
**Board of Governors of the Federal Reserve System
Federal Deposit Insurance Corporation
National Credit Union Administration
Office of the Comptroller of the Currency
Office of Thrift Supervision**

December 3, 2008

Mr. Russell G. Golden
Technical Director
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, Connecticut 06856-5116



LETTER OF COMMENT NO. 69

Re: File Reference Nos. 1610-100, 1620-100
Exposure Drafts of Proposed Statements of Financial Accounting Standards: *Accounting for Transfers of Financial Assets, an amendment of FASB Statement No. 140, and Amendments to FASB Interpretation No. 46(R)*

Dear Mr. Golden:

As principals of the agencies entrusted by Congress with responsibility for the safety, soundness, and stability of U.S. financial institutions, we support the Financial Accounting Standards Board's (FASB) ultimate goal of improving the accounting standards that apply to securitizations and other asset-backed financing arrangements and acknowledge that there needs to be greater consolidation of off-balance sheet entities. Nevertheless, we are concerned about the short-term nature of the above referenced Exposure Drafts and strongly advocate that you work with the International Accounting Standards Board (IASB) to produce an accounting standard that will provide financial statement users with a stable and reliable source of information about asset transfers including securitizations. We recognize the need for improved transparency of financial reporting for securitization transactions and other off-balance sheet activities. We also understand the desire of the U.S. Securities and Exchange Commission (SEC) and the FASB to provide a short-term fix for the accounting in this complex area in response to the financial turmoil observed since mid-2007.¹ However, we are concerned that making short-term changes to the U.S. accounting standards for financial asset transfers and consolidation could have an impact on credit markets in the U.S.

We applaud the October 20, 2008, joint decision of the FASB and the IASB to compare the short-term changes to consolidation standards both Boards are now developing. It is our understanding that the Boards will attempt to produce a converged set of changes or, at a minimum, ensure that their different standards produce similar results for a sample of known transaction types. However, taking additional time at this stage to develop a long-term,

¹ We also recognize that the President's Working Group on Financial Markets and the Financial Stability Forum have called for improvements.

converged approach would permit a thorough consideration of all alternative approaches and promote greater consistency on an international basis. We believe that the FASB's proposed improved disclosures² will provide additional transparency during the time necessary to work jointly with the IASB on a converged approach.

Furthermore, we believe that the needs of U.S. financial statement users will be better served by improved disclosures than by the discontinuity in the primary financial statements that will result from multiple sets of changes to the accounting standards for financial asset transfers and consolidation beginning in 2010. Some U.S. entities may potentially be confronted with three sets of revised standards in this area within a few years if they first must implement the proposed amendments to Statement No. 140 and Interpretation No. 46(R) in 2010, then move to International Financial Reporting Standards when permitted by the SEC, and finally be required to adopt a fully converged FASB-IASB model. We are concerned that so many changes could lead to an excessive level of incomparability in entities' yearly financial statements.

Should FASB choose not to defer its proposals to amend the accounting standards for transfers of assets and consolidation as we strongly recommend, then we would like to provide input on the proposed amendments. To achieve that purpose, our Chief Accountants have provided specific input in the form of an attachment to this letter. Please contact the agencies' Chief Accountants if you wish to discuss these comments further.

Sincerely,

Randall S. Kroszner
Governor
Board of Governors of the
Federal Reserve System

Sheila C. Bair
Chairman of the Board
Federal Deposit Insurance Corporation

Michael E. Fryzel
Chairman of the Board
National Credit Union Administration

John C. Dugan
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John M. Reich
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² FASB Staff Position FAS 140-e and FIN 46(R)-e, *Disclosures about Transfers of Financial Assets and Interests in Variable Interest Entities*

Detailed Interagency Comments on the Exposure Drafts

The staffs of the five federal financial institution regulatory agencies are pleased to submit detailed comments on the Exposure Drafts of Proposed Statements of Financial Accounting Standards: *Accounting for Transfers of Financial Assets*, an amendment of FASB Statement No. 140, and *Amendments to FASB Interpretation No. 46(R)*. Although we echo the recommendations of our principals with regard to focusing efforts on a long-term, converged standard governing the accounting for transfers of financial assets and consolidation of special purpose entities, we offer the following recommendations related to the short-term changes to existing standards contained in the Exposure Drafts.

Exposure Draft, Proposed Statement of Financial Accounting Standards,
Accounting for Transfers of Financial Assets,
An amendment of FASB Statement No. 140

Participating Interest – Government-Guaranteed Loans

Consistent with our comments on the 2005 Exposure Draft proposing amendments to FASB Statement No. 140 (FAS 140) and based on discussions with the FASB staff, we understand that questions have been raised as to how the characteristics of a participating interest should be evaluated in the context of transactions in which an institution transfers the portion of an individual loan that is guaranteed by a U.S. Government agency and retains the unguaranteed portion of the loan. U.S. Government agencies that provide these guarantees include the Small Business Administration (SBA) and the Department of Agriculture's Farm Service Agency. Many institutions, including a significant number of smaller community institutions, originate or purchase these Government-guaranteed loans and transfer the guaranteed portions into the secondary market using a transfer document issued by the guaranteeing agency.

