NATIONAL ASSOCIATION OF GOVERNMENT SUBBANIED LENDERS

LETTER OF COMMENT NO. 38

November 14, 2008

Technical Director – File Reference 1610-100 Financial Accounting Standards Board 401 Merritt 7 PO Box 5116 Norwalk, Connecticut 06856-5116

RE: Proposed FASB Statement, Accounting for Transfers of Financial Assets – An Amendment of FASB Statement No. 140 (File Reference No. 1610)

Dear Technical Director:

The National Association of Government Guaranteed Lenders (NAGGL) is a national trade association that for 25 years has represented approximately 700 banks, credit unions, non-depository lenders and service providers who participate in the Small Business Administration's 7(a) loan guarantee program. The 7(a) program's public policy purpose is to provide access to credit for the many small businesses unable to qualify for loans in the commercial marketplace. Small business owners need access to capital to succeed and SBA lenders offers the primary vehicle for delivering much needed, long-term capital. As the association that represents the institutions responsible for over 80% of the SBA's 7(a) loan volume, we appreciate the opportunity to comment on the Proposed Statement of Financial Accounting Standards, FASB No. 140, Accounting for Transfers of Financial Assets – An Amendment of FASB Statement No. 140 (No. 1610-100, September 15, 2008) (the Proposed Statement).

As originators of SBA 7(a) loans, our members have communicated to NAGGL their strong concern about the Amendment to FASB No. 140 currently under consideration. The concern revolves around the negative impact the Proposed Statement will have on participating interests, and the result that the proposed accounting treatment may not be consistent with the underlying economics of the transaction.

Under the SBA's 7(a) program, the federal government guarantees a portion of the loan (generally 75%). Over many years, an active secondary market has developed for the guaranteed portion of 7(a) loans. SBA statistics show that 40% of all 7(a) loans' guaranteed portions are sold into the secondary market. Before the guaranteed portion is participated, the originating lender must enter into a three-party agreement with the SBA and the registered holder or a broker/dealer (Buyer). The terms of this agreement are found in SBA Form 1086, Secondary Participation Guaranty Agreement, which requires that a minimum fee be retained by the lender.

SBA lenders sell the guaranteed portion of a 7(a) loan for a premium and retain the unguaranteed portion plus at least the minimum fee of 1%; or, they sell the guaranteed portion of the loan to retain a fee in excess of 1%. After the loan participation, payments from the borrower are split on a pro-rata basis, generally equal to the percent of the SBA guarantee. On the other hand, the Buyer's interest is reduced not only by the fee



retained by the lender, but also by other SBA required fees. In the event of loan default, the SBA purchases the Buyer's interest in the loan, and the lender and SBA share in the liquidation proceeds and expenses on a pro-rata basis.

Additionally, when the guaranteed portion is sold for a premium, the lender is subject to two warranties as delineated in *SBA Form 1086*, (6-02), OMB NO.: 3245-0185: The first warranty is "If the borrower prepays the loan for any reason with 90 days of the Warranty Date, the Lender must refund any premium received." The second warranty is "If the borrower fails to make the first three monthly payments due after the Warranty Date and the borrower enters uncured default within 275 calendar days from the Warranty Date, Lender shall refund any premium received." The Warrant Date is the date that the loan participation is settled.

NAGGL is particularly concerned about the effect of Paragraph 8B on the vitality of the SBA 7(a) lending program. In the Proposed Statement, Paragraph 8B (a) states that a participating interest represents a proportionate ownership interest in an entire individual financial asset. Our members who are active in the 7(a) secondary market question the potential negative impact of such a change:

- How would an SBA guarantee impact the proportionate ownership interest?
- If a lender retains a fee greater than the 1% minimum required by the SBA 1086 Agreement (as is common in the 7(a) secondary market), what would the impact be on the proportionate interest?

Paragraph 8B (b) states, "All cash flows received from the asset are divided among the participating interests ... in proportion to the share of ownership represented by each." In the SBA secondary market, after the guaranteed portion of a SBA 7(a) loan is participated, the Buyer has a full faith and credit guarantee of the United States. Therefore, typically the Buyer receives a market yield on the guaranteed portion that is substantially lower than the borrower's note rate.

 Because of the difference between the note rate and the Buyer's guaranteed portion, would the transaction fail to meet the requirements of this proposed paragraph 8B (b)?

NAGGL has reviewed several earlier comment letters and agrees with the opinion voiced in them that origination fees and the cash flows received that represent the transferor's gain or loss on the sale of a portion of a financial asset should be <u>excluded</u> from the requirements of paragraph 8B(b) of the Proposed Statement.

Paragraph 8B(c) of the Proposed Statement says that "The rights of each participating interest holder ... have the same priority." By SBA program requirements, if an SBA 7(a) loan defaults, the SBA purchases the guaranteed portion from the Buyer. The lender and the SBA proportionally share the proceeds and expenses of the liquidation. NAGGL believes that given the requirements of paragraph 8B(c), the SBA's purchase of the guaranteed portion from the Buyer would result in a violation of this provision.

There are also outstanding concerns whether SBA Form 1086 Agreement's terms regarding the two warranties (90 day prepayment warranty and the first three monthly

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payments warranty) for SBA 7(a) loans would qualify as standard representations and warranties, or represent a form of recourse?

One NAGGL member, Citigroup, provided comments authored by their vice president and deputy controller, Robert Traficanti on October 30, 2008. NAGGL supports Mr. Traficanti's statement: "The concept of a participating interest adds unnecessary complexity to the proposed Statement, which we believe is unwarranted. We recommend that this concept be eliminated from the proposed Statement and, instead, require transfers of both entire financial assets and portions of a financial asset to meet the same criteria for sale accounting. We believe that the application of the requirements in paragraph 9 to all transfers of financial assets, including transfers of a portion of a financial asset, should be conceptually consistent and should not result in two economically identical transactions being accounted for differently." In addition, we support other members, such as United Western Bancorp, Temecula Valley Bank, and Excel National Bank, when they assert that the sale of a participation of a senior or junior portion of a financial asset should not preclude sale accounting, and that other accounting guidance (including FAS 5), adequately addresses the need to consider whether a warranty claim needs to be accrued. As lenders service their loans, they are aware of any payment default. The warranties required by SBA Form 1086, (6-02), OMB NO.: 3245-0185, should not preclude sale treatment of the participating interest.

If the participations of SBA 7(a) guaranteed portions fail to meet sales treatment under the new requirements of paragraph 8B of the Proposed Statement, many lenders will abandon the SBA government guaranteed lending programs that often represent the last recourse for a small business to access credit to start and grow their company. We all know that providing credit to small businesses is critical to our economy. On behalf of our member lending partners, I thank you in advance for your positive consideration of this request. NAGGL wants the SBA program to continue to be the fuel that drives the economy.

Respectfully.

Anthony R. Wilkinson President & CEO