



**COMMERCIAL MORTGAGE  
SECURITIES ASSOCIATION**



LETTER OF COMMENT NO. 4

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July 28, 2008

Financial Accounting Standards Board  
401 Merritt 7, P.O. Box 5116  
Norwalk, CT 06856-5116

Re: Current Board Projects on FAS 140 and FIN 46(R)

Ladies and Gentlemen:

The Commercial Mortgage Securities Association (CMSA) appreciates the opportunity to work with FASB through the external review process with respect to proposed amendments to Statement 140 and Interpretation 46(R) and hopes to continue to provide substantive input and value to the FASB staff on these issues. Based on the Board's public discussions, however, we feel it is important to share our serious concerns with the Board's current course of action and the significant unintended consequences for our financial markets and the U.S. economy.

As you know, CMSA is the global trade organization for commercial real estate capital market finance. In the United States alone, there is almost \$1 Trillion in outstanding commercial mortgage-backed securities (CMBS). The organization's primary mission is to promote the ongoing strength, liquidity and viability of commercial real estate capital market finance worldwide. Based in New York, with a government relations office in Washington DC as well as a strong presence in Canada, Europe and Japan, CMSA is the voice for the industry, with a diverse global membership of over 400 member firms represented by more than 5,000 individuals who actively engage in commercial real estate capital market finance activities. These members embody the full spectrum of the CMBS market, including senior executives at the largest banks and investment banks, insurance companies, investors such as money managers and specialty finance companies, servicers, other service providers to the industry, and the rating agencies, including DBRS, Fitch Ratings, Moody's, Realpoint and Standard & Poor's. CMSA and its members are the leaders in setting standards and maintaining a favorable investing environment in the United States and abroad, and we submit these comments in an effort to further advance these dual objectives.

CMSA recognizes the seriousness of the market turmoil resulting from the residential subprime crisis and related issues, and we understand your desire to take quick action to address these problems. As you know, the Board has reached tentative decisions in its fast-tracked deliberations on Statement 140 and Interpretation 46(R) that would bring about sweeping changes to securitization accounting at a time when our markets are facing tremendous challenges. In addition to the specific issues outlined below, we also have broader-based concerns that introducing any changes at this time – even if implementation of those changes is delayed or phased-in over time – will serve only to further chill an already frozen real estate and other asset-backed securities markets. This seems especially imprudent at a time when business and policymakers are attempting to breathe life back into the markets.

As you are aware, the CMBS market uses QSPEs as the vehicles to securitize commercial mortgage loans. Other asset-backed securities within the \$9 trillion securitization markets (such as residential mortgages, home equity loans, student loans, auto loans and credit card receivables) also utilize QSPE accounting structures for securitization purposes. Like residential mortgaged-backed securities ("RMBS"), CMBS are bonds that are collateralized by pools of mortgage loans from which all of the principal and interest paid on those mortgages flows to investors. To create these investment vehicles, mortgage loans of varying dollar amounts, property type, and location are pooled and transferred to a trust. Bonds then are issued backed by the pool of assets held in the trust. Those bonds vary in yield (the amount of return on the bonds), duration (the length of time before the bond is expected to be paid off), and payment priority (the order in which investors are paid a return on their investment).

Use of a QSPE has enabled issuers of CMBS bonds to receive “sales treatment”, which allows the investors who purchase bonds to reflect the assets they own on their balance sheet. Based on the potential changes discussed thus far, we are concerned that investors may be forced to consolidate an entire pool of loans on their balance sheet despite owning only *a fraction* of the transaction. In 2007, the average size of a CMBS transaction was \$2.7 billion<sup>1</sup>. Under the proposed changes, the investor owning the first-loss piece (averaging less than 2 percent of the deal), would be required to reflect on balance sheet the remaining 98% percent of the transaction that the investor does not own when the investor also serves as the special servicer. In addition, the consolidation obligation for investors may shift over time (if, for example, the lowest tranche in a deal is eliminated through defaults), potentially imposing this burden even on investment-grade buyers which inevitably could further erode market liquidity or stifle its resurgence due to investment-grade buyers’ reluctance and/or inability to bear this burden. Furthermore, there could be a substantial increase in regulatory capital requirements for bank issuers and investors that may also have significant liquidity implications.

