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August 29, 2002

Letter of Comment No: 63
File Reference: 1082-200
Date Received: 09/03/02

Director of Major Projects and Technical Activities Financial Accounting Standards Board 401 Merritt 7 P.O. Box 5116 Norwalk, Connecticut 06856-5116

Re: File Reference No. 1082-200, Exposure Draft of Proposed Interpretation: Consolidation of Certain Special-Purpose Entities, an Interpretation of ARB No. 51

(the "Proposed Interpretation")

Ladies and Gentlemen:

The Commercial Mortgage Securities Association (the "CMSA") is pleased to have the opportunity to provide you with comments on the exposure draft of the Proposed Interpretation. The CMSA is the international trade organization for the commercial real estate capital markets, whose mission is to improve the liquidity of commercial real estate debt securities through access to the capital markets. The CMSA is comprised of over 295 members, representing more than 3,000 professionals, including many of the largest money-center institutions, insurance companies, investment banks, money managers, loan servicers, national statistical rating agencies and ancillary service providers. Our members represent all aspects of the commercial and multifamily mortgage backed securities ("CMBS") industry including commercial banks, investment banks, insurance companies and conduit loan originators, warehouse and portfolio lenders, transferors into CMBS transactions, purchasers of all classes of CMBS and parties acting as master servicers and special servicers for CMBS transactions.

The CMBS market creates significant liquidity for both U.S. and international commercial and multifamily real estate. Morgan Stanley estimates global CMBS outstanding at the end of July, 2002 at approximately \$370 billion, with U.S. CMBS constituting approximately \$317 billion of that number.

CMBS transactions require the use of bankruptcy remote special purpose entities ("SPEs") in order to isolate a pool of assets from insolvency, tax and other economic risks outside of the securitization structure itself and to provide a flexible vehicle to allocate risks among participants. The issuers in these transactions are exactly the types of risk dispersing SPEs which should be considered financial SPEs ("Financial SPEs") under paragraph 22 of the Exposure Draft which generally should not require any party to the transaction to consolidate the Financial SPE. We believe that the wide variety of economic interests created in these transactions is most meaningfully disclosed to investors and regulators by using a financial components accounting approach with disclosure explaining the context in which the financial

components arise in the related Financial SPE transaction (or categories of these transactions). The members of CMSA are significant investors in the capital markets, both domestically and internationally, and strongly support meaningful financial disclosure.

In addition to the specific concerns identified below as to CMBS transactions, we are also concerned about the effect of the Proposed Interpretation on SPEs which are issuers of collateralized debt obligations ("CDOs"). CDOs are significant investors in both investment grade and below investment grade classes of CMBS. We believe that CDOs are risk dispersing vehicles which should receive the benefits intended by Paragraphs 22 and 23.

Our comments address the impact of paragraphs 8(a), 19, 22 and 23 of the Proposed Interpretation on Financial SPEs which issue CMBS and we briefly discuss the impact of the Proposed Interpretation on SPEs which issue CDOs, an important source of liquidity for the CMBS market.

Typical CMBS Securitization Structure

The CMBS market creates liquidity for long term commercial and multifamily mortgage loans and real estate in the U.S. and internationally. Qualifying SPEs ("QSPEs") as defined in paragraph 35 of Financial Accounting Standards Board Statement No. 140 ("FAS 140") are customarily used as the issuers of CMBS transactions. In a typical CMBS securitization, one or more commercial and multifamily mortgage loan originators transfers an identified portfolio of existing commercial and multifamily mortgage loans to an SPE (a "first step SPE") in true sales for an agreed-upon price. Concurrently therewith, the first step SPE conveys the mortgage loans in a second step transfer to a QSPE. The QSPE issues CMBS of various senior and subordinate classes which represent economic interests in the pool of mortgage loans held by the QSPE. Cash flow from the mortgage loans is used to pay the CMBS. Credit support for the senior classes of CMBS is generally achieved through a combination of sequential payment of principal and reverse-sequential allocation of losses on the pool of mortgage loans through the classes of CMBS issued. CMBS transactions may use a portion of the proceeds from the CMBS issuance to create reserves to cover certain liquidity or other risks inherent in the particular transaction.

The parties who provide services to a CMBS transaction typically include a trustee, a master servicer and a special servicer. Typically a "master servicer," acting as agent for the QSPE, is responsible for the day-to-day administration of performing mortgage loans. The "special servicer" administers mortgage loans which are in default by performing workouts or foreclosures and administers any properties which are acquired as a result of exercising remedies due to such default. The master servicer or the special servicer may or may not be a transferor of mortgage loans to the first step SPE and may or may not own some portion of the subordinate CMBS issued by the OSPE.

