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Ms. Suzanne Bielstein
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Financial Accounting Standards Board
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Dear Ms. Bielstein:

FASB Exposure Draft: Proposed Statement of Financial Accounting Standards, Qualifying Special-Purpose Entities and Isolation of Transferred Assets, an amendment of FASB Statement No. 140 (File Reference No. 1200-001)

We appreciate the opportunity to comment on the FASB's Proposed Statement of Financial Accounting Standards, Qualifying Special-Purpose Entities and Isolation of Transferred Assets, an amendment of FASB Statement No. 140, (hereinafter referred to as the "Exposure Draft" or "Proposed Amendment"). We support the Board's objectives of providing additional guidance related to certain powers of qualifying SPEs and improving the consistency of application of FASB Statement No.140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities (Statement 140). However, we are concerned about several of the provisions of the Exposure Draft, and we believe that other provisions require clarification or modification to ensure consistent application.

Following the issuance of Statement 140, and its predecessor Statement 125¹, Qualifying Special Purpose Entities ("QSPEs") have served a significant role in the allocation of capital in the financial markets, most notably in the home mortgage and credit card industries. We believe the Board's Proposed Amendment inserts a risks and rewards model into Statement 140, and therefore represents a significant change to the Board's conceptual approach to QSPEs. As a result, the Proposed Amendment will have a significant effect on the financial markets.

¹ FASB Statement No. 125, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities

A risks and rewards concept was previously rejected by the Board because it conflicts with the fundamental basis of Statement 140, which was founded on a financial-components approach that focused on control and recognized that financial assets and liabilities can be divided into a variety of components. The inclusion of a risks and rewards concept into a financial components model effectively converts Statement 140 from a financial asset derecognition model to a consolidation model. As a result, we do not believe that the Board should adopt a mixed attribute model. Instead, the Board should achieve its objective of limiting the activities of a QSPE within the confines of a financial components model.

However, if the Board decides to continue with the proposed approach, the Board should strongly consider enhancing the background information and basis for conclusions with respect to certain provisions of the Exposure Draft. Additionally, consideration should be given to providing examples to demonstrate the concepts that the Board would intend with the issuance of the final standard.

Our other principal comments are as follows:

Limitations on Activities of a QSPE

- 1. The Board should clarify the proposed amendments to paragraphs 35(c) and 35(f) of Statement 140 with respect to the impact of forward contracts entered into in revolving-period securitizations on QSPE status. In the proposed amendment to paragraph 35(e), the Board specifically permits a QSPE to enter into forward contracts³ in revolving-period securitizations. However, we believe that paragraph 35(f) could be interpreted to preclude a QSPE that reissues beneficial interests from entering into these types of forward contracts. If the Board's intent was to permit revolving-period securitizations, an exception like the one provided in paragraph 35(e) should be added to paragraph 35(f) of the Proposed Amendment.
- 2. The Proposed Amendment includes a provision that precludes a QSPE from entering into passive derivative instruments if the counterparty is the transferor, its affiliates or agents (the new paragraph 35(e)). This provision potentially creates significant inconsistency in the accounting treatment for certain economically similar transactions, and represents a significant departure from existing GAAP.

The Proposed Amendment would create significant inconsistency in the accounting for transfers of financial assets to trusts or similar entities between those transactions where the transferor has retained risks (such as credit risk or interest rate risk) by entering into derivative instruments with, or guarantees to, the transferee entity and

² See paragraphs 7 and 140 through 149 of Statement 140 which discusses the Board's rejection of the risks and rewards approach for derecognition of financial assets.

³ As described in paragraphs 77 through 79 of Statement 140.

those where such risks are retained in the form of subordinated interests. For example, if a transferor sells fixed rate assets to a trust that issues floating rate beneficial interests, QSPE status would be precluded by the Proposed Amendment if the transferor were to enter into an interest rate swap with the trust. In contrast, the transferor could retain the interest rate risk in a residual interest if the trust does not enter into any derivative instrument and changes in interest rates either increase or reduce the amount of cash flows paid to the residual interest holder. The difference between the two transactions is that if interest rates increase then the transferor in the first example must pay cash whereas the transferor in the second example would have reduced cash inflows from its subordinated interest. The economic difference between these transactions is not significant enough to warrant the dramatically different accounting treatment proposed in the Exposure Draft. Further, if DIG Issue D-1 is resolved and embedded derivatives are ultimately bifurcated from a residual beneficial interest, it is not clear whether QSPE status would then be precluded.

