



COMMERCIAL  
MORTGAGE  
SECURITIES  
ASSOCIATION

30 Broad Street, 28<sup>th</sup> Floor  
New York, NY 10004-2304  
Tel 212.509.1844  
Fax 212.509.1895  
[www.cmbs.org](http://www.cmbs.org)



September 14, 2007

LETTER OF COMMENT NO. 12

Mr. Russell G. Golden  
Director of Technical Application  
& Implementation Activities  
[director@fasb.org](mailto:director@fasb.org)  
Financial Accounting Standards Board  
401 Merritt 7  
P.O. Box 5116  
Norwalk, CT 06856-5116

File Reference: Proposed FSP FAS 140-d

Dear Mr. Golden:

The Commercial Mortgage Securities Association ("CMSA")<sup>1</sup> appreciates the opportunity to express our views on the Board's proposed FASB Staff Position 140-d, *Accounting for Transfers of Financial Assets and Repurchase Financing Transactions* (the "proposed FSP").

CMSA believes that the proposed FSP fails to accomplish the Board's goals as it does not appropriately identify those transactions which should be linked and those which should be accounted for separately. CMSA believes that the proposed FSP would produce accounting results that are materially inconsistent with the substance of the underlying transactions by inappropriately collapsing, in many cases, two transactions which have valid and distinct business purposes. This will not result in an improvement in final reporting.

---

<sup>1</sup> CMSA is a global trade organization for the commercial real estate capital market financial industry. The organization's primary mission is to promote the ongoing strength, liquidity and viability of the commercial real estate capital markets finance worldwide. Based in New York and with 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 finance activities. These members embody the full spectrum of the industry, including senior executives at the largest banks and investment banks, insurance companies, investors such as money managers and specialty finance companies, servicers, rating agencies and other service providers to the industry.

September 14, 2007

Page 2

### **CMSA's Response**

In the balance of this letter we will describe certain standard practices involving repurchase transactions in the commercial mortgage finance business, and comment on several of the questions specifically raised in the Notice to Recipients of the proposed FSP.

### **Examples of Market Transactions and Prevalent Practices**

The commercial mortgage finance market uses repurchase arrangements typically to provide leverage for the aggregation of commercial mortgage and real estate debt-type investments. In some cases, such leverage is designed to facilitate a hold to maturity strategy and in other cases is designed as a short term warehouse facility to accumulate assets for securitization or other market transactions. Broadly, a repurchase or "repo" structure is viewed as an alternative to the traditional secured line of credit in which the lender obtains a perfected security interest in accumulated financial assets. We note that the proposed FSP uses the terminology of "initial transferee/borrower" and "initial transferor/lender" when referring to the borrower and lender, respectively, under a repo transaction where the lender is also the initial transferor of the financial asset. However, because the analysis below regarding repo facilities includes instances where the initial transferor is not the lender, we have generally used the terminology of "repo borrower" and "repo lender" in this letter.

In recent years, the repurchase structure has become the dominant legal architecture for the financial arrangements described above because of advantages accorded to a repo lender vis-à-vis a secured lender under the Bankruptcy Code (Bankruptcy Code Sections 362(b)(7), 546(f)) with respect to the automatic stay. In 2005, the Code was amended to include the repo lender as a party exempt from the automatic stay of its counterparty's bankruptcy. Consequently, notwithstanding a bankruptcy of the repo borrower, the repo lender is free to sell the assets transferred under the repurchase facility if the repo borrower is in default under the terms of the repo facility and any customary cure rights of a borrower have expired. Obviously, this change in the Bankruptcy Code made it much more attractive for a lender to utilize the repo structure. This, in turn, resulted in a cost of funds which was lower and an advance rate which was higher for the repo borrower than was available in other forms of financing.

While in some instances asset-specific repurchase arrangements are entered into by a repo lender and a repo borrower with respect to an asset purchased by the repo borrower from the repo lender, the more common practice is for a party which intends to accumulate commercial real estate financial assets to enter into a long-term warehouse-type financing agreement with a financial institution using the repurchase architecture. Such arrangements are usually multi-year in duration and allow the repo borrower to finance a range of commercial financial assets, including whole loans, subordinate interests in loans and other real estate-related debt instruments through the repurchase mechanism. Regardless of whether the repo lender was the initial transferor of the transferred financial assets under the repo facility, the rights that the repo lender has to the financial assets as collateral under the repo facility do not emanate from the repo lender status as the initial transferor and previous owner of the transferred financial assets, but as the repo lender which holds a range of rights and powers which are in place for any lender using the repurchase structure.