1. Issues Pertaining to SPE Issuers of CMBS

(a) Expansion Needed to Paragraph 8.a.

Since the typical QSPE used in a CMBS transaction is a quintessential limited discretion risk dispersing SPE with the parties to the transaction allocating risk a variety of different ways, we believe that the rationale permitting transferors not to consolidate a QSPE under FAS 140 should be expanded so that no party to a transaction which qualifies under FAS 140 should be required to consolidate the QSPE issuer. We believe that the most meaningful, transparent and comparable accounting disclosure of the economic interests held by the parties in a CMBS transaction is a financial components accounting approach, not consolidation. Therefore, we request an expansion of paragraph 8.a. of the Proposed Interpretation so that the "safe harbor" from consolidation under FAS 140 covers all entities holding interests in QSPEs.

Given the risk dispersing nature of CMBS transactions and the lack of discretion permitted a QSPE, this expansion of paragraph 8.a. is consistent with the intent of the Proposed Interpretation. It leads to greater transparency and comparability of financial statements for investors and it avoids diametrically opposed accounting treatment of the same transaction depending on whether a transferor or its affiliates retains or transfers their interests in a OSPE. For example, if a transferor transfers assets to a QSPE and its servicing subsidiary owns a subordinate interest in the QSPE and acts as a servicer to the QSPE for a fee which cannot be demonstrated as satisfying the market based criteria in the Proposed Interpretation, so long as the transaction satisfies the standards of FAS 140, neither the transferor nor its servicing subsidiary is required to consolidate the QSPE. However, if such transferor later sells its servicing subsidiary, or if the servicing subsidiary sells the servicing (with the same fee) and its subordinated interests in the QSPE to a third party, then the previously non-consolidated transaction must be consolidated by the third party under paragraph 23 of the Proposed Interpretation even though there has been no contractual change in the CMBS transaction other than the identity of the holder of the subordinated interest/servicer. We see no logical reason why any entity holding an interest in a QSPE which meets the requirements of FAS 140 should be required to consolidate the QSPE under circumstances in which neither the transferor nor its affiliates was required to consolidate it. This disparate accounting treatment and resulting consolidation risk for third parties will have a chilling effect on mergers, acquisitions and divestitures in the CMBS industry. It also leads to financial statements which are not transparent to investors, and which are difficult to compare, making it very difficult for investors to evaluate similar companies.

We also request clarification that the "safe harbor" from consolidation under paragraph 8.a. of the Proposed Interpretation also applies to QSPEs under FAS 125, the predecessor to FAS 140, which are grandfathered under FAS 140, since the same rationale exists for the safe harbor in both cases.

(b) Comments to Paragraphs 19, 22 and 23 of Proposed Interpretation

(i) Support for the Concept of Financial SPEs

We support the approach taken by paragraphs 22 and 23 of the Proposed Interpretation dealing with Financial SPEs which own pools of financial assets and are structured to effectively disperse risk with the result that no single entity involved in the transaction must consolidate it. To consolidate this type of transaction in any one entity generally will result in misleading financial statements as discussed below in our general comments on paragraphs 23.b and 23.c. In addition, operationally it will be quite difficult (if not impossible) and expensive to try to determine which entity holding a variable interest in the transaction should consolidate the SPE particularly if this decision must be made on a quarterly basis leading to consolidation and deconsolidation based on incomplete information. We strongly support a financial components accounting approach for these types of transactions which recognizes that financial assets divided into a variety of components is more appropriate accounting for the true economic position of the different participants therein. We support disclosure which explains the context in which the financial component arises in the Financial SPE transaction (or category of similar transactions).

While we understand that in most CMBS securitizations the QSPE issuer of CMBS qualifies as a Financial SPE which satisfies the requirements of paragraph 22 of the Proposed Interpretation, as developed in our comments below, we are concerned that certain portions of paragraphs 19 and 23 as currently drafted could be interpreted in a manner which creates what we believe are unintended results.

(ii) Support for Paragraph 23.a.

We support the language of paragraph 23.a.. We believe that the exercise of the authority to both purchase and sell assets is necessary before an entity should be considered as possibly having sufficient control over the economic outcome of a transaction to undertake the further consideration required by the rest of paragraph 23 to determine whether it may be a primary beneficiary required to consolidate the SPE. In order to have sufficient control over the economic outcome of a transaction, this purchase and sale discretion should affect revenues. expenses, gains and losses of the SPE in a manner that benefits the SPE to a significant extent (excluding dispositions intended to protect security holders from loss). The typical CMBS transaction consists of a fixed pool of mortgage loans; no mortgage loans are added more than 90 days after the closing of the transaction and there is no purchase discretion in the QSPE. A mortgage loan can be sold by the QSPE only after the default of the mortgage loan and then only through the exercise of limited remedies and conditional call options granted to a transferor pursuant to a removal of accounts provision or to the special servicer. We believe that this lack of discretion regarding the purchase and sale of mortgage loans by a QSPE or any agent on behalf of the QSPE is consistent with the view that no party to a QSPE meets the condition in paragraph 23(a).