Additionally, existing GAAP permits a QSPE to enter into derivative contracts that are passive in nature and pertain to the beneficial interests sold. In practice, many QSPEs have entered into derivative contracts such as interest rate swaps, interest rate caps or currency swaps with the transferor or its affiliates. We do not believe that the Board has provided sufficient support for its position in the basis for conclusions for precluding many of these instruments. The Board states in paragraph A12 of the proposed amendment that the "additional requirements result from concerns about the potential for enterprises to execute transfers that do not change their economic position in any essential way but that significantly change their financial statements." This argument illustrates the introduction of a risks and rewards concept into a control based financial components model, two concepts that, as we have discussed earlier, are incompatible.

3. The Board should clarify whether the term "written options" in the proposed paragraph 35(e) should apply to all written options, or only written put options. Consistent with the provisions of 35(e), written put options commit the transferor to deliver additional cash to the QSPE. However, it is not clear to us whether written call options such as ROAPs, which are described in paragraph 87 of Statement 140⁴,

⁴ Paragraph 87 of Statement 140 states:

The following are examples of ROAPs that do not preclude transfers from being accounted for as sales:

a. A ROAP for random removal of excess assets, if the ROAP is sufficiently limited so that the transferor cannot remove specific transferred assets, for example, by limiting removals to the amount of the transferor's retained interest and to one removal per month

A ROAP for defaulted receivables, because the removal would be allowed only after a third party's action (default) and could not be caused unilaterally by the transferor

c. A ROAP conditioned on a third-party cancellation, or expiration without renewal, of an affinity or private-label arrangement, because the removal would be allowed only after a third party's action (cancellation) or decision not to act (expiration) and could not be caused unilaterally by the transferor.

would also be precluded from being written by a QSPE based on the proposed amendment to paragraph 35(e).

- 4. We do not believe that it was the Board's intention to preclude QSPE status as a result of the transferor providing basic representations and warranties on an asset transferred to a QSPE. As currently proposed, basic representations and warranties would meet the paragraph 35(e) prohibition of the transferor providing a commitment to deliver additional cash or assets to the SPE. Perhaps the Board could consider a scope exception for basic representations and warranties or similar arrangements.
- 5. It is not clear to us what is meant by "indirectly" in the Proposed Amendment to paragraph 35(e). For instance, if the transferor purchased a guarantee of specific assets from a third party, and those assets were subsequently or contemporaneously transferred into a trust, would the trust be precluded from being a QSPE? Alternatively, if the transferor purchased the same guarantee from a third party but designated it as a guarantee of the beneficial interests issued by a QSPE, would that constitute an indirect guarantee by the transferor? The Board should clarify what they meant by the term "indirectly", and consider providing illustrative examples, to ensure consistent application of their intentions.
- 6. The Board should consider providing additional guidance on whether it considered credit enhancement provided by the transferor in the forms of over collateralization or cash reserve accounts (spread accounts) to be permissible in a QSPE. Paragraph 35(e) indicates that the prohibition on transferor guarantees to a QSPE applies even if the commitment is prepaid and regardless of the face amount of the instrument. Some have interpreted the proposed paragraph 35(e) to preclude the transferor from providing over collateralization or cash reserve accounts (spread accounts) and similar arrangements.
- 7. Paragraph 35 (f) refers to a QSPE that "reissues beneficial interests"; however there is no discussion or definition provided as to what the Board meant by the phrase "reissuing beneficial interests". For instance, would a variable rate pass-through certificate with no scheduled maturity representing a beneficial interest in a revolving pool of assets held by a trust be considered reissuing a beneficial interest? We understand that the Board intended the notion of reissuing beneficial interest to be based on whether new beneficial interests are issued to fund any portion of an existing asset held by a QSPE. To ensure consistent application of paragraph 35(f) the Board should provide some additional discussion or examples of the phrase "reissues beneficial interests".
- The Board should clarify whether it believes it is acceptable for a QSPE to have unlimited discretion regarding the issuance of new beneficial interests, provided such

discretion is in the hands of an appropriate party. Paragraph 35(f)(2) may be interpreted to suggest that having unlimited discretion over reissuing beneficial interests is a permissible activity of a QSPE. Such an interpretation seems inconsistent with paragraph 35(b)(1) of Statement 140 and the discussions to date on this matter, and may require clarification or confirmation by the Board.

