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Major Projects & Technical Activities Director Financial Accounting Standards Board 401 Merritt 7 P.O. Box 5116 Norwalk, Connecticut 06856-5116

RE: File Reference No. 1200-001

Ladies and Gentlemen:

Merrill Lynch appreciates the opportunity to comment on the proposed amendment to Statement No. 140 (the "ED"). We have followed with interest the development of Statement No. 140 and its predecessor, Statement No. 125, and have provided a number of comments and suggestions relating to the content of these standards. We continue to be keenly interested in the development of this guidance as it has far reaching effects on both our business and that of our clients.

Executive Summary

As a general matter, we believe that the proposed guidance would have a profoundly detrimental effect on securitization markets by dramatically limiting the ability to derecognize assets when control has been relinquished. It is our view that the guidance established in the ED will make lending more costly, and those costs are likely to be borne by customers through increased interest and fees in mortgage, credit card and auto loans. While we think that this should not be an overriding factor in establishing accounting guidance, we do believe that the Board should have an understanding of the implications of this guidance especially when the guidance will provide, in our opinion, no improvements in financial reporting.

More fundamentally, we believe that the ED is conceptually flawed. Our general concerns with the ED are summarized below:

 The ED is not based on broad principles but rather introduces a myriad of detailed rules regarding specific types of prohibited transactions.

- The ED is not consistent with the underlying principle of Statement No. 140 in that it mixes risk and reward concepts with the basic financial components/control approach of Statement No. 140.
- The ED assumes that all derivatives and liquidity facilities entered into between a
 transferor and an SPE will result in the transferor maintaining substantially the
 same economic interest in the transferred assets, which we do not believe will be
 the case
- Though we continue to support the control-based approach of Statement No. 140, if the Board is concerned about transactions where a transferor maintains substantially the same economic interest in transferred assets, we believe this is better addressed by amending the effective control criteria of Statement No. 140 rather than introducing prohibitions on specific types and amounts of transactions.
- The ED establishes situations where a transferor's accounting can be affected by the independent actions of an unrelated third party, even in cases where such actions are relatively minor in nature.
- The ED provides inconsistent results for identical transactions depending on whether the counterparty is an operating entity or an SPE.
- Because QSPE status would be impacted by transactions that are external to the QSPE documents, the ED eliminates a third party investor's ability to determine if an entity is a QSPE. As such, many investors would no longer be able to avail themselves of the QSPE scope exception for revolving structures.

We elaborate on these points below. We also propose an alternative solution to accounting for securitization transactions (the "matched presentation") for the Board's consideration.

ED is not principles-based

It is our opinion that the ED sets forth detailed rules rather than working from broad principles. Recently, the Board issued a Preliminary Views document that proposed a principles-based approach to accounting standards. Under this approach, new accounting pronouncements would follow a broad conceptual basis, and departures from and exceptions to the underlying concept would be rare. The SEC also recently released a similar study endorsing a principles-based accounting system. Merrill Lynch strongly supports this approach. We believe that the increasing amount of rule-based guidance has led to increasingly complex standards and has reduced the accountant's ability to rely on intuition and logic when analyzing transactions. We believe that this has, in many cases, resulted in form-based rather than substance-based accounting treatment. Additionally, one can never design the rules carefully enough to address all current and future transactions. Accordingly, we are disappointed that the Board has elected to issue an ED that is almost entirely rule-based, and inconsistent with the basic principles of Statement No. 140.

ED is inconsistent with principles of Statement No. 140

The ED also represents a departure from the existing Statement No. 140 model in that it attempts to commingle a control framework with a risks and rewards model. Over the past decade, the Board worked to establish a theoretically consistent accounting

framework for financial instruments, and the primary aspect of this is the financial components approach. The Board concluded in Statement No. 125, and subsequently in Statement No. 140, that a significant issue associated with previous standards was that they generally required that financial assets be accounted for as "inseparable units that have been either entirely sold or entirely retained." The Board rightly acknowledged that this all-or-nothing approach was an oversimplification of complex transactions that led to inconsistent results.

As a result, the Board developed the financial components approach that has become the fundamental concept when accounting for financial instruments. Under this approach, an entity accounts for only the portion of the financial asset to which it is exposed. Fundamental to the financial components approach is the basic concept in Statement No. 140 that an entity should reflect assets on its balance sheet if that entity has control over those assets, and it should derecognize assets when control has been surrendered.

