We appreciate the opportunity to comment upon the proposed amendment to FASB Statement No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities concerning the effect of setoff rights on sale treatment.

We are counsel to numerous credit unions, many of which frequently engage in participation loan transactions. In doing so, our credit union clients uniformly intend to affect a complete transfer of ownership in the underlying loan or applicable portion thereof (a so-called "true sale"); not a secured borrowing. To that end, and in accord with the clear market expectation and acceptance of such classification, we strongly urge the Financial Accounting Standards Board to reconsider its conclusions regarding the impact of potential setoff rights on FAS 140 sale treatment or, alternatively, to adopt appropriate methods to facilitate sale transactions in the participation environment. Moreover, we highlight below a crucial distinction between credit unions and conventional financial institutions that renders the Board's concerns about the impact of common law setoff rights on the FAS 140 isolation criterion irrelevant in the credit union context.

The existence of a potential common law setoff right should not preclude "true sale" treatment.

While we leave it to others to debate the finer points of the nature of setoff rights, we do not view the possible existence of this "defense", in isolation, as dispositive of the isolation factor. To date, our sale versus financing analysis in relevant part has largely focused on the "risks and rewards" of owning an asset. Under this rubric, the setoff right is simply a defense to which the buyer takes an asset (or a proportionate risk of loss), which could adversely affect the buyer's ability to collect fully the amount to which it is contractually owed. To address this risk, a buyer may, for example, negotiate for a provision in the purchase agreement for the sharing of setoff proceeds. Assuming arguendo that a common law right of setoff is available to a borrower/depositor in the participation context, and setting aside whether the amount on deposit is outside insurable limits, this factor alone should not preclude "true sale" treatment.

Common law setoff rights may be lawfully extinguished.

Continuing with the assumption that there is in fact a common law right of setoff available to a member/borrower or receiver in the insolvency context, and that the existence of that right negates sale treatment under existing FAS 140 standards, there are practical and legally justifiable solutions that the Board should consider to properly address this issue.

N.Y.S.2d 650 (1991) (waiver of setoff right by borrower and guarantor not against public policy); Loader Leasing Corp. v. Kearns, 83 F.R.D. 202 (W.D. Pa. 1979) (right of setoff may be contractually waived). We are unaware of any court decision to the contrary. A provision that the borrower and lender specifically waive any rights to setoff with respect to participated loans could, for example, be included in the underlying loan documents.

The common law setoff right is inapplicable in the credit union context.

Whether or not the Board's concern for setoff rights generally is warranted, such rights do not apply to credit unions, as nonprofit, democratically controlled, financial cooperatives owned by their members. Members of credit unions, in contrast to account holders in conventional financial institutions, by virtue of their share accounts, are equity owners, not creditors of the credit union. A member's status as a "shareholder" or "owner" is perhaps best exemplified by the payout provisions in the regulations implementing the Federal Credit Union Act to "creditors and members" upon voluntary or involuntary liquidation. Pursuant to Parts 709 and 710 of the National Credit Union Administration Regulations "members" or "shareholders" are paid only after secured and unsecured creditors have been paid in full.

As stated in the FASB Staff Request for Information, it is generally accepted that a common law right of setoff requires mutuality. This principle means that common-law setoffs are permitted only when parties hold offsetting obligations in the same capacity or under the same circumstances. See Carbajal v. Capital One, 219 F.R.D. 437 (N.D.III.2004). As described above, a credit union's obligation to a member as a depositor/equity owner is qualitatively different than the member's obligation to the credit union as borrower. There being no mutuality, the common law right of setoff is unavailable to either party in the insolvency context. A contrary result would be inequitable and wholly contrary to well-understood priority schemes. Kansas Credit Union League v. Redmond, 216 Kan. 451 (1975) provides further support to this analysis. In that case, the Supreme Court of Kansas held that, because Kansas statutes concerning the liquidation of credit unions provided that shareholders share in a distribution of assets only after all other liabilities to creditors are paid, a borrower/shareholder could not offset its obligation against its share account. Thus, where credit unions act as lead lenders, common law setoff rights are properly not considered in reaching conclusions about the isolation of transferred assets.

Thank you for your time and consideration of our views on this matter. Please contact me at if you should need any additional information.

Terri Keeley
Moore, Brewer, Jones, Tyler & Wolfe
4180 La Jolla Village Drive, Suite 540
La Jolla, CA 92037
Phone 858.626.2880
Fax 858 626.2899
tjk@mbjtw.com

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