(iii) Paragraphs 23.b. and 23.c. in General

We strongly support the proposition that there should be a presumption that an Financial SPE will be consolidated only by an entity that holds a majority of the variable interests in the Financial SPE and, as with non-SPEs, consolidation should also be required if a party holds a controlling financial interest through other means which should be assessed similar to the current accounting treatment for non-SPEs. We are quite concerned that to require any holders of variable interests in a Financial SPE (which do not own the assets of the Financial SPE and are not responsible for the liabilities of the Financial SPE while have recourse only to the assets of the Financial SPE) to consolidate the Financial SPE will result in financial statements which are misleading and are neither transparent to, nor comparable by, investors.

Given the nature of a Financial SPE, such SPEs should require consolidation less frequently than other SPEs. However we are concerned that for risk dispersing Financial SPEs, the interplay of paragraphs 23.b. and c. leads to a more restrictive approach to consolidation for Financial SPEs than the general variable interests approach. Paragraph 23 does not have any size requirement for a variable interest that would require consolidation. This is of particular concern to the CMBS market since in most transactions, a subordinate interest holder also acts as special servicer for a fee. If this fee cannot be demonstrated to be market based, then even if the subordinate interest held was quite small, the special servicer would be required to consolidate the QSPE if it is the only entity in the transaction which meets two out of the three parameters currently set forth in paragraph 23. Such an entity does not provide significant financial support to the Financial SPE and should not be required to consolidate the Financial SPE.

(iv) Paragraphs 23.b. and 23.c.: Alternative 1

In order to determine whether an entity provides significant financial support to a Financial SPE, we believe that the two separate conditions in paragraphs 23.b. (subordinate interests) and 23.c. (non-market fees), which both look for a type of variable interest, should be combined in a single test that measures an entity's total variable interests against an appropriate size threshold. We request that FASB revise paragraph 23 so that consolidation of a Financial SPE is required by an entity only if two conditions are met: (a) the entity has discretion over purchase and sale of the Financial SPE's assets which affects revenues, expenses, gains and losses of the SPE in a manner that benefits the SPE to a significant extent (excluding dispositions intended to protect security holders from losses) and (b) the entity holds a majority of the variable interests in the Financial SPE by virtue of holding interests of the types referred to in paragraph 23.b. and/or receiving non-market based fees..

(v) Paragraphs 23.b. and 23.c.: Alternative 2

If FASB rejects our request in Alternative 1, then we request that FASB require consolidation of a Financial SPE only under circumstances in which (x) an entity meets two out of the three conditions in paragraph 23 (subject to the other modifications to paragraph 23

suggested in this letter) and (y) the entity holds a majority of the variable interests in the Financial SPE.

If FASB is unwilling to adopt the majority of variable interests standard for purposes of consolidating a Financial SPE, we request that paragraph 23 be revised so that if any entity meets two out of the three conditions in paragraph 23, no consolidation should occur unless the entity in question owns a substantial portion of the total variable interests in the Financial SPE which is significantly more than the variable interests held by any other individual party.

(vi) Clarification Requested Regarding Paragraph 23.b.

Finally, we request that FASB clarify that the holding of a subordinated security in a Financial SPE by a servicer or collateral manager not be considered asset support for purposes of paragraph 23.b. Unlike a guarantee, a back-up lending arrangement, or other types of liquidity or credit support, once the subordinate security is acquired, no additional investment must be made or risk incurred by the servicer or collateral manager in connection with its investment in such a subordinate security. Such investment is already fully accounted for on the balance sheet and there is comprehensive accounting guidance on recognition of income and possible impairments in value of the investment.

(vii) Clarification Needed Regarding the Interplay between Paragraph 23(c) and Paragraph 19.