Under the SBA's secondary market program, for example, in certain circumstances following the borrower's default on a guaranteed loan, the transferee holding the guaranteed portion receives cash from the SBA for the remaining balance of that portion of the loan, but the holder of the unguaranteed portion does not receive cash at the same time. We understand that some may view this outcome as being contrary to the characteristic of a participating interest cited in proposed paragraph 8B(c) that states that "no participating interest holder is entitled to receive cash before any other participating interest holder." However, we believe that when the SBA distributes cash to the holder of the guaranteed portion of the loan, it is more appropriate to treat this transaction as the transfer of the guaranteed portion of the loan from one holder to a new holder (the SBA). The guaranteed portion of the loan remains outstanding and the borrower's obligation has not been extinguished. All of the cash flows received from the loan after the holder of the guaranteed portion has transferred this interest in the loan to the SBA continue to be divided among the holders in proportion to their respective shares of ownership in the loan.

The SBA's transfer document also indicates that the transferor of the guaranteed portion has no authority to unilaterally repurchase the transferred guaranteed portion. However, in certain circumstances following the borrower's default, the SBA may offer the original transferor the option to repurchase the guaranteed portion from the transferee. The SBA may also approve such a repurchase in an emergency situation when a change in the loan's repayment terms is necessary to prevent the failure of the borrower's business. These should be viewed as conditional repurchase options under paragraphs 9(c) and 55 of FAS 140 rather than as an entitlement of the holder of the guaranteed portion to receive cash before other holders of interests in the loan under proposed paragraph 8B(c). This view would be consistent with the concept of not maintaining "effective control" under FAS 140 when the guaranteed portion is transferred and, therefore, the conditional options should neither prevent the guaranteed and unguaranteed portions of the loan from qualifying as participating interests nor preclude sale accounting at the initial date of transfer. However, once either option is no longer conditional based on the terms of the SBA's transfer document, the transferor is deemed to have regained effective control over the guaranteed portion and therefore must recognize it as an asset because it can no longer be treated as sold.

In addition, we note that the SBA's transfer document requires the transferor to refund any premium received on the transfer of the guaranteed portion to the transferee if either the borrower repays the loan within 90 days of the transfer or certain borrower default conditions are met within less than one year of the transfer. The definition of recourse in Appendix E of FAS 140 also encompasses "[t]he right of a transferee of receivables to receive payment from the transferor of those receivables for (a) failure of debtors to pay when due, [or] (b) the effects of prepayments." As previously mentioned, proposed paragraph 8B(c) states that one characteristic of a participating interest is that "[p]articipating interest holders have no recourse to the transferor." We understand that the transferor's obligation to refund the premium occurs infrequently. Under existing FAS 140, the transferor recognizes the premium refund obligation as a liability incurred at fair value when accounting for the sale of the guaranteed portion of the loan. Because the SBA imposes this premium refund obligation on the transferor, we believe that it should be excluded from the scope of the "no recourse" characteristic in paragraph 8B(c) and that its existing accounting treatment under FAS 140 should be retained.

As a practical matter, if the guaranteed and unguaranteed portions of a U.S. Government-guaranteed loan, such as an SBA loan, fail to qualify as participating interests, it is unclear that the lender could transfer the entire loan to a Special Purpose Entity (SPE) to achieve sale accounting due to concurrently proposed changes to FASB Interpretation No. 46(R) (FIN 46(R)) that may result in consolidation of the SPE. Even if technically possible, based on the feedback we have received, it would not be cost effective for smaller institutions, which may be the only source for Government-guaranteed loans in certain communities, to structure transfers of the guaranteed portions of these loans in such a manner.

Furthermore, we do not believe that the well-established practice of dividing Government-guaranteed loans into their guaranteed and unguaranteed portions for purposes of transferring the guaranteed portion to another party should disqualify these transactions from sale accounting. We are not aware of accounting abuses that have arisen in the market for the Government-guaranteed portions of loans that would justify a change in the existing accounting treatment of these transfers under FAS 140, which takes the Government guarantee into account in the valuation of the sold versus retained portions of the loan. Therefore, we urge the FASB to clarify that when a loan partially guaranteed by a U.S. Government agency is divided into guaranteed and unguaranteed portions, the transfer of the guaranteed portion would be eligible for sale accounting without having to structure an SPE that is not consolidated under the new requirements of FIN 46(R), which would avoid a potentially significant disruption to the credit availability initiatives administered by the SBA and other U.S. Government agencies.

