October 10, 2005

Technical Director—File Reference 1225-001
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Via E-mail: director@fasb.org

Re.: Accounting for Transfers of Financial Assets Exposure Draft
(Revised)

Dear Sir or Madam:

The Credit Union National Association (CUNA) is pleased to provide comments in response to the Financial Accounting Standards Board (FASB)'s revised Exposure Draft (proposed Statement or proposal) – Accounting for Transfers of Financial Assets (amendment of FASB Statement No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities). The proposed Statement would make changes to the accounting rules that govern loan participations. Specifically, it prescribes how loan participations should be conducted to qualify for accounting treatment as a sale. By way of background, CUNA represents approximately 90% of the nation’s nearly 8,900 state and federal credit unions that serve nearly 87 million members. This letter was drafted under the auspices of CUNA’s Accounting Task Force, chaired by Scott Waite, SVP/CFO of Patelco Credit Union in San Francisco.

Under the proposed Statement, the transferred portion (or portions) and any portion retained by the transferor must meet the definition of participating interests. A participating interest, among other things, must involve no recourse or subordination provisions. In addition, the transferred portion (or portions) must meet the conditions for surrender of control. Those conditions are the following: (1) the transferred financial assets have been “isolated” - put presumptively beyond the reach of the transferor and its creditors, even in bankruptcy; (2) the transferee has the right under the loan participation agreement to pledge or exchanged the transferred financial assets it received; and (3) the transferor does not maintain control through an agreement that entitles and obligates the transferor to repurchase or redeem the assets before their maturity or the ability to unilaterally cause the holder to return specific assets.
If the transfer does not meet those conditions, sales accounting can be achieved only by transferring the entire original financial asset or group (pool) of assets to a “qualifying special purpose entity” (SPE). In that case, the entire transferred financial asset(s) must meet the conditions for surrender of control.

Many of our members are currently involved in loan participation activity. This accounting rule is of great importance to our members that buy or sell loan participations. Sales accounting treatment is advantageous for originating institutions because it allows the institution to deduct the transferred portion of the loan from its balance sheet. If the transaction involves the transfer of a member business loan (MBL), the loan balance would be excluded when calculating compliance with the MBL cap (even if servicing the loan is retained). In contrast, loan participations that do not qualify for sales accounting treatment would have to be shown on the books of the financial institution as a collateralized borrowing subject to the MBL cap.

Loan participations are an important tool for credit unions and other financial institutions to control interest rate risk, credit risk, balance sheet growth, and maintain net worth. In addition, participations also enable credit unions to redeploy assets (cash) to make more credit available to membership than they otherwise would be able to do.

**SUMMARY OF CUNA’S POSITION**

- CUNA believes that this rule will not impact the credit unions that are involved with loan participations without recourse. The proposed Statement would benefit these credit unions by not requiring them to obtain a “true-sale-at-law” opinion for every loan participation deal.

- As there are credit unions that are interested in loan participations with recourse or have a portfolio of such loans, CUNA requests FASB to consider revising the definition of participation interest to enable loans with limited recourse to achieve sales accounting treatment. This would help institutions avoid the costly and time-consuming process of setting up and running an SPE.

- CUNA requests that the provision requiring loan participation transactions with recourse shown on an institution’s books as a sale to be recharacterized as a secured borrowing upon issuance of the final rule be modified so that it is prospective instead of retroactive. Alternatively, the effective/transition date should be delayed for one year to allow institutions time for implementation of the rule, including the establishment of an SPE.
CUNA'S VIEWS

We commend FASB for taking into consideration the comments of CUNA and other stakeholders on this project in issuing this Exposure Draft. During its deliberations, FASB considered disallowing sales treatment for loan participations marked by rights of setoff (the common-law right of debtors and creditors to set off – that is, net – amounts due to one another if one of the parties defaults, becomes insolvent, or enters into bankruptcy or receivership.) Based on FASB’s review of the comments, the proposal now does not stipulate that rights of setoff preclude the use of sales accounting treatment.

