs in FAS 140 that discuss these calls have not been amended in the Proposal, the final amendment language should be clear that a transferor may hold both ROAPs and cleanup calls.

Delivery of Cash or Other Assets Used to Pay Beneficial Interest Holders
We are particularly disturbed by the language in the Proposal that forbids a transferor to enter into any instrument with the QSPE that requires it to transfer cash or other assets

needed to make payments to beneficial interest holders. We think such language is overly broad and encompasses a far wider range of activities than FASB intended. This language could be deemed to apply to interchange fees in credit card receivable securitizations, customer rights to return merchandise purchased with credit cards, certain ROAPs, clean-up calls, and short-term reinvestment of proceeds from maturing securities (prior to distribution to beneficial interest holders) in qualifying securities of the transferor, as well as to passive derivatives (our objections to FASB's proposals with respect to derivatives are discussed above). We believe that each of these items should continue to be acceptable under the Proposal.

Interchange fees are payments by merchants that accept the credit card to the bank card issuer which assumes credit risk on the customer receivable, absorbs fraud losses and funds the receivables between the purchase and collection dates. These fees are included in customer payments of principal and interest and, if the customer's balance has been securitized, are remitted to the QSPE and ultimately returned to the transferor as part of the excess spread. When a customer returns merchandise to a merchant, it results in a cancellation of the related receivable. The transferor generally reimburses the trust for the amounts credited to the customer's account. In certain ROAPs allowed by paragraphs 87 and 88 of FAS 140, the transferor may give cash to the QSPE in exchange for the receivables being removed from the QSPE. While these paragraphs have not been amended by the Proposal, a broad reading of the language in the Proposal could lead to a view that these ROAPs cannot be held by a transferor. Broad restrictions on a transferor's entering into any derivative with a QSPE would create significant practice concerns in properly and consistently evaluating whether certain financial instruments meet the definition of a derivative, since it can be difficult to determine whether the underlying assets are readily convertible to cash.

Standard Representations and Warranties

We have an even greater concern that the prohibition on a transferor's obligation to give cash or other assets to a QSPE could apply to standard representations and warranties. If payments under standard representations and warranties are considered to be unacceptable for QSPEs under the Proposal, nearly every QSPE will no longer meet the requirements for QSPEs. In virtually every business transaction, the seller makes representations that the assets transferred meet the standards specified in the transaction documents. In the event that a particular asset is found not to comply with the specified standards, a remedy is offered which could involve replacement of the deficient asset with a conforming asset or payment of cash. Since all assets and cash transferred into a QSPE could be used to make payments to beneficial interest holders, it is not clear whether the Board intended such commonplace representations and warranties to be drawn into the scope of this provision of the Exposure Draft. We believe that the Board must include an exception to this provision in the Proposal or virtually every asset-backed securitization using QSPEs, including mortgage and credit card securitizations, would not comply with the Proposal. Furthermore, it would not be possible to restructure the QSPEs to avoid this problem, since business cannot be conducted on terms excluding these customary representation and warranties.

Even though the bank regulators have long had stricter standards for achieving sales treatment for risk-based capital purposes than FASB's standards, the Federal Reserve specifically recognizes in its recourse rules that standard representations and warranties that are unrelated to ongoing performance or credit quality are excluded from the definitions of recourse and direct credit substitute.

Limitations Relating to Reissuance of Beneficial Interests

FASB rightly expresses a concern that the power to reissue beneficial interests could be used to actively manage interest rate exposure of the QSPE. Accordingly, a party that held a residual interest in the QSPE could use such a power to benefit itself. While this could occur in the case where there is a right to switch beneficial interests from the commercial paper markets to the term securitization markets or vice versa, it is not the case where commercial paper rolls over at maturity to new commercial paper. Our experience with Dakota, the commercial paper issuance facility in Citibank's Credit Card Master Trust, shows that the difference between the average spreads in the one, two, or three-month categories versus one-month LIBOR is less than 2 basis points over a one-year period. Such small spreads cannot lead to any material differences in returns to the residual interest holders. In our view, reissuance decisions that are restricted to the commercial paper markets should not be prohibited to transferors.

