



LETTER OF COMMENT NO. 18

Mr. Russell G. Golden  
Director of Technical Application and Implementation  
Financial Accounting Standards Board  
Technical Director - File Reference: Proposed FSP FAS 140-d  
401 Merritt 7  
PO Box 5116  
Norwalk, CT 06856

**UBS AG**  
Postfach  
8098 Zürich  
Tel. +41-44-234 11 11

Accounting Policies and Support

John Gallagher  
677 Washington Blvd  
Stamford, CT 06901  
Tel. +1-203-719 4212  
Fax +1-203-719 3945  
john.gallagher@ubs.com

www.ubs.com

September 14, 2007

**Proposed FSP No. FAS 140-d, Accounting for Transfers of Financial Assets and Repurchase Financing Transactions**

Dear Mr. Golden,

UBS appreciates the opportunity to provide comments on proposed FSP No. FAS 140-d, *Accounting for Transfers of Financial Assets and Repurchase Financing Transactions*. We strongly support the FASB's open due process and are pleased to participate in that process.

We do not believe that the proposed FSP is necessary. If the Board determines that guidance is necessary, we have proposed an alternative model based on indicators; we believe that model places greater emphasis on the substance of the transactions.

We encourage the Board to focus its efforts and resources on researching and developing the linked-presentation model—we believe that work has tremendous potential.

Additionally, we note that the proposed FSP in its current form will create another difference between IFRS and US GAAP. Under the proposed FSP, we believe that most transactions will be linked. IAS 39's model generally will result in many of these transactions being accounted for separately as the risk-and-rewards have been transferred to the counterparty. While the derecognition models of Statement 140 and IAS 39 are different and therefore give rise to different accounting treatments, we think the Board should be utilizing its limited resources to develop an improved derecognition model that could form the basis of a future IFRS standard.

We understand that this issue arose as a result of certain practices in the REIT industry, specifically, practices designed to ensure compliance with certain regulatory requirements associated with asset holdings as of specified reporting dates. We believe that the proposed FSP may have been designed with too much emphasis on that particular industry. We believe that accounting standards should ensure that the economics of transactions are appropriately reflected; however, we do not believe that the proposed FSP's approach accomplishes that objective.

We have responded to the Board's request for comments on the questions raised in the proposed FSP's notice to recipients in the appendix to this letter. We would be happy to respond to any questions you

may have about our comments. If you would like to discuss them, please contact John Gallagher at (203) 719-4212 or Mike Tovey at (203) 719-8164.

Regards,

UBS AG

John Gallagher  
Managing Director  
Accounting Policies and Support

Mike Tovey  
Executive Director  
Accounting Policies and Support

## APPENDIX

### Question 1

Are the criteria in paragraph 7 of this proposed FSP operational and do they appropriately identify those transactions that should be accounted for separately? If you disagree, please provide example transactions that do not meet the criteria but should be accounted for separately or that do meet the criteria but should not be accounted for separately. Explain the business purpose (or lack thereof) of the example transactions provided.

No, those criteria are not operational. Before providing further comments in that regard, we note that Paragraph 4 states the following:

The lapse of time between the initial transfer and the repurchase agreement is not relevant when determining if the transaction is a repurchase financing with the scope of this FSP.

This statement makes the proposed FSP non-operational for financial institutions who engage in high volumes of asset transfers and repurchase agreements with counterparties. For example, an entity might sell many fungible securities in early December and in December of the following year enter into repurchase agreements for those same securities. Because the criteria are too stringent, those transactions might be linked even though they are clearly separate transactions having a valid and distinct business or economic purpose. The time period between transactions above could be expanded to 2 years, 5 years, or 10 years and still result in linkage. Linking such transactions in those cases would more than likely result in outcomes which do not represent the substance of the relationships between counterparties. Moreover, an entity would have to track all securities transactions with counterparties from the beginning of time. Because the same fungible securities may be bought from and sold to the same counterparty thousands of times (in the case of financial institutions) in the course of a single annual period, tracking such data and identifying potentially linked transactions will require new systems with immense storage capacity. We believe that that requirement does not take into account the activities of securities brokers and dealers. Under all circumstances, the language in Paragraph 4 requires modification.