We support this approach because we believe that it more accurately portrays a transferor's economic position and relationship to assets that have been transferred. Under the financial components/control approach, financial statements present only the assets and liabilities to which the reporting entity is exposed. As a result, there is no risk that users of financial statements, including creditors, mistakenly believe that the transferror has full rights to the entire asset transferred.

The ED undermines this basic premise by expanding the definition of control to include virtually any continued involvement with assets transferred to QSPEs, short of retaining an interest in a QSPE and providing limited asset servicing. By expanding the definition of control in this way, the Board seems to be replacing the control guidelines established in Statement No. 140 with the risks and rewards concepts of FIN 46, so that in situations where a transferor retains no control over the assets and no ability to reacquire the assets from the SPE, it would still be required to report those assets on its balance sheet. Under the ED, assets transferred in securitization transactions are less likely to be treated as sales and therefore less likely to be accounted for under the components approach even though the transferor relinquishes control over the assets. In our opinion this approach does not reflect an entity's true economic exposure, and therefore application of the ED will generate less transparent rather than more transparent financial statements.

Derivatives and liquidity facilities do not cause a transferor to maintain control In particular, the ED prohibits transferors from entering into derivatives with and providing liquidity to QSPEs. Apart from being very transaction-specific and rules based, we believe that this approach is inconsistent with the financial components/control-based concepts established in Statement No. 125 and Statement No. 140. A primary underpinning of Statement No. 140 is that in cases where the transferor has surrendered control, it is more representationally faithful for a transferor to reflect its remaining economic exposure to a financial asset than to reflect the transferred asset itself. We do not believe that economic exposure to an asset is equivalent to the concept

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¹ Statement No. 125 paragraph 7 and Statement No. 140 paragraph 7.

of control over that asset and do not support an approach that conflates these two concepts.

Paragraph A12 of the ED explains that the prohibition on a transferor's ability to enter into derivatives and liquidity facilities with QSPEs "result[s] from concerns about the potential for enterprises to execute transfers that do not change [the transferor's] economic position in any essential way but that significantly change [the transferor's] financial statements." We believe that this is an overbroad characterization of most derivatives and liquidity facilities that transferors enter into with SPEs. We agree that this is true for some derivatives, such as total return swaps or other derivatives that replicate the economics of a total return swap. However, we do not believe that a simple interest rate swap or currency swap (accounted for under Statement No. 133) results in the transferor retaining its original economic position in relation to the transferred assets. While the transferor retains *some* of the exposure to the underlying assets, it is clearly not in the same economic position as it was before the transfer.

Similarly, many liquidity facilities that transferors enter into with SPEs provide short-term financial support that is terminated if the assets held by the SPE default or are downgraded. For example, a transferor may provide to an SPE a liquidity facility by giving the holders of certain beneficial interests an option in certain circumstances to put back the beneficial interest to the transferor at its par value. Alternatively, the transferor may provide liquidity to the SPE in the form of a direct line of credit to the SPE. These liquidity facilities are typically collateralized by excess assets in the entity. (The purpose of these facilities is to enhance the marketability of the beneficial interests.)

Because the liquidity facility terminates if the assets held by the SPE default or are downgraded, the liquidity facility does not expose the transferor to all of the risks associated with the transferred assets. Accordingly, we do not agree that a transferor that enters into these types of liquidity facilities would be in the same economic position before and after the transfer, and therefore, we believe the rationale for the prohibition on this type of activity with a QSPE is flawed. Essentially, under the ED, transferors may be precluded from derecognizing transferred assets if they retain a small share of the economic exposure to the transferred assets, even though their economic position has changed significantly.

Alternative solution: Expanding the notion of effective control

In general, we disagree with any limitations on derivatives and liquidity because we do not believe that introducing a risks and rewards model into Statement No. 140 is theoretically consistent with the financial components/control model. That said, if this is an area of concern for the Board, we believe that it would be better addressed by modifying the effective control criteria in paragraph 9.c. than by modifying the QSPE rules.

More specifically, under Statement No. 140, there are situations where an SPE meets all of the criteria of a QSPE, however, the transferor is still unable to derecognize the assets because it maintains effective control over those assets. As currently written, effective

control relates to the physical ability to directly or indirectly reacquire the transferred assets. However, the concept of effective control could be expanded to include the risk and rewards/controlling financial interests concepts that the Board is concerned about. Under this approach the Board would be able to simply add a paragraph to expand the definition of effective control.

