May 10, 2004

TA & I Director,
Financial Accounting Standards Board
Setoff and Isolation
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Re: FASB Staff Request, Setoff and Isolation

Dear TA&I Director:

The Pennsylvania Credit Union Association (PCUA) is a statewide trade association that represents approximately 90% of the 690 credit unions that are located in the Commonwealth of Pennsylvania. Credit unions are increasing the extent to which they utilize loan participations to manage their consumer loan portfolios. In addition, credit unions are increasing the origination of small business loans to their members. Accordingly, the accounting treatment of loan participations has emerged as a significant issue within the credit union community. The PCUA appreciates this opportunity to comment on the Financial Accounting Standards Board (FASB) staff request regarding FAS 140 and setoff and isolation.

The FASB staff request identifies one significant issue: whether a loan participation transaction that includes the right of setoff sufficiently isolates the transaction to justify an accounting treatment wherein the lead institution documents the transaction as a sale of a particular portion of the asset. For example, if a credit union were to sell 90% of a small business loan, its records would reflect ownership of only 10% of the asset.

The presence or possibility of the exercise of the common law right of setoff or similar remedies should not impact the sales treatment of a loan participation transaction. A multitude of variables could apply to the loan participation such that setoff rights might not be invoked. The participation agreement might limit or alter the remedies available to the lead institution and participants. Though a depositor would hold setoff rights by virtue of any deposits held by the institution, the timing or actual exercise of such rights could be impacted by the nature of the
In the case of a bank or credit union liquidation, the depositor would exercise rights subject to the administrative rules of the appropriate regulator. Any action taken outside of the proceeding might be undone by the regulator's claim regarding fraudulent transfers pursuant to state law. In the case of a bankruptcy, Federal Bankruptcy laws dictate the exercise of debtor-creditor rights and remedies. In the event a party invoked setoff at or near the time of the bankruptcy, the transaction could be reversed by the bankruptcy trustee pursuant to Federal law.

Disallowing sales treatment for loan participations that include rights of setoff creates undue portfolio management burdens for credit unions. Credit unions utilize loan participations to manage credit risk and liquidity needs. The proposed amendments to FAS 140 could foreclose a legitimate avenue that enables a credit union to achieve the appropriate balance of real estate loans or manage ceilings that are imposed against business loans. Realistically, credit unions could be forced to curb lending activities in response to FAS 140, thereby decreasing credit available from non-profit financial cooperatives.

Setoff is a significant legal remedy in a debtor-creditor relationship. However, its exercise is not absolute. Common law or contract rights can be impacted by the facts and circumstances of each individual transaction or legal proceeding. Therefore, the FASB could reasonably conclude that setoff does not impact the isolation of an asset from the originating institution. Sales treatment should continue to apply to a loan participation or similar transfer of an asset consist with the availability of setoff as a legal remedy.

Sincerely,

Pennsylvania Credit Union Association

Richard T. Wargo, Jr., Esq.
Sr. Vice President/General Counsel

cc: Regulatory Review Committee
PCUA Board of Directors
J. McCormack
Mary Dunn, Credit Union National Association