As there is no definition of the term "reissuance" in the Exposure Draft, it is not clear whether new issuances of securities from the seller's interest in a master trust are included in the Proposal's restrictions. In our view, since the additional assets transferred to the trust were attributed to the seller's interest and were not treated as sales at the time of transfer to the QSPE, the issuance of beneficial interests from seller's interest should be considered a new issuance, not a reissuance. Supporting this view is the fact that when term notes issued by a master trust mature, they are paid from collections, not with proceeds of issuances from seller's interest. In addition, cash flow collections from customers in certain master trusts are sufficient to pay investors upon the maturity of its commercial paper issuances. It is unclear why these commercial paper programs should be subject to the restrictions in the Exposure Draft, since there is no repledging of assets taking place in these programs. It is also unclear whether or not instruments such as extendible maturity commercial paper, commercial paper program renewals, auction rate notes, reset notes, and variable rate notes are to be considered reissuances. Economically, there is no difference between resetting an interest rate or extending the maturity of an existing note and replacing a maturing note with a new note. In addition, for auction rate notes and reset notes, it is the investor – not the transferor – that determines the new interest rate through the bidding process at each reset date. In each of these instruments, the original note remains outstanding. Moreover, since the CUSIP number remains the same for most of these instruments, we believe no "new" security is being issued.

We are perplexed at the Board's assertion in the Basis for Conclusions that they did not realize that QSPEs would be reissuing beneficial interests and the Board is now troubled that the ability to reissue constitutes too much activity for passive QSPEs. FAS 140 clearly contemplates that QSPEs will issue beneficial interests in the parentheticals of

paragraph 9(b), and the glossary definition of beneficial interests explicitly includes commercial paper in the list of instruments that are beneficial interests. Paragraph A7 notes that prohibiting a transferor from participating in an auction of beneficial interests prevents the transferor from retaining effective control over the transferred assets. We do not disagree, since participation in the auction could result in the transferor's reacquiring assets it previously transferred. However, we think that an auction is very different from making decisions about reissuing beneficial interests. Reissuance of beneficial interests cannot result in the transferor's recovering ownership of the assets transferred.

Additional Limitations When Beneficial Interests May Be Reissued

We believe the restriction that limits one party from holding more than 50% of the aggregate fair value of all commitments to deliver cash or other assets to a QSPE to be used to make payments to beneficial interest holders when the QSPE has a reissuance capability is unreasonable. The 50% limitation seems to be based on the FIN 46 concept that a single holder of a majority of the expected loss or expected residual return of a variable interest entity ("VIE") must consolidate the VIE. However, FIN 46 is measuring risks and rewards, while the Proposal is addressing when a transferor has a right to derecognize assets transferred. In addition, it is extremely unlikely that the provider of a liquidity facility or secondary credit enhancement to a QSPE could ever be considered the primary beneficiary of a VIE since, under the Proposal, the providers are also precluded from holding any other interest in the QSPE that is not the most senior. Further, a majority concept for a consolidation standard is logical, while in a financial components framework, it make little sense. Moreover, this restriction seems incongruous, when a transferor is allowed to hold up to 90% of the beneficial interests in a QSPE under FAS 140 (only 10% of the beneficial interests must be in the hands of third parties). This restriction seems to be a rule just for the sake of rule-making and creating additional obstacles for would-be QSPEs and serves no substantive purpose. We think the 50% restriction should be eliminated from the final standard.

The Exposure Draft requires that a liquidity or other commitment provider may not hold a beneficial interest that is not the most senior, when beneficial interests may be reissued. We do not see how it would be possible for a transferor to monitor whether any interests held by a third-party liquidity or other commitment provider are other than the most senior beneficial interests in the QSPE. In large financial institutions, it is quite possible that the trading desk may take a position in a QSPE's beneficial interests without the knowledge of the credit/lending or liquidity departments. Such a restriction would be hard enough to monitor within the transferor's own institution. In an unrelated institution, the transferor would have no knowledge of the positions taken and no ability to enforce a restriction on the positions that can be taken by that institution. Thus, actions taken even inadvertently by an unrelated financial institution can lead to a QSPE's losing its qualifying status without any action by the transferor. We think this provision should be eliminated from the final standard as it is not operational.

Prohibition of Equity Securities in a QSPE

We do not object to a prohibition on holding equity securities in a QSPE. However, just as FAS 140 provides that a QSPE may temporarily hold nonfinancial assets obtained in connection with collection of financial assets that it holds, there should be a provision that a QSPE may temporarily hold equity securities that it receives in settlement of financial assets that it holds.

Change to Paragraph 9(a)

We fear that extending the requirement that transferred assets be isolated from the transferor to require isolation from any consolidated affiliate of the transferor that is not also a special-purpose entity or bankruptcy-remote entity will result in an inability to achieve sales treatment for transfers between sister companies. One consequence of this inability would be that in an acquisition, "push down" accounting could not take place. The acquiring company would not be able to transfer the assets and liabilities of the acquired company to the various sister companies that are engaged in compatible activities. This would create an obstacle to the streamlining of operations that is usually one of the goals of the acquisition. We do not believe the Board would intentionally undermine this accounting.

