



LETTER OF COMMENT NO. 10



Citigroup Inc.
909 Third Avenue
19th floor
New York, NY 10022

September 14, 2007

Mr. Russell G. Golden
Director of Technical Application & Implementation Activities
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Re: Proposed FASB Staff Position No. FAS 140-d, *Accounting for Transfers of Financial Assets and Repurchase Financing Transactions*

Dear Mr. Golden,

We appreciate the opportunity to comment on the proposed FASB Staff Position No. FAS 140-d, *Accounting for Transfers of Financial Assets and Repurchase Financing Transactions* (the proposed FSP). We have several conceptual and operational concerns about the guidance in the proposed FSP and do not support its issuance. We believe that introducing another model for linking transactions into the accounting literature introduces new complexity in US GAAP without any material improvement in financial reporting. Further, we believe the off-balance sheet financing implications of the proposed guidance are significant and would create a material lack of transparency in financial statements. Beyond our conceptual concerns, we believe that developing the systems needed to obtain the data required to comply with the proposed guidance will require multiple years and material resources and will be useful for no other business purpose.

Clarification of Intent

We ask that the Board reconsider its objectives in issuing the proposed FSP. We generally believe that FSPs and other new accounting guidance are appropriate when either (a) there is diversity in practice among preparers or (b) existing literature or interpretations result in financial reporting that is either not transparent or is not consistent with the underlying economics of transactions. Neither is true for repurchase financings.

We believe that current practice is relatively uniform in considering repurchase financings to be two distinct transactions that are accounted for separately in most cases. While we can conceive of transactions where the sale of a financial asset and concurrent repurchase financing are so closely tied economically and contractually that they merit joint consideration for accounting purposes, those transactions are extremely rare in

practice, in our view, and the current proposal goes well beyond addressing those unique situations.

We believe that the balance sheet treatment under current practice accurately and transparently conveys to financial statement users the risk position to which seller and the buyer of the financial asset are each exposed and the financial asset that each controls. Further, we do not understand what abuse the Board sees in current practice. Indeed, paragraphs A2-A4 of the proposed FSP are labeled “the Need for Improvement in Financial Reporting,” yet these paragraphs merely summarize the Board’s understanding of current practice without actually presenting any argument that current practice results in misleading financial reporting. If it is the Board’s belief that constituents are avoiding income statement volatility resulting from mark-to-market accounting by executing sale and repurchase transactions separately, we observe that since combining the sale and repurchase transactions results in a derivative instrument subject to FASB Statement No. 133, *Accounting for Derivatives and Hedging Activities*, that derivative could be designated as an all-in-one cash flow hedge of the anticipated bond purchase, with all mark-to-market changes reflected in other comprehensive income¹. In other cases, the forward contract may be subject to EITF Issue No. 96-11, *Accounting for Forward Contracts and Purchased Options to Acquire Securities Covered by FASB Statement 115*, which also may result in the combined transaction not being marked to market through earnings.

We further observe that these repurchase financings are executed as separate transactions (rather than a forward purchase) for valid business reasons. There is generally more liquidity in the sale and repurchase markets versus the forward contract market. In addition, buyers of financial assets generally separate the purchase of an asset from the financing of that asset in order to obtain best execution on each transaction. The financial assets purchased are under the economic control of the purchaser, and purchasers can and often do seek financing for those purchases from counterparties other than the seller both at inception and over the term of the financial asset.

Therefore, we believe that the Board should not proceed with issuance of the FSP as proposed. However, if the Board does decide to proceed, we have further comments on the specifics of the proposal, as noted below.

Other Linkage Considerations

If the Board proceeds with this project, we request that the Board consider whether it is prudent to introduce another model for linking transactions, particularly one which is designed for a specific fact pattern. We believe that a fundamental tenet of the accounting literature for asset transfers is the separate accounting for separate transactions. In cases where the presumption of separateness is overcome, combination is appropriate. The proposed FSP takes the opposite approach, presuming combination of transactions unless proven otherwise. We are aware that the approach for presumed

¹ Derivatives Implementation Group Issue G2, *Hedged Transactions That Arise from Gross Settlement of a Derivative (“All-in-One” Hedges)*



separateness was considered and rejected in deliberations and ask the Board to reconsider whether this is a prudent approach.

If the FASB continues to believe an updated linkage model is necessary, we suggest that it consider the utility of the existing linkage models. Currently, linkage models exist in both Derivatives Implementation Group Issue K1, *Determining Whether Separate Transactions Should Be Viewed as a Unit*, and EITF Issue No. 98-15, *Structured Notes Acquired for a Specific Investment Strategy*, and a similar model was contemplated in EITF Issue No. 02-02, *When Certain Contracts That Meet the Definition of Financial Instruments Should Be Combined for Accounting Purposes*. While directed at specific fact patterns, each of the models incorporates notions of contemporaneous and in-contemplation execution and substantive business purpose. These principles are consistent with the criteria many constituents already apply in practice to determine whether a sale transaction and a financing transaction are so closely linked as to merit joint consideration. We suggest that the Board either expand the scope of these existing models to embody a broader transaction set, or include the concept of contemporaneous/in contemplation execution in the proposed FSP.

