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MP&T Director—File Reference 1200-001 Financial Accounting Standards Board 401 Merritt 7 P. O. Box 5116 Norwalk, Connecticut 06856-5116

Also delivered by e-mail to director@fasb.org.

Re: File Reference 1200-001. Exposure Draft on Qualifying Special-Purpose Entities and Isolation of Transferred Assets

To the Members of the Board:

We wish to comment on FASB's exposure draft entitled "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"). FASB set July 31, 2003 as the deadline for public comments.

We are a law firm which regularly represents issuers, investors and trustees in securitization transactions. Our comments focus on the relatively routine two-step revolving transactions pursuant to which many common asset types (including auto loans, equipment loans, credit card receivables and trade receivables) are securitized. In such a transaction, the transferor first transfers financial assets to an SPE (usually a wholly-owned subsidiary of the transferor) in a transaction that constitutes a sale for bankruptcy purposes, and the SPE then transfers those assets (or interests therein) in a non-bankruptcy sale to one or more investors. The SPE may be a QSPE under current FAS 140, but the investor cannot be structured as a QSPE under current FAS 140 (for various reasons, including the active management of its purchased assets).

The proposed amendments would prohibit a QSPE from entering into any agreement—other than a forward contract in a revolving-period securitization, or an agreement to make discretionary servicing advances—with the transferor or its affiliates or agents which would commit any of such parties to deliver additional cash or other assets to the QSPE or its beneficial interest holders. (Exposure Draft at 2 (adding a new ¶ 35(e) to FAS 140)). However, that language draws this prohibition too broadly. The prohibition, apparently intended to restrict total return swaps and other derivative instruments, liquidity commitments and credit support arrangements, might also be read to prohibit standard or customary transferor indemnities and/or

repurchase obligations for breach of representations and warranties or for dilution.\* In transactions in which the transferor acts as the QSPE's servicing and collection agent, this prohibition might also limit the servicer from giving customary indemnities as to the performance of its servicing obligations. We can see no logical reason for preventing a seller of financial assets from making representations as to the nature and quality of the assets sold or from agreeing to be responsible for performing its arm's length contractual duties. Indeed, we fear that the proposed amendments, as presently worded, would make it difficult, if not impossible, to structure viable arm's-length securitization transactions. We therefore ask FASB to clarify that the amendments will allow arm's length indemnities, repurchase obligations, and similar remedies in securitization transactions.

The proposed amendments also are inconsistent in that the limitations on reissuance in proposed new  $\P$  35(f) do not take into account revolving transactions or discretionary servicer advances—both of which are explicitly excepted from the new restrictions on transferor commitments in new  $\P$  35(e). This appears to be merely an oversight. To achieve consistency, the references to "commitments" in new  $\P$  35(f) should incorporate these exceptions, which are an unobjectionable feature of numerous securitization transactions. (The exception for customary indemnities and repurchase obligations discussed in the preceding paragraph should also be included in  $\P$  35(f)).

Finally, the proposed amendments would impose a new requirement that, for FAS 140 to apply in a two-step transaction, the *transferee* in the second step must be a QSPE. (Exposure Draft at 3 (amending ¶ 83 of FAS 140)). In existing two-step transactions where a QSPE is employed, however, the transferor may sell its financial assets directly to the QSPE, which then transfers those assets to the investor. In these cases—where the first transferee is already a QSPE—requiring the second SPE also to be a QSPE would introduce an additional, and

Dilution consists of credits or adjustments granted by the transferor to its customer for defective goods or services, returned items, volume discounts or other changes to the terms of payment. Since the transferor (either in its capacity as transferor or servicer) has the ability to control whether defective goods are sold and whether returns are accepted, as well as other types of dilution, the transferor typically agrees to indemnify the SPE for dilution or to repurchase the portion of any receivable which becomes diluted.

The seller of financial assets, by virtue of its involvement in the creation of those assets, has superior knowledge and information as to the characteristics and quality of the financial assets. Although the buyer of financial assets will perform its own due diligence investigation, such an investigation does not, and cannot be expected to, cover each and every receivable in a typical securitization transaction. Even if such a complete investigation by the buyer were possible (and it may not be in many cases, for example, in a revolving transaction involving short-term receivables), the transaction costs incurred by the buyer, as well as the length of time to perform it, would render transactions untenable.

seemingly unnecessary, step and thereby increase costs (the costs of creating, documenting and maintaining a new, and otherwise unnecessary, QSPE between the first QSPE and the investor). In summarizing the proposed amendments in paragraph 2 of the section of the Exposure Draft titled "Introduction", FASB states only that the second step must "involve" a QSPE (Exposure Draft at 1), not that the second step transfer must be to a QSPE. We therefore ask FASB to clarify that, for FAS 140 to apply in a two-step transaction, it will be sufficient if the second step "involves" a QSPE and that, therefore, a second-step transfer from a QSPE to a non-QSPE will be permitted under FAS 140.

We thank you for the opportunity to submit these comments and are grateful for your consideration.

Very truly yours,

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