Thank you for the opportunity to comment from an attorney's perspective on the setoff issue under consideration in connection with FASB Statement No. 140. I have four comments to make.

1. All participation agreements of which I am aware provide for the sharing of setoff proceeds among the lead bank and the participants. Each lender typically is required to purchase and sell additional participations as needed to maintain the contractual participation levels after any exercise of the right of setoff. The concern raised in the Request for Information will arise only when the lead bank is unwilling or unable to fulfill its contractual obligation to conform the lenders' holding after the exercise of the right of setoff. Is the possibility that one party to a contract will not or cannot perform enough to support a conclusion that the other party to the contract has no ownership rights in the subject of the contract? Consider the analogous situation where one bank has a deposit with another bank. The fact that the depository bank may not or cannot perform its obligations under the deposit agreement does not alter the conclusion that the first bank can show the deposit on its balance sheet.

2. The setoff issue is significant only if the FDIC (or comparable insurance provider for non-bank depositories) were to refuse to honor the participation agreement by not sharing the setoff proceeds with the participant banks. In order to make an accurate assessment of the this issue, the FDIC's position on this issue must be explored.

3. It is important that the setoff issue not be allowed to become bigger than it should be. In most cases, the amount of the deposits will be a small fraction of the size of the loan. A concern regarding the impact of setoff rights with respect to a small deposit should not result in the disqualification from sale treatment of the entire balance of a much larger loan. If the right of setoff is to affect sale treatment, it should only have an effect to the extent of the balance in the deposit account from time to time. From a bank lending limit perspective, a partial loss of sale treatment due to the balance in a deposit account does not present a problem because under Federal (and possibly many state) lending limit laws, the deposit account supports a loan in the amount of the deposit without regard to other lending limits that might be applicable.

4. The 2001 revisions to Uniform Commercial Code Article 9 introduce a wrinkle to the setoff issue that was not present in most states prior to the revisions. Under the revisions, a secured party may obtain a security interest in deposit accounts and a depository bank may have an automatic security interest in its own deposit accounts to secure all loan obligations of the depositor. Accordingly, an analysis of the setoff issue only addresses part of the problem. The depository bank has, or at least can obtain, a security interest that parallels the right of setoff. Since the security interest is statutory and contractual in nature, it is much easier to analyze and customize than the common law right of setoff. In particular, it may be possible for the the lead bank in a participation to take a security interest in the deposit account for the benefit of all of the lenders just as the lead bank might take a security interest in the depositor's accounts receivable, inventory or other assets. Such a security interest would be available for the pro rata benefit of all of the lenders notwithstanding the uncertainties of the right of setoff.

Thank you for your consideration of these comments.
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