Common to these transaction structures are (i) a pricing and advance rate matrix for different types of financial assets with different risk and duration characteristics, (ii) comprehensive repo

borrower representations, warranties and covenants, including financial covenants, (iii) substantial recourse, and (iv) the capacity of the repo lender to mark the portfolio on a frequent (usually daily) basis with the concomitant obligation of the repo borrower to pay margin amounts based on the repo lender's determination of the fair value of the repurchased assets. Prior to an event of default under the repo facility, any voting, consent or servicing rights with respect to the transferred financial assets customarily remain with the repo borrower rather than being transferred to the repo lender. Generally, the repo borrower under a commercial mortgage repo facility will be structured as a special purpose entity. Once the facility documentation is executed, individual transactions occur when (i) the repo borrower identifies an asset to be financed through the facility, (ii) the repo borrower provides comprehensive underwriting information to the repo lender as required by the legal documentation, and (iii) the repo lender verifies that the proposed asset meets the criteria of the repurchase facility legal documentation.

The typical warehouse repo facility is multi-asset and is not limited to financial assets originally acquired by the repo borrower from the repo lender. Of course, in the context of a "one-off" transaction, the financing is specific to a particular asset and may be sourced from an affiliate of the repo lender. However, providers of repo facilities typically do not limit the availability of the facility to only those assets initially transferred by the repo lender or its affiliates to the repo borrower. Also, prevalent practice is for the parties not to distinguish in interest rate or advance rate (haircut) between assets sourced from the repo lender or affiliates and third-party originators/sellers.

The prevalent industry practice is to account for these transactions as the separate purchase and sale of the transferred financial assets and separate financing evidenced by the repurchase arrangements. Regardless of whether the initial transferor is the repo lender, generally both the repo borrower and the repo lender (and/or its affiliate) treat the transfer of the financial assets in the first transaction as a sale. From a legal perspective, the first transaction is generally opinionable by experienced counsel practicing in the field as a "true sale" of the financial assets and regulated institutions recognize the separate sale and financing transactions for statutory accounting, asset reporting and risk-based capital purposes.

#### **The Rule Based Structure of the FSP Does Not Work**

CMSA believes that the proposed FSP should not be adopted because it:

- (i) fails to recognize the valid business purposes for which the commercial mortgage finance market uses repurchase arrangements and would produce accounting results that are materially inconsistent with the substance of the underlying transactions by inappropriately collapsing, in many cases, two transactions which have valid and distinct business purposes;
- (ii) fails to recognize the substance of the transactions which is evidenced by the fact that the repo borrower possesses the primary benefits and burdens of ownership of the financial asset transferred pursuant to the repurchase agreement; and
- (iii) would result in inconsistent accounting results for a repo borrower which is investing in identical financial assets merely because in one instance the repo borrower purchased

the transferred financial asset from the entity which then acted as the repo lender rather than a third-party lender, despite the economic substance of the repo financing being the same as if the third-party lender had provided the financing.

**The Proposed Non-Linked Criteria**

Paragraph 6 of the proposed FSP states it is necessary for an initial transfer and the repurchase financing to satisfy **all** of the criteria set forth in paragraph 7 in order to indicate “that a valid business or economic purpose exists and control has not been regained by the initial transferor.” CMSA believes that the failure to satisfy any of the criteria set forth in paragraph 7, however, should not be dispositive as to whether a valid business or economic purpose exists and control has not been regained by the initial transferor. Rather, CMSA believes that the totality of the facts and circumstances of the transactions should be considered in making such a determination. As discussed below, while certain of the criteria in paragraph 7 of the proposed FSP may appropriately be considered as factors in making the determination as to whether the initial transfer and the repurchase financing should be treated separately, the failure to meet any one criterion should not in and of itself be conclusive. Moreover, several of the factors, even in a principles-based decision model, are flawed and need to be modified as described below.

**7(a)**

The first sentence of 7(a) seems straightforward and not objectionable. Inclusion in this criterion of “implied commitments that are entered into at or near the same time with the same counterparty” however, is problematic. The example contained in 7(a) seems more appropriate to the question of whether a contractual commitment exists, and is inappropriate as applied to implied commitments. To the extent that a facility may be used not only for assets acquired from the repo lender but also from other sources, a presumption should exist that the transactions are not “contractually contingent” and should not be linked.