We welcome efforts to reassess and improve disclosure and financial reporting. In fact, CMSA has been a leader in providing transparency to the CMBS market through the creation of our CMSA Investor Reporting Package (IRP®) that allows investors and other market participants at the initial time of securitization as well as on an on-going basis, to drill down and review each commercial real estate loan in a CMBS pool. This on-going surveillance also provides bond level information, such as updated bond balances, amount of interest and principal received on the bonds and bond ratings, as well as property level information such as current net rentable square feet, three largest tenants, date of last inspection and net cash flow. Investors also have access to many other sources of information from servicers, research firms like Trepp and Realpoint that accumulate and analyze data, and investment bank research departments, which essentially all CMBS investors utilize at some level to independently evaluate their investments and potential investments in this sector. With all the sources of transparency provided in the CMBS industry, investors can see through the bonds and mortgages to the collateral of the income producing properties and their performance, including the cash flow available to service the debt of the commercial mortgages. In keeping with our transparency standards, CMSA supports the supplemental disclosures recommended by various bodies in response to the recent market disruptions, which many reporting entities already have begun to provide.

Ultimately, CMSA strongly believes it essential that the Board take the time necessary to produce a standard that will result in an improvement to the accounting in this area, rather than imposing changes hastily that are not beneficial in the long run. It is CMSA’s position that these issues require full deliberation over a reasonable period of time given the impact on the U.S. financial markets and overall economy. As such, CMSA respectfully requests FASB to consider a timeframe of January 10, 2010 for finalizing any rule changes. This timeline, while still aggressive, would permit the full consideration of all policy alternatives, allow time for possible field testing of any proposal to ensure that policymakers and market participants can fully gauge the outcome of the proposal, and provide for a public comment period commensurate with the importance of the changes under consideration.

In closing, we again urge you to extend the timeframe for considering changes to Statement 140 and Interpretation 46(R) in order to allow for full deliberation of the proposed changes and complete understanding of their implications. CMSA believes such a reasonable and appropriate timeline for any final decision will lend itself to the creation of the most accurate accounting standard in the least disruptive manner.

Thank you for your consideration of our views.

Sincerely,



Dottie Cunningham  
Chief Executive Officer  
Commercial Mortgages Securities Association

Enclosure

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<sup>1</sup> Commercial Mortgage Alert CMBS Database and Commercial Mortgage Securities Association internal data.

CC: Securities and Exchange Commission  
Christopher Cox, Chairman  
Paul S. Atkins, Commissioner  
Kathleen L. Casey, Commissioner  
Elisse B. Walter, Commissioner  
Conrad Hewitt, Chief Accountant  
Erik R. Sirri, Director, Division of Market Regulation  
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Federal Deposit Insurance Corporation  
Sheila C. Bair, Chairman

Office of Thrift Supervision  
John M. Reich, Director

Federal Reserve Bank of New York  
Timothy F. Geithner, President



## **CAPITAL CONSORTIUM TALKING POINTS RE:**

### **FASB PROJECT TO REVISE FAS 140 AND FIN 46(R)**

The President's Working Group on Financial Markets and various individual federal agencies have moved vigorously to respond to the disruptions in the credit and capital markets, attempting to mitigate impacts on consumers and the broader economy. The Capital Consortium<sup>1</sup> applauds the government's timely and creative response in these difficult times. The organizations in the Consortium have tried to provide constructive market perspective and other input in connection with many of these initiatives and will continue to do so.

While speedy and decisive actions have been beneficial in many areas, the Consortium believes that there is one area where pressure for prompt action may have serious unintended consequences. The area of concern is accounting policy relating to securitization. Responding to a request from the Chief Accountant of the Securities and Exchange Commission, the Financial Accounting Standards Board (FASB) has accelerated the pace and expanded the scope of its long-running deliberations on securitization accounting, with a goal of adopting final rule changes by the end of this year, to be applied at the beginning of next year.

FASB has reached tentative decisions in its fast-tracked deliberations that are likely to bring sweeping changes to securitization accounting, with dramatic direct and indirect consequences for the economy, the capital markets and consumers:

- Banks, finance companies and other entities (including possibly the GSEs) that currently do not consolidate the issuing entities used in securitizations may be required to consolidate some or all of those entities. The affected transactions may include many garden variety transactions (such as mortgage loan, credit card, student loan and retail auto loan securitizations).
- These changes affect large markets that provide a substantial funding for U.S. business and consumers. As of December 31, 2007, the aggregate outstanding balance of potentially affected transactions included:
  - \$7,210.3 billion mortgage-related securities;<sup>2</sup>

<sup>1</sup> The Capital Consortium is a federation of six financial services industry organizations—the American Securitization Forum (ASF), the Commercial Mortgage Securities Association (CMSA), the Mortgage Bankers Association (MBA), the National Association of Realtors (NAR), the Real Estate Roundtable (RER), and the Securities Industry and Financial Markets Association (SIFMA)—dedicated to ensuring and enhancing the availability of capital for commercial real estate finance. Individual Consortium member organizations also represent broader segments of the securitization and structured credit markets, including the markets for mortgage-backed and asset-backed securities.

