October 10, 2005

Attention: Technical Director
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116
Via email: director@fasb.org


File reference No. 1225-001

Dear Director:

America’s Community Bankers (“ACB”)\(^1\) is pleased to comment on the Exposure Draft (“ED”) issued by the Financial Accounting Standards Board (“FASB”), containing proposed amendments on the accounting for transfers of financial assets. ACB appreciates FASB’s efforts to clarify the conditions under which a qualifying special purpose entity (“QSPE”) is required to achieve sale accounting and its continued work on improving the transparency and comparability of financial statements. The proposed standard introduces some new criteria for sale accounting treatment and derecognition of portions of financial assets when transferred as loan participations. Our comments will focus on the concerns that ACB has on the potential impact that the proposed standard could have on community banks’ ability to maintain sale accounting treatment for loan participations and the additional undue burden and costs associated with obtaining a true sale legal opinion.

**ACB Position**

ACB believes that the language on obtaining a true sale opinion in Appendix A of the proposed standard is ambiguous and, if maintained, will result in increased costs and unnecessary complexities for community banks. ACB has closely monitored FASB’s

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\(^1\) America’s Community Bankers is the member driven national trade association representing community banks that pursue progressive, entrepreneurial and service-oriented strategies to benefit their customers and communities. To learn more about ACB, visit [www.AmericasCommunityBankers.com](http://www.AmericasCommunityBankers.com).
extensive deliberations on the FAS 140 amendment, and we certainly appreciate FASB’s efforts to amend an earlier proposal that would have required that loan participations be performed through a QSPE in order to gain sale accounting treatment.

We also appreciate FASB’s efforts to try and reach a workable solution in allowing loan participations to maintain sale accounting. However, we are very concerned about the implementation guidance provided in Appendix A, especially the language in paragraphs 27 and 27A, with regards to participations being deemed a “true sale at law.”

**True Sale Opinions**

Paragraph 27A is especially troublesome and vague, in that it asserts “A transfer of a financial asset... is considered to have isolated the transferred financial assets only if a legal analysis would support the following conclusions under laws in the applicable jurisdiction.” Paragraph 27A goes on to discuss the nature of a true sale opinion to support a conclusion that financial assets have been isolated and that a true sale opinion is often required. It is our understanding that legal opinions are not “often” required, especially when smaller community banks do loan participations. Rather, it is rare for these banks to incur the significant expense of a true sale legal opinion in connection with their loan participation agreements. Loan participations are used extensively by community banks of all sizes in the ordinary course of business with the intent to “sell” an interest in the loan, so that for a variety of reasons, the transferred portion of the interest can be removed from the asset side of the balance sheet.

The process of obtaining a true sale opinion is costly and usually only available from sophisticated law firms, which makes it even more difficult and unlikely that banks in smaller markets will be able to readily obtain the opinions when doing participations. The opinions are based on the facts given to the lawyers through representations and warranties made by management. The opinions are only as good as these factual representations and contain so many assumptions and qualifications that they are really of little value.

Paragraph 27 of Appendix A concludes with the statement, “A legal opinion is not required if a transferor has a reasonable basis to conclude that the appropriate legal opinion would be given if requested.” It further provides that a “transferor might reach a conclusion without consulting an attorney if it had experience with other transfers with the same facts and circumstances, including under similar applicable laws and regulations.” ACB believes that this disclaimer will provide little assistance to community banks who have done “good” participations for many years, and will further open for challenge any participations that do not obtain a true sale opinion. ACB believes that the “expectation” that entities will obtain the opinion will be interpreted as “required” in practice. We are very concerned about the subjective criteria that would be used in evaluating the satisfaction of a legal definition to determine if a loan participation qualifies for sale accounting, absent a standardized agreement.
Standardized Agreement

Some of the concerns surrounding the dilemma of obtaining true sale opinions might be resolved through the development of a “standardized” participation agreement that would be expected to meet the criteria set forth in the ED and would presumably gain a true sale legal opinion. However, upon further analysis, we are unconvinced that such a standardized agreement could ever be developed. The ED does not provide a standard agreement that would qualify a participation as a “true sale”, and it is unlikely that any legal or accounting organization could establish such an agreement that would be universally accepted. ACB is concerned that absent a standardized agreement that would limit the costs of obtaining an opinion, varying participation agreements and the associated legal opinions remain exposed to inconsistencies when external auditors and others evaluate whether individual participations qualify for sale accounting treatment under the proposed FAS 140 amendment.

Unintended Consequence of FASB’s Project to Amend FAS 140

FASB’s project on QSPEs and the isolation of transferred assets emerged in light of the fall-out from the highly publicized off-balance-sheet scandals epitomized by the Enron Corporation scandal. ACB believes the current dilemma on how to properly structure loan participation agreements in order for banks to maintain favorable sale accounting treatment and derecognition has become an unfortunate and unintended consequence of FASB’s FAS 140 amendment project and a focal point of its deliberations. ACB and other observers in the banking industry, including the federal banking regulators, have consistently maintained that there were no abuses when banks engaged in loan participation transactions, nor were there any instances of financial institutions misusing the structures for financial statement misrepresentations. Loan participations are well-understood and widely used in the banking industry, and ACB believes that they should have been scoped out of the FAS 140 amendment altogether.

In current practice, banks take extensive precautions to ensure that proper due diligence is performed to ensure that both parties’ interests, future payments and credit risks are shared on a pro-rata basis. If FASB moves forward with the implementation guidance in Appendix A with regards to isolation and true sale legal opinions, ACB is concerned that many smaller banks will lose a vital risk management tool, and face further competitive disadvantages upon losing the ability to diversify credit risk and accommodate larger customer borrowing needs.

Recommendation

ACB believes there is a way to avoid the confusion and burden generated by the new language in paragraphs 27 and 27A. The better approach is to require that certain conditions, established by case law as important in defining sales transactions, be met to get sale treatment. As presented by lawyers to the FASB at the roundtables in 2004, these conditions include an intent by the lead bank to sell an interest in the proceeds of the loan, no right of recourse by the participant against the lead bank, the right of the
participant to repayment only after the lead bank is repaid by the original borrower, and
durations of the loan participation and the underlying loan that are identical. With
specific conditions established, the banking industry can develop standard agreements
that can be used in loan participation transactions, rather than having to rely on the
wasteful, fact-specific review of lawyers in different jurisdictions. We urge FASB to
reconsider the language in Appendix A that infers a legal opinion will be “required.” We
believe that a less burdensome, more consistent and more practical alternative is
available. This approach will also assist the auditor in quickly identifying whether the
specific conditions needed for sale treatment are met.

Conclusion

As the FASB is well aware, banks of all sizes use loan participations to enhance liquidity,
diversify risk in their loan portfolios and meet statutory and regulatory restrictions on
loans to one borrower or industry. The basic objective of a loan participation is for
banks to gain a much needed ability to economically participate in credit opportunities or
risk diversification that is otherwise not available. Participations have been a critical
element of community bank operations for many years, and the imposition of an
“expectation” that all banks would need to obtain a true sale legal opinion for
participations would certainly place unnecessary complexities and costs associated with
these well-understood transactions.

ACB appreciates the opportunity to comment on this important matter. If you have any
questions, please contact the undersigned at (202) 857-3158 or dhild@acbankers.org or
Diane Koonjy at (202) 857-3144 or dkoonjy@acbankers.org.

Sincerely,

Dennis M. Hild
Vice President – Accounting & Financial Management Policy