**7(b)**

The proposed 7(b) requires full recourse to the repo borrower. To the extent the proposed FSP was designed with a particular transaction in mind, which was a transaction in which repurchase financing was critically essential to the purchase of the financial asset in the first instance, and in which the repo borrower has little or no investment in the financial asset independent of the leverage provided by the repurchase financing, that example is not helpful in understanding the bulk of the transactional activity in the commercial mortgage finance industry. CMSA believes that full recourse is not the most relevant question in determining whether the market risk remains with the initial transferor. Rather, CMSA believes the more relevant issue is whether the repo facility provides an arm’s length, market interest rate and advance rate resulting in the appropriate amount of recourse for a given financial asset. While the typical repo facility does provide for full recourse to the special purpose repo borrower; it should be noted, however, that it is not unusual to see some limitation on recourse to the parent of the repo borrower. In addition to contractual recourse, the analysis should also take into account the “haircut,” or the advance rate. In cases where the cash investment in the financial asset by the repo borrower is material, this should indicate the sale transaction had a separate and valid business or economic purpose vis-à-vis the financing. To the extent the repurchase facility provides an arm’s length, market advance rate and recourse, this should create a presumption against a linked transaction conclusion, as it evidences the substantive feature of separate transactions.

7(c)

Paragraph 7(c) stipulates that the “financial asset subject to the initial transfer and repurchase financing has a quoted price in an active market” which is further specified to be a Level 1 input under FASB Statement No. 157, *Fair Value Measurements*. Paragraph A8 of Appendix A to the proposed FSP states that the reasoning behind the inclusion of these criteria was that:

if the initial transferor provides the initial transferee with a lower rate on the repurchase financing than would otherwise be obtained in an active market (as described in paragraph 7(c)) or if the initial transferor requires specific knowledge of the asset to provide a better rate on the repurchase financing, the initial transferee is economically compelled to execute the repurchase financing with the initial transferor. In that circumstance, the Board believes that the initial transferor effectively maintains control over the transferred financial asset because the initial transferee is unlikely to execute the repurchase financing with anyone other than the initial transferor.<sup>2</sup>

This argument is not well grounded in light of commercial practice. The bulk of assets which are financed in the commercial mortgage markets through repurchase facilities are whole loans and portions of whole loans and tranches of commercial mortgage backed securities (“CMBS”). Such assets, in the case of whole loans, will not have a quoted price in a Level 1 input market and CMBS tranches may not have a quoted price in a Level 1 input market, particularly whole loans and lower tier CMBS tranches which are not widely traded. Consequently, all initial transfers and repurchase financings of these assets would be considered linked.

The proposed Section 7(c) criteria presumably reflects a view that assets without easily established values will be financed by the repo lender who is also the initial transferor on terms materially more favorably than those available from other lenders because of other lenders’ inability to appropriately value such assets. The commercial mortgage finance market place is broadly recognized as being capable of valuing assets for which no Level 1 input market exists, in part because the repurchase facilities typically require the valuation of such assets for purposes of margin determinations. Moreover, as a substantial share of all financial assets are no longer routinely held to maturity, valuation of these assets is an everyday occurrence. By way of example, multi-seller securitizations have driven consensus on values. Market participants are able to reverse engineer rating agency models designed to facilitate securitization. There is a substantial body of easily accessible and highly transparent market data for comparative valuation purposes and the market, in fact, values such assets every day.

The process of determining value or margin levels is generally the same whether the asset was initially sourced from the repo lender or another institutional seller. The participants in the commercial mortgage market place believe lenders (whether as repo buyers or otherwise) can underwrite and value these assets. There is little expectation among repo borrowers that improved terms in any material respect will be provided by a repo lender simply because it originated an asset. Differences in pricing in advance rate amongst repo lenders are generally the

---

<sup>2</sup> Appendix A to the proposed FSP, *Background Information and Basis for Conclusions: The FASB Staff Position; Marketability (“Appendix A to the proposed FSP”)*

result of analytical differences driven by the respective parties' underwriting model and not unique asset knowledge. In market practice, repo facilities in this market customarily do not distinguish in terms of interest rate or advance rate between financial assets that were originated by an affiliate of the repo lender or another party. While there may be modest cost advantages to financing with the originator of an asset due to reduced diligence cost, diligence cost is not a material amount compared with the proceeds of the financing. It certainly does not provide an economic compulsion for the repo borrower to seek financing from the initial transferor.

Consequently, the failure of the transferred financial asset to have a Level 1 market does not seem to correlate to any degree of control by the repo lender over the financial asset. There is a broad and deep market to finance these assets with highly similar terms and pricing/valuation. There is real and robust competition to finance these assets through repo arrangements and repo borrowers have real choices as to financing sources. The choice of repo lender is driven primarily by business relationships and not by a lack of availability of financing from other providers.