We request clarification with respect to the reference to paragraph 19 at the end of paragraph 23.c.. Paragraph 23 permits a party which does not meet at least two of the following three conditions not to be considered as providing significant financial support to the Financial SPE through a variable interest and thus not to have to consolidate the SPE. The three conditions are (a) whether the party has authority to purchase and sell assets for an SPE with sufficient discretion to significantly affect the revenues, expenses, gains and losses of the SPE, (b) whether the party provides liquidity, credit or asset support that is subordinate to the interests of other parties, and (c) whether the party receives a "fee that is not market based (Refer to paragraph 19)."] The first sentence of paragraph 19 states in part "[c]ontracts to provide services to an SPE in return for a fee negotiated at arm's length under competitive conditions (a market-based fee) are not variable interests unless the holder has an investment at risk...". Some in our industry are concerned that the two paragraphs read together mean that no one who has an investment at risk, (i.e. owns a subordinate class of CMBS) and who receives a fee for providing services to the transaction can be viewed as having a "market based fee". In CMBS transactions, the holder of the subordinate interests frequently will act as the special servicer in order to protect its subordinate economic interests and the economic interests of the other security holders in the transaction. The fees paid to special servicers are materially consistent from deal to deal ("market based fees") and are contractually fixed at the inception of the transaction. Accordingly, they do not represent a way for subordinate class holders to create additional variable interests. We do not believe the FASB intended to imply an interpretation which would

suggest that if a holder has a subordinate interest any fees collected by that party could never meet a 'market based' test. We believe that the cross reference in paragraph 23.c. to paragraph 19 exists solely for the purpose of determining the meaning of the term "market based fees" which, for purposes of paragraph 23.c. as currently drafted, means a fee negotiated at arm's length under competitive conditions which can be demonstrated to be comparable to fees in similar observable arm's length transactions. We request a clarification of this in the final version.

(viii) Comments Regarding Market Based Fees

We object to the presumption that a fee is not market-based unless the fee can be demonstrated to be comparable to fees in similar observable arm's length transactions. We agree that there should be simply an objective standard, without a presumption. We believe the objective standard should include any of the following circumstances, all of which may give rise to market based fees: (1) the fees are "market" based on observable similar transactions in the marketplace (including private transactions of which the evaluator and its accountants are aware, since many CMBS transactions are privately placed Rule 144A transactions, not public transactions) or (2) the fee was the result of bargaining between independent substantive entities with an interest in the outcome or was set by one party based on what that party believed to be a market level and then accepted by another interested and independent substantive entity (frequently the case for CMBS transactions) or (3) the fee is the result of competition for a particular transaction or other engagement to which the fee relates.

Given the long history of securitization in the CMBS market, the fact that the assets underlying the securitizations are well understood, the number of transactions completed, some of which are public, and the fact that there exist numerous reputable and experienced servicers providing a competitive CMBS servicing market, we expect that it may be somewhat easier in the CMBS market than in some other structured finance markets to establish observable market rate fees based on "competitive conditions". However, we strongly support the development of new risk dispersing products with new or relatively unique assets involving novel structures in the structured finance market, the economic interests in which are best recognized and disclosed by the financial components approach. The requirement that fees be determined "under competitive conditions" will have a stifling effect on new product development and market liquidity.

Therefore, we request the deletion of the phrase "under competitive conditions" from paragraph 19 since it implies either a competitive marketplace or some type of competitive bid for a fee to be considered "market based".

In addition, we believe that it may be very difficult or impossible to demonstrate "observable" market data due to legally binding confidentiality requirements in non-public transactions which constitute a large portion of the CMBS market, or for novel transactions with a very thin market. Therefore, fees which are negotiated by bargaining between independent substantive entities or which are set by one party at what it believes to be a market level and

accepted by another interested independent substantive entity (frequently the case in CMBS transactions) also should be permitted to satisfy the standard for market based fees, whether or not "demonstrated to be comparable to fees in similar observable arm's length transactions" "under competitive conditions". If the FASB is unwilling to adopt this approach, at a minimum the concept of a "market based fee" should be dynamic and flexible enough to reflect the range of fees payable in transactions which are observable at the time the determination of whether such fee is market based is made (see our comment below as to when this determination should be made).

(ix) Clarification of the Time When Market Based Fees are Determined.

Fees in CMBS transactions are determined at the time the transaction is entered into and cannot be contractually modified without a majority or super-majority vote of one or more classes of the economic interests in the transaction and frequently a statement by the rating agencies rating the transaction that such modification will not cause a downgrade of the ratings of securities issued in the transaction. Older transactions whose fees were market based at the time they were entered into should not be penalized due to changes in market rates for fees in the future, particularly due to the limited contractual ability to modify fees. We request clarification from the FASB that the determination of whether or not a fee is market based occur only at the time the fee is originally negotiated or, if such fee is thereafter contractually modified, at the time of modification.