That paragraph could state that the transferor to an SPE would have effective control over the transferred assets if it retained virtually all of the risks associated with the transferred asset (including interest, currency, and credit risk) through a total return swap or some other combination of interests. By defining effective control to include maintaining the full risks and rewards of the assets, the Board would be able to more narrowly target the problematic transactions while maintaining the components approach for transactions that result in the transferrol laying off substantial portions of the risk to the transferred assets. We believe that this approach would be cleaner than revising the QSPE rules as it would be very difficult to develop a principle to support the proposed approach.

Transferor's accounting affected by actions of unrelated third parties

The ED also introduces an approach whereby a transferor's accounting will be affected by the actions of an unrelated third party, and those actions may be relatively trivial in nature. We fundamentally disagree with this approach.

Specifically, the ED proposes new requirements for QSPEs that have the ability to reissue beneficial interests. Paragraph A13 of the ED states that the purpose of the new requirements are 1) to prohibit an entity from being in a position to enhance or protect the value of its own interest and 2) to reduce the difference between the effects of applying Statement No. 140 and the effects of FIN 46 on similar SPEs. To that end, the ED proposes the following new rules for QSPEs.

First, an SPE cannot be a QSPE if a single entity provides more than 50% of any liquidity provided in the vehicle, regardless of the amount of subordination in the vehicle. Assume the following structure:

- The SPE holds investment grade securities
- The SPE issues four equally sized classes of beneficial interests
- The SPE purchases a liquidity facility to provides additional credit protection to the most senior tranche (25% of the asset balance)

It is our understanding that if one counterparty provides this liquidity facility, the SPE could not be a QSPE; however, if the liquidity is participated to a second liquidity provider, the entity could be a QSPE. Paragraph A12 indicates that the purpose for providing this guidance is that the liquidity facility is essential to reissuing beneficial interests and would thereby give the liquidity provider an incentive to direct that activity. This requirement is therefore meant to ensure that a single liquidity provider would be required to analyze the SPE under FIN 46 to determine if it is the primary beneficiary. As a practical matter, while in most large securitization structures a liquidity provider would be able to sell a participation in its risk, in many small securitizations (under \$10 million), it is often uneconomical for a second liquidity provider to do the necessary due

diligence to make the arrangement profitable, so in these securitizations it would be virtually impossible to meet this requirement.

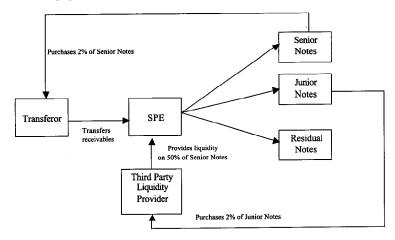
Second, an SPE that reissues beneficial interests cannot be a QSPE if, to paraphrase, any party to the SPE retains more than two of the following types of involvement with the SPE:

- Provides liquidity in any form to the SPE
- · Holds an interest in any but the most senior securities issued by the SPE
- · Makes decisions about reissuance of beneficial interests

Merrill Lynch has the following two issues with the approach taken by the Board whereby an SPE is analyzed not by what it does but by the interaction it has with other entities.

First, the ED will, under certain circumstances, prevent a transferor from derecognizing assets as a result of actions by a third party that is unrelated to the transferor. Assume the following: a transferor transfers assets to an SPE. The SPE does not have the ability to sell or pledge the assets and therefore does not meet first criterion of paragraph 9.b. of Statement No. 140. The transferor also has some minor continuing involvement with the SPE – say, for example, it retains a portion of the senior notes issued by the SPE. Because of this continuing involvement, it does not meet the derecognition criteria of Statement No. 140 (originally promulgated in EITF Topic D-99). Thus, the only way that the transferor would meet the requirements of paragraph 9.b. and be able to derecognize these assets is if the entity qualifies as a QSPE.

Now assume that an unrelated third party maintains two of the three relationships to the SPE as proposed in the ED, as illustrated below:



Because of the actions of an unrelated third party (the liquidity provider in this example, who provides liquidity to the SPE and also purchases a small portion of the junior notes issued by the SPE), the SPE does not meet the conditions to be considered a QSPE, and the end result is that the transferor is unable to derecognize the transferred assets.

We fail to understand why the actions of a party unrelated to the transferor should have any effect on the transferor's accounting. We see no conceptual basis for including this guidance in a document that is designed to govern when a transferor derecognizes assets. We do not understand how the SPE's relationship with independent third parties should have any bearing on whether or not the transferor has maintained either control of the transferred assets or (under the ED) has maintained economic exposure to the transferred assets.