Paragraph 7's criteria are non-operational. We believe that the first part of the Board's linking principle in Paragraph 6 is appropriate, that is, transactions are not linked if they have a valid and distinct business or economic purpose for being entered into separately. However, the second part of the principle is flawed for repurchase financings. The majority of repos and reverse repo transactions in the US do not pass the legal isolation test in paragraph 9(a) of Statement 140. Such transactions are typically accounted for as financings with the securities collateral accounted for off balance sheet. During the repurchase period, the entity holding the off-balance-sheet collateral generally has the right to pledge or exchange it. That control is intended from the outset of the transaction to be temporary. In addition, absent a default event, that temporary control does not convey rights to the risks and rewards of ownership of the securities collateral. We emphasize further that paragraph 7(d)'s criteria appears to be more stringent than Statement 140's criteria for determining control because the ability to pledge or sell collateral would not indicate that control has been transferred. The second part of the principle makes no allowance for such temporary control because of the detailed criteria in Paragraph 7. Therefore, we believe the first part of the principle should be retained as the general principle.

As discussed in the preceding paragraph, we think that a transfer and a repurchase agreement with respect to the same security should not be linked if such transactions have a valid and distinct economic purpose for being entered into separately. We recommend that an indicators approach, based on the substance of the transactions, be used for making an assessment under that principle.

For example, the following indicators could be considered:

1. The initial transferee should have economic substance apart from that provided by the initial transferor.
2. The risks and rewards of the security in the initial transfer are transferred to the initial transferee and are not transferred in the subsequent refinancing agreement.
3. The transactions are entered into contemporaneously and in contemplation of one another. This should be interpreted consistent with practice relating to Statement 133 Implementation Issue No. K1, *Miscellaneous: Determining Whether Separate Transactions Should Be Viewed as a Unit*.
4. Transactions are entered into by separate business units that are managed independently of one another, that is, each business unit manages its own operations and is compensated based on its own respective business activities.
5. The subsequent repurchase financing is made via an electronic exchange or other inter-dealer market<sup>1</sup> based solely on pricing and other relevant terms (that is, the counterparty is not known until after the agreement is consummated).
6. The counterparty has a history of requesting that special pricing be given as a result of entering into the two transactions contemporaneously and in contemplation of one another.

Those indicators would lead to certain presumptions. For example, Indicators 1 and 2 provide strong evidence that the initial transfer is independent of any subsequent refinancing agreement unless Indicator 3 is present. Indicator 3's presence is strong evidence that the transactions should be linked. Indicator 4's presence may provide evidence that the initial transfer is independent of any subsequent refinancing agreement. Indicator 5 provides indisputable evidence that any prior transaction with said counterparty is not linked to the subsequent repurchase transaction. Indicator 6 provides strong evidence that the transactions should be linked.

If the Board chooses to retain the proposed approach in the FSP, we have the following observations:

- From a US legal standpoint, it is our understanding that the initial transferor's prior ownership of the securities serving as collateral in a subsequent repurchase agreement has no bearing in assessing whether legal isolation occurs in the subsequent repurchase agreement. Consequently, there is no legal basis suggesting that the transactions be linked.
- Criterion 7(c) seems to be designed to provide a basis to verify that transactions have occurred at market rates. That suggests that this criterion is designed for purposes of auditability rather than to determine that transactions have valid economic purposes. Derecognition decisions should not be based on the quality of fair value inputs.
- Most standardized repurchase agreements do not provide for substitution rights, which would be required by criterion 7(d) to overcome the linkage presumption. We suggest that that criterion be eliminated. The point is that the initial transferee retains the risk and rewards of ownership. Entities holding securities collateral exchange or pledge that collateral to earn a spread on the cash received. That subsequent sale of the securities collateral is a separate and distinct transaction with its own economic purpose. In fact, it is something we would add to

---

<sup>1</sup> Transactions in the inter-dealer market occur in such large volumes that it is highly likely that the fact pattern described in the proposed FSP will occur; however, due to the format of such exchange transactions, it is not possible to determine the counterparty prior to the consummation of the transaction. Nevertheless, the stringent criteria may result in linkage because the criteria create a "form-over-substance" linkage.

our list of indicators because it suggests that a subsequent refinancing agreement has its own purpose.