2. Issues Pertaining to SPE Issuers of CDOs.

We are also concerned about the impact of the Proposed Interpretation on the CDO market. The CDO market is a significant purchaser of both investment grade classes and below investment grade classes of CMBS. Since a robust CDO market is an important CMBS investor for purposes of real estate capital markets liquidity and better execution, both of which benefit consumers of real estate, we reiterate our comments as they relate to paragraphs 19, 22 and 23 of the Proposed Interpretation discussed above since they are applicable to SPE issuers of CDOs as well as of CMBS.

In this regard we note that CDOs should be permitted to qualify as Financial SPEs given the fact that (i) they hold financial assets on a fully diversified basis, frequently (although not always) purchased in the public or private markets and not previously owned by any party participating in the CDO other than in connection with the accumulation of assets intended for the CDO prior to its closing, (ii) they include the risk dispersing features of a securitization allocating and dispersing risks among multiple parties to the transaction, and (iii) financial components accounting leads to the best recognition and disclosure of true economic interests in the transaction.

We urge FASB to revise paragraph 22 to eliminate most limitations on derivatives that may be held by Financial SPEs. The FASB should be aware that almost every CDO includes a rating agency approved synthetic security investment basket for financial assets which can be

held by the SPE issuer permitting investment in credit default swaps and other credit-linked derivatives intended to help diversify the portfolio of assets held by the SPE issuer. Investment in these synthetic securities is generally subject to rating agency review and approval of the types of derivatives held. Synthetic security derivatives are purchased when a direct investment in the security of an issuer is not available on similar terms. There is no reason to distinguish between types of financial assets held by a Financial SPE since the diversification investment objective is the same. We urge the FASB not to force these SPEs into the primary beneficiary analysis outside the scope of paragraphs 22 and 23 simply because, due to the cross reference in paragraph 22 to QSPEs under FAS 140, Financial SPEs permitted under paragraph 22 are limited under clause (2) of paragraph 35 of FAS 140 to holding "[p]assive derivative financial instruments that pertain to beneficial interests (other than another derivative financial instrument) issued or sold to parties other than the transferor, its affiliates, or its agents...". The effect of this is that most CDOs could not qualify as Financial SPEs which is contrary to the FASB's stated objectives underlying paragraphs 22 and 23. CDOs which hold credit default and other synthetic securities which are derivatives should qualify as Financial SPEs within the framework contemplated by paragraphs 22 and 23. Financial component accounting of the derivatives in the transaction should be, and is, addressed by FASB guidance for derivatives.

In addition, we call to FASB's attention the fact that SPE issuers of CDOs are exempt from registration under the Investment Company Act of 1940, as amended, since, among other things, CDOs cannot be publicly sold but must be sold in private placements. Therefor the presumption in paragraph 19 that a fee "is not market based unless it can be demonstrated to be comparable to fees in similar observable arm's length transactions" is even more difficult for a party to a CDO to overcome. This presumption is too restrictive and will force parties in risk dispersing SPEs to go through a burdensome primary beneficiary analysis which will add significantly to transaction costs over the life of the transaction and be difficult to administer given the lack of publicly available information and lack of knowledge of transferred interests. We reiterate our comments made earlier in this letter regarding market based fees under paragraphs 19 and 23 since they also apply to CDOs.

3. Grandfathering and Transition Period

Although we are aware that the FASB has considered this issue in its discussions prior to circulation of the Proposed Interpretation, we request that transactions which were closed before the issuance of the final interpretation be grandfathered since the current accounting uncertainty in this area is having a negative effect on new issuances and market liquidity. If the FASB is unwilling to permit grandfathering of past transactions, we request a longer period of time to permit closed transactions to be modified if appropriate to adjust to the final version and we ask that FASB clarify that such modifications are acceptable under its guidance in connection with the final version. That is, a Financial SPE can be a Financial SPE from the date of such modification even if it was not a Financial SPE at its date of inception. In addition, we ask that the final interpretation be effective for new transactions beginning in a fiscal period more than two months after the release of the final interpretation.

4. Conclusion

We hope our comments are helpful to the FASB in your further consideration of the Proposed Interpretation. We believe that the CMSA's requests for modification and clarification of the Proposed Interpretation will avoid application of the Proposed Interpretation in a manner which would otherwise produce unintended results which would have a chilling effect on the real estate capital markets. Participants in the CMBS market are hesitant to enter into transactions which pose accounting risks which are difficult to interpret and quantify, and which may change over time based on incomplete information.

We would be happy to discuss our comments further with you or clarify any points raised in this letter. If you would like to do so, please contact Robyn Stern at 212-773-7602.

Very truly yours,

Robyn Stein
/cjw/ Robyn Stern