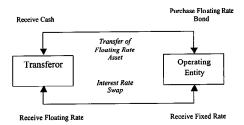
We believe that the more conceptually consistent way to address this issue is by amending the FIN 46 scope exception in paragraph 4.d. Under the current scope exception in FIN 46, an enterprise that holds a variable interest in a QSPE is not required to consolidate unless it has the unilateral ability to cause the entity to liquidate or to change the entity so that it no longer meets the QSPE requirements. We recommend revising the FIN 46 scope exception so that an enterprise is required to analyze its relationship with a QSPE if it provides more than the majority of the coverage provided by any liquidity facilities or if it retains two or more of the described relationships with the OSPE.

Second, under FIN 46, most investors in QSPEs are not required to consolidate the QSPE because of the scope exception provided in paragraph 4.d. The proposed guidance would significantly decrease an investor's ability to gather sufficient information to determine whether or not an entity that reissues beneficial interests is a QSPE. Investors in more subordinated tranches of a securitization vehicle would not be able to tell whether or not a liquidity provider holds any other interest in the vehicle, or whether a single liquidity provider has participated out half of its risk. Accordingly, for QSPEs that reissue beneficial interests, the FIN 46 scope exception would in many instances be impossible to apply with any degree of certainty. Thus, because investors will no longer be able to rely on their analysis when determining if the SPE they are investing in is a QSPE, the reliance on this scope exception is likely to become very rare.

Inconsistent results for similar transactions

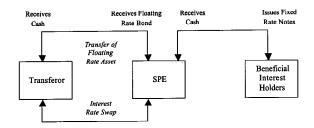
While we understand the Board's concern that transfers to SPEs should be subject to more stringent requirements than transfers to operating entities (i.e., non-variable interest entities), under the ED, a transferor could have radically different accounting treatment when transacting with an SPE compared to a non-variable interest entity, even though the economics of the transaction and the transferor's relationship to the transferred assets are the same.

For instance, a transferor may sell securities to an operating entity (i.e., a non-variable interest entity) and at the same time may enter into an interest rate swap that converts the floating payment of the transferred assets to a fixed rate. The following diagram illustrates this transaction:



Under Statement No. 140, this transaction would be accounted for as a sale, and the transferor would account for the transaction under the components approach by reflecting the fair value of the interest rate swap.

Now assume that the same transaction were entered into with an SPE that does not have the right to pledge or sell its assets:



Under the ED, the SPE could not be a QSPE (because it enters into an interest rate swap with the transferor). Further, since the SPE does not have the ability to pledge or sell assets the transferor would not be able to record the transaction as a sale. Therefore, the transferor would continue to recognize the transferred assets on its books and would recognize a liability that reflects that it has entered into a secured financing transaction.

In the above example, even though the transferors have the identical exposure to the assets, the accounting would be significantly different. The transfer to the operating entity would be accounted for under the components approach, and the transfer to the

SPE would be accounted for as a financing. In our opinion, this results in misleading financial statements. If the ED were consistent with the conceptual underpinning of Statement No. 140, like transactions would result in similar accounting treatment, regardless of the counterparty.

Other Concerns

Requirement for a QSPE as the second SPE in a two-step transfer. The proposed change to paragraph 83 is quite confusing. We have spoken to many market participants and several lawyers and there seems to be no consensus on what this proposal is meant to address or what are the practical implications of this proposal. One possibility is that the Board intended to eliminate transactions where the second SPE receives beneficial interests from the first SPE but does not have the ability to pledge or exchange those assets, such that the second SPE does not satisfy the requirements of paragraph 9.b. However, it is not clear whether the proposed guidance would apply to transactions where the second SPE does in fact have the ability to sell or pledge the beneficial interests that it receives from the first SPE. Due to the considerable amount of confusion in understanding this aspect of the ED, we strongly urge the Board to clarify its intent with respect to this provision and the implications of any proposed changes.

Prohibiting OSPEs from holding equity securities

In general, we do not support the prohibition on QSPEs holding equity securities, as we do not believe there is a strong conceptual basis for doing so. However, if this change is made, we recommend that an exception be made where the holding is temporary and occurs as the result of an event outside of the control of the transferor (e.g., the issuer of a bond held by a QSPE goes into a debt restructuring and issues equity securities to the bondholders).