- 9. The Board should clarify whether the additional limitations imposed on QSPEs under the proposed paragraphs 35(f)(2) and 35(f)(3) apply to beneficial interest holders who hold both the most senior in priority (the servicer) and the most subordinate (the residual interest holder).
- 10. We concur with the Board's proposed addition to paragraph 45 and recommend that the Board provide either guidance or examples of the degree of specificity on the manner of asset disposition that they consider appropriate.
- 11. The Board should clarify what it meant by the term "equity instrument" in proposed paragraph 35(c)(1). Paragraph A14 of the Proposed Amendment indicates that the reason the Board decided to prohibit QSPEs from holding equity instruments was to ensure that the Statement 115 accounting model would not be applied to instruments otherwise excluded from the scope of that Statement. This suggests that QSPEs would be permitted to hold equity securities that are within the scope of Statement 115. However, the Board indicated in its public deliberations that the rationale for prohibiting QSPEs from holding equity instruments was that such instruments have no maturity date and, therefore, would necessitate the use of discretion. The Board should clarify its intent and should provide a definition of those equity instruments that QSPEs are prohibited from holding.

Transition

12. The proposed effective date does not provide sufficient implementation time for financial statement preparers, auditors, and other affected parties to analyze the impact of the amendment on the various structures that are currently QSPEs. It is our understanding that the amendment, as proposed, would impact a significant number of entities, particularly large revolving structures like master trusts, which would likely lose their qualifying status under the Proposed Amendment and require consolidation under FIN 46. The consolidation of such entities is likely to impact the accounting for other entities as well. An immediate transition period of the first quarter beginning after the issuance of the Proposed Amendment therefore does not provide sufficient time to adequately address the concerns of preparers, auditors, regulators, lenders and rating agencies given the accounting ramifications of consolidating such entities. We recommend that the Board consider extending the transition period to six months, at a minimum.

⁵ The amended Paragraph 35(f)(2) provides details of who is permitted to hold such discretion.

Transfers

13. The proposed amendment to paragraph 83 will represent a significant change in practice. Statement 140, in paragraphs 9 and 104, provided guidance that a transfer of an undivided interest is the equivalent of selling either a pro rata or senior participation interest in a financial asset. As currently drafted, paragraph 83 could be interpreted to require that all transfers of undivided interests (including participation interests), whether pro rata or subordinated, be done through a QSPE structure, if sale accounting is to be achieved. Legally, we understand there is little or no difference between an undivided interest and a participation interest. If the Board's intent is to amend Statement 140 to prevent sales of portions of financial assets, the Board should address this more clearly in the basis for conclusions, and amend both paragraphs 9 and 104.

Isolation

14. The amendment to Paragraph 9(a), as proposed, will now explicitly require that transferred assets "be isolated from the transferor and any consolidated affiliate of the transferor that is not a special-purpose corporation or other entity designed to make remote the possibility that it would enter bankruptcy or other receivership" (emphasis added). The Board should clarify whether the criteria in the proposed paragraph 9(a) would preclude sale treatment for a sale of assets from a parent to a subsidiary, in their respective standalone financial statements. Additionally, the amended paragraph 9(a) seems somewhat inconsistent with the Exposure Draft Summary which states that the assets should be isolated from all members of the consolidated group that includes the transferor, except for certain bankruptcy remote entities. The Board may wish to conform the summary to the amended paragraph 9. If the summary is more accurately expressing the Board's intent, the Board may want to consider whether the guidance in Question 20 of the FASB Staff's Implementation Guide on Statement 140 regarding transfers between subsidiaries of a common parent should also be changed because of the Proposed Amendment. The Implementation Guide indicates that such a transfer would be accounted for as a sale "if (a) all of the conditions in paragraph 9 (including the condition on isolation of the transferred assets) are met and (b) the transferee's assets and liabilities are not consolidated into the separate-company financial statements of the transferor." The Board should explicitly address such transfers in the proposed amendment.

If you have questions about our response or wish further to discuss any of the matters addressed herein, please contact John Guinan at (212) 909-5449 or David Britt at (212) 909-5573.

Very truly yours,

KPMG LLP