<sup>2</sup> The source of all the following market data is SIFMA.



- \$2,472.4 billion other asset-backed securities<sup>3</sup> (excluding asset-backed commercial paper); and
- \$816.3 billion asset-backed commercial paper.
- We cannot presently estimate which or how many of these transactions would be affected by the proposed changes, but consolidation of even a significant fraction would be a momentous change, with the potential to substantially tighten credit for consumers and businesses.
- Consolidation of securitization SPEs is likely to swell the balance sheets of the affected entities, impairing financial ratios and financial covenant performance and regulatory capital tests.
- The abrupt swelling of balance sheets is likely to bring a new chill to credit markets that may be just beginning to thaw. Among other chilling factors:
  - regulated entities will face capital constraints; and
  - both regulated and unregulated entities will be distracted (and capital raising efforts complicated) by explaining the dramatic changes in their financial statements to investors and lenders; and
  - in some cases, regulated and unregulated entities will be further distracted by the need to seek waivers for financial covenant breaches triggered by accounting changes in an environment where lenders may be unreceptive to these requests.
- Policy changes without international convergence may create competitive imbalances.

FASB has had multiple projects relating to securitization accounting over the last several years. There are reasons why these issues have taken a long time to resolve. Among other things: the subject transactions are inherently complex; the market is relatively young and has evolved rapidly; and U.S. and international accounting policy makers have historically taken different approaches in this area, which are the subject of an international convergence project. Haste for a response to the current market issues will be counterproductive if it keeps FASB and other policy makers from giving full consideration to accounting policy options, direct and indirect consequences of proposed policy changes and possible compensating adjustments to bank capital rules and other regulations.

<sup>3</sup> This included \$585.6 billion backed by home equity loans, \$347.8 billion backed by credit card loans, \$243.9 billion backed by student loans, \$198.5 billion backed by automobile loans, \$46.2 billion backed by equipment leases \$26.9 billion backed by manufactured housing and \$1,023.5 billion backed by miscellaneous other receivables. The \$1,023.5 billion miscellaneous category includes collateralized debt obligations (CDOs) and numerous smaller asset classes. The assets underlying the CDOs include other asset-backed securities (CDOs of ABS), some or all of which might be viewed as double counting with other ABS outstandings. The available data do not permit us to determine the amount of any such double counting.



While many market participants (including many members of Consortium organizations) believe that changes in disclosure and/or financial reporting by securitizers are needed, that does not mean that an abrupt swing towards consolidating everything is the right response. It is important to remember that too much consolidation of SPEs can be just as confusing to users of financial statements as too little. As one important example: if the current FASB plans were adopted and another major player in the securitization markets approached insolvency, efforts by regulators and potential purchasers to analyze the entity's balance sheet could be severely complicated by the presence of billions of dollars of assets that are in securitization trusts which the entity does not own.

More nuanced approaches should be considered, in particular approaches that (1) enable users of financial statements to differentiate between assets that are truly controlled by the consolidated reporting entity vs. those that have been isolated from that entity and its creditors and (2) appropriately recognize differences among the prevailing structures used for various asset classes. For instance, for several years some Consortium organizations have advocated a linked presentation<sup>4</sup> as a concept with great potential as part of the final resolution of the issues surrounding securitization accounting. The Consortium supports full deliberation of a linked presentation as part of the current round of accounting policy changes. We understand that FASB's preliminary decisions relating to the policy changes scheduled for the end of this year exclude linked presentation except as incremental footnote disclosure, in large part because the year end deadline does not allow time for all the ancillary, but nevertheless important, issues.

We do not think that a year-end deadline for final rules is a necessary response to current market conditions. A more measured and realistic but still aggressive deadline (such as January 1, 2010) that permits full deliberation of policy alternatives (including the linked presentation) and a public comment period commensurate with the importance of the changes under consideration will be better for the markets in both the short and long-term. In the interim, the Consortium supports the supplemental disclosures recommended by various bodies in response to the recent market disruptions, which many reporting entities have begun to provide.

The last time that FASB acted with this kind of haste on consolidation policy, the result was FASB Interpretation No. 46, which was so flawed as to require immediate revision and a series of staff interpretations and is again being considered for substantial revision as part of this project. The markets and the economy will be much better served by allowing a little more time for accounting policy makers and affected constituents to fully consider the available options and work out the details for a smooth transition process.

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<sup>4</sup> Under the linked presentation, the liabilities issued in securitizations would be shown on the asset side of the balance sheet, as a deduction from the amount of securitized assets, within a single caption. Parallel presentations would apply on the income and cash flow statements. The ASF suggested a linked presentation in a December 2003 comment letter to FASB relating to the project that resulted in the adoption of FASB Interpretation No. 46.