In addition, we would like to point out that money market shares would meet the Statement No. 115 definition of equity. We believe that an exception should be made for these types of equity securities since they are very low risk short term investments and are currently permitted as securities appropriate for temporary investments of undistributed cash under paragraph 35.c.(6) of Statement No. 140.

Alternative Solution: Matched Presentation

Although we believe that Statement No. 140 as written is conceptually superior to the ED, we believe that if the Board decides to proceed with an amendment, a better alternative would be to require the reporting of many types of SPEs using a matched approach similar to the linked presentation reflected under UK GAAP in FRS 5. (Our recommended approach would be broader than the guidance in FRS 5 because that guidance prohibits linked presentation if there is any recourse to the transferor.) Under our proposed approach, transferors that relinquish control and meet other criteria (discussed below) would be able to account for their investment using a matched presentation. The matched presentation would require the transferor to reflect on the asset side of the balance sheet the gross assets of the SPE and the gross non-recourse liabilities and minority interest in the SPE to arrive at the transferor's investment in the

SPE. We believe that using a matched presentation to account for relationships in many SPEs is conceptually sound for the following reasons:

- 1. In situations where the transferor does not maintain either control or all of the risks and rewards of transferred assets, this provides an efficient solution to the "all-or-nothing" problem first noted by the Board in Statement No. 125 that is, the fact that the requirement to account for financial assets as inseparable units that are either entirely sold or entirely retained is an oversimplification of the complexity that is inherent in the securitization process. The matched presentation would allow the ED to continue to fit within the conceptual framework of Statement No. 140 by allowing transferors who do not maintain control over assets to account only for the components to which they are exposed.
- 2. This method would provide more transparent accounting: readers of financial statements will be easily able to distinguish assets controlled by the company from those over which control has been surrendered. Similarly, readers of financial statements will be able to easily distinguish between general obligations of the reporting entity and non-recourse obligations that are the result of a securifization that for some reason does not meet the criteria for derecognition.

The determination of which transactions could be reported using the matched presentation would have to be thoughtfully reviewed. In our view, this presentation would be appropriate in situations where the assets are legally isolated and the beneficial interests issued by the SPE are primarily valued based on the credit quality of the underlying assets rather than the credit quality of the transferor. In these situations, the investor has limited or no recourse beyond the transferred assets.

In situations where the investors have limited recourse to the transferor for market movements such as changes in overall interest rates and currency rates (as is the case with interest rate swaps and liquidity facilities that pay only when the assets are performing), the transferor would be required to account for the recourse relationship either as a derivative or a FIN 45 guarantee (or both). In addition, while this letter specifically proposed this presentation for transferors to SPEs, the Board may also wish to consider extending this approach to primary beneficiaries in SPEs that meet certain non-recourse criteria to be developed.

We understand that certain Board members have rejected this approach on the grounds that the assets and liabilities in these transactions would not meet the netting requirements of FIN 39 or FIN 41. However, we do not believe this is an issue for the following reasons:

- These Interpretations prescribe criteria for netting individual transactions entered into with the same counterparty. In transfers to an SPE, a transferor enters into only one transaction with the counterparty. The assets and liabilities that would be recorded on the financial statements are the result of a single transaction.
- The matched presentation approach shows both the transferor's gross as well as net investment in the SPE.

In sum, we believe that the matched presentation is a possible solution, which merits serious consideration by the Board, as we believe it has the ability to achieve transparent accounting and reporting for investors while at the same time avoiding many of the conceptual pitfalls that the ED presents.

In closing, we believe that there are significant issues and inconsistencies with the ED that should be addressed before the Board moves forward with this project. We understand the Board's desire to limit the use of QSPEs to achieve sale accounting treatment; however, we do not believe that the ED addresses this issue in an approach that is consistent with the principles established in the guidance that it is amending. We believe that Board has taken an overly broad approach that will significantly affect the securitization market without regard to the true substance of the transactions in question. We also question whether there exists a significant population of financial statement users that will realize any benefit from the proposed changes.

Thank you again for the opportunity to comment on the ED. We hope that the Board will give serious consideration to our comments as they further deliberate this project. In addition, we would like to participate at the roundtable on August 28th and look forward to discussing our views further on this important topic. Please do not hesitate to contact me with any questions or requests for additional information.

Sincerely,

Esther Mills First Vice President Accounting Policy Merrill Lynch