The FAS 140 glossary definition of a "consolidated affiliate of the transferor" covers only affiliates that are included in the consolidated financial statements of the transferor. Thus, sister companies whose separate-company consolidated financial statements did not include the other sister company would be able to satisfy the revised isolation requirement in paragraph 9(a). However, the language in the Summary of the Exposure Draft and in paragraph A16 differs from the language in the revised paragraph 9(a) and seemingly requires isolation from the parent company and its consolidated group. In this case, a transfer between sister companies would not meet the isolation requirements. The Summary requires isolation from "all members of the consolidated group that includes the transferor, except for certain bankruptcy-remote entities." We do not believe that the Board could possibly have intended to preclude all sales between sister companies. Accordingly, the language in the Summary and in paragraph A16 should be changed to conform to the language in the revised paragraph 9(a). This would also be consistent with Question 20 of the FAS 140 Q&A.

Two-step Transfers

We believe it is arbitrary to require that the second step in a two-step transaction be to a QSPE in order to satisfy the paragraph 9(b) requirement that the transferee have the right to pledge or exchange the transferred assets when paragraph 9(b) offers two paths to satisfy its requirement – one for QSPEs and one for all other transferees. In fact, other entities may well have full rights to pledge or exchange assets transferred to them and

such rights should not be ignored. Furthermore, the criteria for achieving sales accounting should not be mingled with the criteria for establishing a QSPE, since the proposed requirement would create a disparity for obtaining sales treatment between transfers to SPEs and to other transferees that we believe is unjustified.

We fail to see what is achieved in the provision of the Proposal that requires the second transfer in a two-step transaction to be to a QSPE. This would simply result in the creation of a third step in which the QSPE issues beneficial interests to the original transferee entity. All this achieves is adding costs for setting up a QSPE to the total transaction costs. Moreover, under existing guidelines in the situation where the second transfer of a two-step transfer is not to a QSPE, the consolidation analysis for the second entity would now be required to be in accordance with FIN 46, which seems to be FASB's preference, and would consider all variable interests of all parties involved with the entity. If FASB's objective is to bring more entities under the scope of FIN 46, that objective has been achieved already and no further restrictions are needed.

Transition Provisions

The transition provisions of the Proposal are inadequate. Consider a QSPE meeting the existing criteria of FAS 140 which does not meet the new criteria set forth in the Exposure Draft and is not eligible for the grandfathering set forth in the Exposure Draft. It is not clear what steps that QSPE can take to modify its activities to conform to the new requirements. For example, the existing limitations on the activities of a QSPE only allow a new derivative to be entered into at the time new beneficial interests are issued to third-party investors. But if the existing derivative counterparties currently include the transferor, it is not clear whether the QSPE would be able to terminate those derivatives and enter into new ones as part of the restructuring effort at a time when no new beneficial interests are being issued. The final standard needs to clarify that an existing QSPE may take steps to conform its activities to the new requirements. At the very least, the transition provisions should allow existing passive derivatives entered into with the transferor to remain in place so long as new derivatives are entered into with third parties and meet the new requirements.

As discussed above, a transition period that may be as short as a few days or only as long as a few weeks, but certainly less than three months, is inadequate to implement a standard of this magnitude. Not only must a transferor evaluate each of its QSPEs to determine whether they meet the new standard's criteria, the transferor must consider whether any restructuring alternatives are possible. In the event that restructuring a former QSPE is not feasible, then that SPE must be evaluated under the provisions of FIN 46. In the event that it is not clear who the primary beneficiary is, the transferor must then do the calculations required in Appendix A of FIN 46 to measure the expected loss and expected residual return, gathering the data necessary to assess the possible outcomes and the related probabilities and finding or building a model to use for the necessary calculations. In our experience, this can be a very complex and time-consuming process.

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In conclusion, we urge you not to go forward with this project and, to the extent you have specific issues (e.g., conduits, total return swaps, and equity securities), handle them through FASB Staff Positions. In this manner, the capital markets will not be disrupted and will continue to function for the benefit of investors and borrowers.

We would be pleased to discuss our comments with you at your convenience.

Very truly yours,

Bob Traficanti

Robert Traficanti
Vice President and Deputy Controller
Corporate Accounting Policy