Clarification of Scope

We ask that the FASB further refine the definition of repurchase agreements, clarifying the scope of the proposed FSP. While paragraph 4 references the term repurchase agreement as defined in Statement 140, footnote 2 may be read to broaden the scope of the FSP significantly to incorporate many types of financing arrangements other than repurchase agreements. We question whether other types of financing transactions create whatever concerns the Board has with “repurchase financings” and whether they should be within the scope of the FSP.²

Defining Business Purpose

We believe one proposed criterion for separately accounting for a transfer and related repurchase financing (that is, the “transactions have a valid and distinct business or economic purpose for being entered into separately”) establishes a principle that could be applied in practice (In fact, it is similar to one of the criteria in DIG Issue K1). However, we believe the more detailed rules in paragraphs 7(a) through 7(c) are neither appropriate nor sufficient indicators of business purpose. The validity of a business or economic purpose is dependent upon the facts and circumstances of the subject transaction. For example,

- We disagree that transactions involving instruments valued with Level 1 inputs have a valid business purpose, while transactions involving instruments valued with Level 2 inputs do not. Paragraph 25 of FASB Statement No. 157 notes specifically that the distinction between a Level 1 instrument and a Level 2 instrument may be no more than a preparer’s chosen valuation practice for certain assets and have nothing to do with the financial instrument itself. We do

² Alternatively, if the Board ultimately identifies a more narrow set of conditions under which transactions must be linked, this broad scope may be less of a concern.



not understand why a company's own valuation practices could possibly indicate whether a repurchase financing transaction has a valid business purpose.

- We disagree that whether a financing has full or limited recourse is an indicator of whether the transaction has a valid business purpose. Limited recourse arrangements exist frequently in the normal course of business and simply reflect a lender's tolerance for credit or market risk.

We believe the analysis of business purpose is best left to the reporting companies and should continue to be a facts and circumstances determination.

Contemporaneous Execution or Contemplation

The proposed FSP indicates that the "lapse of time between the initial transfer and the repurchase agreement is not relevant when determining if the transaction is a repurchase financing within the scope of the FSP." We believe that linking the accounting for transactions without consideration of the length of time between those transactions is a radical idea with little precedent in the current accounting literature. This aspect of the proposal is the most serious practical and conceptual flaw in the proposed FSP.

Because the proposed guidance presumes linkage and certain of the criteria to overcome that presumption would not be met in certain fairly common transactions (for example, non-recourse financings, financings using securities valued using Level 2 or Level 3 inputs, and financing permitting rehypothecation of collateral), every preparer must be prepared to monitor the counterparty for each sale and purchase transaction. This evaluation will be complicated by the need to identify what constitutes "substantially the same asset" as well as a potential lack of historical data for all entities included in the consolidated financial statements. This is a monumental data-gathering exercise for existing transactions (in transition) and a major task to add to current systems. Systems will require modification to maintain, perhaps indefinitely, all sales or purchase transactions in a given asset, and also the ability to access that information from any legal entity or financing desk around the globe. For a long-dated asset such as a thirty-year bond, activity tracking could be required for the entire thirty-year period until maturity. We believe that few, if any, global institutions operate on a single platform that could currently support such a requirement globally and it creates an unreasonable reporting burden.

We also believe that attempting to link transactions executed at different times creates fairly significant accounting issues. Consider the following fact pattern:

On January 1, 2008, Company purchases a bond from Citigroup for \$100 and classifies it as held-to-maturity for purposes of SFAS 115, *Accounting for Certain Investments in Debt and Equity Securities*. As of March 31, 2008, the bond has appreciated in value to \$120 and the Company transfers it Citigroup under an agreement to repurchase. For simplicity, ignore any haircut and assume Citi provides \$120 in cash to the Company. The Company agrees to repurchase the security for \$120 (plus periodic interest payments).



We believe this fact pattern raises the following questions:

1. Does the March 31 financing trigger earnings recognition of the \$20 appreciation, even though sale accounting under SFAS 140 has not been met? Although the Company cannot continue to recognize the initial transaction as a purchase, the Company has not relinquished either control or the “risks and rewards” of the bond, and, therefore, we do not believe that entering into the repo financing represents an appropriate earnings event.
2. If the \$20 in appreciation is not recognized in earnings at the time of the financing, what is the liability that the Company would record? It receives \$120 in cash and must remove the bond (recognized at cost of \$100) from its balance sheet. The Company must record some credit for \$20, but it is not clear to us that this amount meets the definition of a liability. (Note that this \$20 is not related to the forward contract, which is an at-market agreement and has no intrinsic value.)
3. Is *termination of the financing and re-recognition of the bond* a new event for purposes of SFAS 115 such that a bond could be newly reflected as available-for-sale, or trading with a new cost basis? If not, why not, since the bond has been de-recognized (and was in fact treated as a purchase by the original seller under paragraph 55 of Statement 140)?
4. If instead of appreciating, the bond had depreciated in value to \$80, would the Company continue to assess other-than-temporary impairment during the term of the repurchase contract, even though the bond is not on the Company’s balance sheet?