7(d)

The criteria in paragraph 7(d) are not operational with respect to commercial mortgage market practice. While it is true that the repo borrower can reacquire collateral and payoff the allocable repurchase facility financing at any time, in most instances the repo borrower will not be able to freely substitute a new asset for the transferred financial assets without the consent of the repo lender. This is uniformly true regardless of whether the repo lender was the initial transferor. Each transferred financial asset under a commercial mortgage repo facility is unique to some extent and the repo lender customarily underwrites and performs some level of diligence on each transferred financial asset.

The second sentence of 7(d) is not entirely in accord with commercial practice. Under traditional ISDA documentation, a repo lender can sell or hypothecate a financial asset and need not return the actual asset subject to repurchase. In commercial mortgage finance practice, this provision is stricken or limited such that the repo lender must return the specific financial asset when the repo borrower requests. Consequently, the second sentence of Section 7(d) should be modified to indicate that a factor suggesting linked transaction treatment is the absence of an obligation that the repo lender return the specific financial asset when requested to do so by the repo borrower. Paragraph A9 of Appendix A to the proposed FSP explains that "the Board believes that when an initial transferee has the ability to use the collateral and has the right to substitute a dissimilar asset in place of the collateral, the initial transferor does not likely control the transferred financial asset." CMSA believes the ability of the repo borrower to pay off the facility and control the asset in and of itself is dispositive of control.

7(e)

Criteria 7(e) should not be given the weight it is accorded in this formula. To the extent that the repo lender has provided financing in an arm's length transaction at market rates, the fact that financing is co-terminous with the maturity of the asset should only be a factor to be considered in determining whether a transaction should be given linked treatment, rather than dispositive of such treatment.

**Additional Comment to Paragraph 4 of the FSP**

Finally, CMSA believes that to the extent the initial sale and the repo financing are not substantially simultaneous, this should also be considered as a positive factor in determining that the initial transfer and the repurchase financing should be treated separately. While CMSA does not believe that a simultaneous initial transfer and repurchase financing indicate continued control by the initial transferor, the lapse of time between such events is a factor that strongly indicates that parties fully intend to terminate control by the initial transferor after the initial transfer, suggesting that the initial transfer and the subsequent repurchase financing should be viewed separately.

**Implementation Costs**

The proposed FSP will have a disruptive effect on commercial mortgage markets by materially increasing the cost of utilizing a repurchase facility as a means of financing commercial mortgage loans, real estate debt and commercial mortgage backed securities. Alternatively, lenders may choose to resort to secured transaction lending which may not require a linked transaction approach but has the same general effect of securing a lender. The accounting treatment of a financing transaction should not turn on such a nuance. A linked transaction approach will unnecessarily burden the appropriate uses of repo financing as an independent, arms length financing technique and cause parties to fall back on more traditional secured creditor financing with the attendant increased costs to the borrower and increased risk vis-à-vis insolvency to the lender. Those consequences are simply not justified by the broad sweep of this FSP. In addition, if transactions must be linked and sale treatment is denied it may eliminate the ability of some institutions with high sensitivity to risk based capital and other regulatory reporting regimes to offer repo financing. The consequence of this would be to advantage certain types of repo lenders and to disadvantage others.

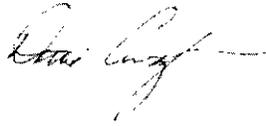
**Effective Date and Prospective Application**

In the event the FSP in its current form will be implemented, the proposed effective date does not provide sufficient time for implementation. As discussed above, the proposed FSP would result in significant changes in the way market participants currently account for repurchase transactions. Such changes will likely result in material changes to the form of the financing structures utilized to procure the same economic purpose. Accordingly, we urge the Board to delay the effective date until the fiscal years ending after November 15, 2009 and to make the application of the proposed FSP prospective to new transactions entered into after the effective date, in order to minimize any market disruptions. In the alternative, we would request that further consideration by the Board of the proposed FSP be delayed and instead the Board considers the issue in connection with the other amendments to FAS 140 that the Board will be considering over the course of the next several months.

We thank the Board for the opportunity to express our views on the proposed FSP and appreciate your consideration of the views of CMSA. We sincerely believe that the proposed FSP would produce accounting results that are materially inconsistent with the substance of the business practice in connection with repurchase financings and urge the Board to consider these comments in finalizing the proposed FSP. If you have any questions or need additional information, please contact me at 212.509.1844.

September 14, 2007  
Page 8

Sincerely,

A handwritten signature in cursive script, appearing to read "Dottie Cunningham", with a horizontal line extending to the right.

Dottie Cunningham  
Chief Executive Officer  
Commercial Mortgage Securities Association