- The criteria do not address factors that we have discussed as indicators. Determining whether two transactions are linked should take into account the purposes for which such transactions are entered into such as selling a security to realize gains or earn brokerage fees and earning a spread on securities collateral received under a repurchase agreement. The substance of the two transactions should be assessed using judgment rather than be defined by the proposed set of criteria.

To conclude, we strongly recommend that the Board adopt a substance-over-form approach by eliminating the linkage presumption and using indicators approach described in our response to this question.

### **Question 2**

What costs would be incurred to implement this proposed FSP?

There are two major factors which will result in significant cost to UBS in complying with the requirements of the proposed FSP:

- For a dealer, the volume of securities and repurchase transactions traded on a daily basis is significant (i.e., volume in millions) and therefore any solution for identifying the "linked" transactions will need to be system based;
- The individual transactions which might be deemed to be linked are originated by distinct parts of the business and are likely reported in on completely separate risk management systems with no common identification. Those systems would have to be modified significantly to make common identification possible.

### **Question 3**

What procedures, controls, and systems are required to implement this proposed FSP? Can such procedures, controls, and systems be in place by the proposed effective date—the beginning of the first fiscal year after November 15, 2007? If not, when can the procedures, controls, and systems be in place to implement this proposed FSP?

Pursuant to Question 2, new system solutions would be required to ensure that "linked" transactions could be identified. A manual solution of identification by business units would not be possible since there may be no causal link to the trades (refer to our response in Question 1). Appropriate procedures also would be required to manually review prima facie "linked" trades identified on an automated basis to assess whether the criteria for delinkage are satisfied. Appropriate procedures and system controls also would be required.

If work on new system solutions were started immediately, we do not believe that it could be completed to meet the proposed effective date. Our experience in the design and implementation of new system solutions of a similar magnitude suggest that it would take a significant period of time to have the solution operational. In that light, we would ask that the proposed implementation date be deferred by at least one year to November 15, 2008.

In addition, if historical trading activity must be included in the system because the time between the two transactions is not relevant, it is not clear how much work would be required. We believe that it could take several years at a minimum.

**Question 4**

Are there other implementation issues that the Board should consider?

We do not know if the proposed FSP is intended to apply to securities lending and borrowing transactions. The description of the term *repurchase agreement* in paragraph 97 of Statement 140 includes the words "Some repurchase agreements are similar to securities lending transactions..." which would seem to indicate that they are excluded from the scope of the proposed FSP. Footnotes 1 and 2 of FIN 41 also contain descriptions of the term *repurchase agreement*. That language also leads to some ambiguity. We encourage the Board to make the scope of this FSP abundantly clear. Also, it is not clear whether it would apply to margin lending transactions in which only a portion (i.e., 50 percent) of the purchase price of the securities is loaned.

Paragraph 4 of the proposed FSP states, "A repurchase financing also typically involves the initial transferor returning the transferred financial asset (or substantially the same asset) to the initial transferee when the financing is repaid at **a fixed price** on a stated date." However, in paragraph 7, the second criteria states that "[T]he initial transferee's agreement to repurchase the previously transferred asset (or substantially the same asset) is for **a fixed price and not fair value**." We understand that a fixed price will only be equivalent to fair value by coincidence. We do not believe that it is necessary to make that notion explicit.

**Question 5**

Are the transition provisions of this proposed FSP, to new transactions and outstanding repurchase financings, appropriate?

We strongly urge the Board to exclude all pre-existing trades and trading activity from the scope of the proposed FSP based on operational/systems grounds; otherwise, the proposed FSP may not be possible to implement (refer to our response to Question 3).