Similar questions exist if the Company had classified the bond as available-for-sale. We believe it is important for the Board to address these questions, as we believe there are no analogous situations in the current accounting literature (these issues are created by the proposed linking of transactions that occur at different times and not in contemplation of each other). The Board could avoid these issues and conceptual problems by linking only transactions that are executed contemporaneously or in contemplation of each other.³

Off-Balance Sheet Financing Implications

Assuming that one is able to access the historical sale data and accurately define what is the “substantially the same asset,” we expect that the accounting for this series of transactions will differ depending on the counterparty, as indicated in the following scenario.

Assume that a customer buys a bond from Citigroup today. One year from now, the customer needs financing. If the customer executes a repurchase transaction with Citigroup (that does not meet all of the criteria in paragraph 7 of the FSP), it is reflected as a forward contract; the bond and the financing liability are not reflected in the customer’s financial statements. If the customer executes a repurchase transaction with an institution unrelated to Citi, the bond and the

³ Of course, other criteria would need to be used as well, since tracking information even contemporaneous transactions would create substantial implementation burdens, since the sale and financing transactions are generally not executed in contemplation of each other.



financing liability are reflected on the customer's financial statements as an asset and a liability, with related interest income and interest expense.

Customers can create off-balance sheet financing opportunities by managing their securities trading counterparties. Investment portfolios and associated financings can be actively managed – dialed up or down at will – simply by choosing the appropriate counterparty for financing. We believe that this ability to “choose-your-own” accounting for identical – and common -- transactions will create a significant lack of transparency to financial statement users regarding a company's financing activities and alter the apparent extent of leverage in the company. We believe this is a disservice to the company's investors, creditors and other financial statement users.

Marketability

Paragraph 7(c) requires that a sale and repurchase transaction be linked if the asset does not have a quoted price in an active market. An active market is defined by the proposed FSP as Level 1 inputs in FASB Statement 157, *Fair Value Measurements*. We understand that the FASB believes the uniqueness of some assets may lead to what it believes is a lower than market rate on the repurchase financing, compelling the initial transferee to execute the repurchase financing with the transferor and providing the transferor with control over the subject assets. In our experience, the financing rate has nothing to do with any desire to maintain control of the transferred asset.⁴ Rather, the pricing on the repurchase agreement and the haircut on the financing extended are indicative of the transferor's institutional knowledge of the underlying collateral, its ability to estimate the value of the collateral, and the credit risk of the counterparty. Further, in most cases, the business units that execute the repurchase financings are entirely separate from those that are buying and selling the subject securities and these units do not make joint decisions about whether to execute the sale and the financing transactions. Given these factors, it is difficult to substantiate the view that a reporting entity is actively pricing its repurchase financings at a level designed to permit continued control over the subject assets. Accordingly, we suggest that the Board remove the first sentence in paragraph 7(c) and simply require that the two transactions be executed at market rates.

If the Board believes that the marketability of an asset is a key condition, we believe that assets valued using either Level 1 or Level 2 inputs would generally meet a reasonable threshold of market liquidity and valuation precision. Many asset-backed and corporate securities, are valued using Level 2 inputs, are not particularly unique and are very liquid.

Effective Date & Transition

We ask the Board to consider whether the proposed FSP can be effective on a prospective basis. Given that repurchase transactions are generally short-term in nature, we believe that periods presented would be substantially comparable.

⁴ Indeed, if the seller wished to maintain control of the financial asset, attempting to do so via a repo financing would be a particularly poor way of doing so, since the buyer generally has broad discretion to repay the financing or substitute collateral and eliminate any legal rights the seller has to the asset at all.



As indicated by the complexities highlighted above, we believe that the historical data required to accommodate the analysis in the proposed FSP is significant. As described, we expect that preparers will need the capability to evaluate all current and historical securities transactions for and across all subsidiaries, agents and affiliates. To build this capability into existing systems will require significant enhancements and systems overhauls. We further believe that reporting entities would need to systematically define and implement definitions of “substantially the same security” for sale and subsequent repurchase transactions. This type of undertaking cannot be completed by January 1, 2008 (the effective date for calendar year companies). We have not had sufficient time during the comment period to scope fully the system changes that would be required to be able to implement the FSP, but believe that it would likely be a multi-year effort.

We would be pleased to discuss our views on this proposed FSP. You may contact me at 212-559-7721.

Very truly yours,

Robert Traficanti
Vice President and Deputy Controller