Transferor's Beneficial Interest – Measurement of Retained Interest

Paragraph 11 of FAS 140, as it is proposed to be amended, would require that a “transferor’s beneficial interest” be initially measured at fair value rather than at its allocated carrying amount based on relative fair values. In the Board’s view, this change in initial measurement is warranted because the beneficial interest is a new asset. According to paragraph A42 of the Exposure Draft, if an entire financial asset has been transferred to an entity that the transferor does not consolidate and the transfer qualifies as a sale, any beneficial interest the transferor receives in return is a new asset even if the cash flows come from the asset originally held by the transferor. We disagree with the FASB’s conclusion that a transferor’s beneficial interest should be treated as a new asset, thereby triggering initial fair value measurement. In our view, such a conclusion is not consistent with the substance of the arrangement and would reduce the transparency of the sale transaction.

Although the transferor must surrender control over the entire transferred individual financial asset or group of financial assets to satisfy the conditions for sale accounting under the proposed revision, the transferor must then gain control of an interest in the transferred financial asset(s) in order to recognize the interest as an asset in the accounting for the sale transaction. Putting aside the steps the transferor has been required to take in order to derecognize the cash flows over which other parties have obtained control, including the establishment of a special purpose entity that the transferor does not consolidate and a transfer of the financial asset or assets in their entirety to that entity, the substance of what has occurred is that the transferor continues to control a portion of the cash flows from the original financial assets. In that case, with respect to the portion of the cash flows over which the transferor has effectively maintained control, we do not believe that the earnings process has been completed or that the cost basis of these controlled cash flows should be restated to fair value, resulting in the recognition of a gain or loss on the instrument the Exposure Draft refers to as the transferor’s beneficial interest.

We are concerned that the proposed remeasurement of retained beneficial interests at fair value introduces discretionary timing of gains and losses on entire assets for what may be a transfer of a small portion of the original assets. Such discretionary timing of gains and losses on entire assets raises significant supervisory concerns about earnings and capital management and the transparency of the transaction. Therefore, we urge the Board to eliminate the proposed requirement for initial fair value measurement of a transferor's beneficial interest.

Participating Interest – Measurement of Retained Interest

Paragraph 10 requires a transferor to measure any participating interests that it continues to hold based on an allocation of the previous carrying amount. We support that position based on the rationale provided in Paragraph 58 indicating that retained participating interests are not part of the proceeds of a transfer.

Guaranteed Mortgage Securitizations

Based on discussions with the FASB staff, we understand that changes to the current FAS 140 and FASB Statement No. 65 (FAS 65) accounting for guaranteed mortgage securitizations would result in (1) the transferor not recognizing the transformation of the loan pool into securities by retaining the underlying mortgages on its balance sheet as "loans" instead of reclassifying the loan pool as "securities" and (2) accounting separately for the guarantee provided by a third-party entity (typically a Government-Sponsored Entity).

Many financial institutions undertake these securitizations primarily for liquidity purposes. If a given pool of residential mortgages has been converted to security form in advance, it will be much easier to sell in a timely manner than the individual, seasoned whole loans underlying the securities. The guarantee also promotes liquidity. Retaining the underlying mortgage loans on the financial institution's books raises significant questions about how the institution would account for the sale of part of the securities backed by the mortgage loans. It also raises questions about whether and how to determine an appropriate allowance for loan losses relative to the securitized mortgage loan pool.

As we understand the current effort leading to this Exposure Draft, it is designed to propose a quick fix for current standards on derecognition and variable interest entity consolidation. A longer-term fix will be necessary through a modified FASB standard, through adoption of *International Financial Reporting Standards* in the U.S., or both. Based on our knowledge of financial institution practices and the current market distress, Guaranteed Mortgage Securitizations do not present concerns for which a critical quick fix is necessary. For that reason and the fact that changing the current FAS 140 and FAS 65 exception for guaranteed mortgage securitizations would create significant implementation challenges, we recommend retaining the current accounting at this time.

Exposure Draft, Proposed Statement of Financial Accounting Standards,
Amendments to FASB Interpretation No. 46(R)

Separate Classification of Consolidated Variable Interest Entities

Item 9 of the Request for Comments section asks whether the elements of a consolidated variable interest entity should be required or permitted to be classified separately from other elements in an enterprise's financial statements. As stated in the cover note to this comment letter, we encourage the FASB to work with the IASB to produce a converged approach on the consolidation of special purpose entities.

Implementation Guidance – Examples

We support providing specific examples to illustrate the principles of the amended consolidation guidance as proposed in Appendix A of the Exposure Draft. While the nine examples provided were helpful illustrations and we understand that practical limitations make providing examples of all possible variable interest entities impossible, we recommend adding several more examples to illustrate specific cases that we find lacking based on our experience with financial institutions.

- Revolving Master Trust – Such structures, like credit card securitization master trusts, are prevalent in the industry and they have unique properties that are not addressed by the examples provided.
- Mutual Fund – Money market funds, in particular, have raised significant consolidation questions under FIN 46(R). Such an example could illustrate the reconsideration provisions amended in the current Exposure Draft as well as other provisions of the amended standard.
- Quantitative Assessment – The examples in the Exposure Draft illustrate cases in which consolidation is determined based on a qualitative assessment. Given that the quantitative assessment has not been entirely removed, consider providing an illustration of a case in which the quantitative assessment drives the consolidation decision.