In addition, earlier this year FASB had tentatively decided that in order to receive sales treatment, a loan participation must pass a “true-sale-at-law” test rather than simply receive a “true-sale-at-law” opinion provided by an attorney. The test had three parts: each interest in the participation, including any retained interest, must have equal rights to the cash flow from the underlying assets; no interest in the participation could be subordinate to any other interest; and there would be no recourse to the originating financial institution or any other interest holder. If the loan participation did not pass the test, then the financial institution would have been required to use an SPE to transfer the participation.

In this new revised Exposure Draft, FASB opted for the more flexible approach of an attorney opinion rather than a strict test, which we support. Furthermore, the proposal indicates that the originating financial institution would not necessarily need to obtain a “true-sale-at-law” opinion in every case. According to the proposal, a “true-sale-at-law” opinion is not required if the transferring institution has a reasonable basis to conclude that the appropriate legal opinion would be given if requested. For example, the originating credit union might reach a conclusion without consulting an attorney if it had experience with other transfers with the same facts and circumstances.

CUNA believes it is important to clarify when sales accounting treatment is appropriate and when secured borrowing treatment is required as well as to clarify the definition of participating interest. Some loan participations in the credit union industry are conducted without recourse. We believe that as the proposal now stands the credit unions with such participations will be able to continue conducting business as they have done with the added benefit that they need not obtain a “true-sale-at-law” opinion for every participation transaction. This provision would also serve to lessen the cost of the transaction for loan participation agreements with the same deal structure.
However, CUNA is concerned with the restrictive definition of participating interest in the Exposure Draft. To employ sales accounting treatment, a participation interest could involve absolutely no recourse or subordination to the originator. This proposed Statement would effectively eliminate loan participations with recourse as a business product. For the credit unions that conduct loan participations with recourse, they would be forced to either restructure the deal so there is no recourse to the originator, or else run the transaction through an SPE. In both situations, the end result would be significantly higher costs to the originator. Neither option is attractive.

Credit unions that have sold loans with limited recourse, thus assuming an element of credit risk, have been able to achieve more favorable pricing by doing so. If the proposal becomes final as currently drafted, these limited recourse participation transactions would have to be restructured through a special purpose entity (SPE). At present, we are not aware of any SPEs in the credit union industry. Therefore, new entities would have to be created by the credit unions themselves or more likely, by the limited liability companies (LLCs) or corporate credit unions (similar to banker’s banks) that facilitate loan participations. The establishment of an SPE is an expensive and time-consuming prospect; the organization would have to have a large book of loan participation business in order to economically justify the establishment of an SPE. Further, there is a cost associated with running an SPE, including the loss of a portion of cash flow as cash would be tied up and sitting in the SPE. The limited subordination amounts are always largely above anticipated actual loss rates on the pool and well above historical loss rates as well. The entire amount of the limited subordination, and likely an added cushion or “reserve” amount, would have to be funded into the SPE which means the credit union would lose the use of those funds until the end of the participation years down the road. That represents an opportunity cost as interest would not be earned on the encumbered cash. With a limited subordination, the credit union simply absorbs the cost of charge-offs as they occur over the life of the participation and at a much lower rate than that which is required under the limited subordination. As a result, the credit union retains full use of the funds received upon the sale.

Therefore, we strongly urge FASB to modify the definition in the final rule to allow for loan participations with limited recourse so they may obtain sales accounting treatment also. This approach limits the losses that can be borne by the originator while at the same time still allows for favorable pricing of loan participation deals.
Further, CUNA is also concerned with the effective date and transition provisions in the Exposure Draft. Under the proposal, it appears that if a credit union has an ongoing obligation in connection with a loan participation which does not meet the surrender of control criterion dealing with isolation (for example, a limited recourse obligation), then when the final Statement is issued the credit union may be required to recharacterize these transactions as secured borrowings rather than sales. That effective date provision as written in the Exposure Draft is unclear. If that is not the intention, we encourage FASB to clarify the provision. If our reading of the provision is correct, we believe it may be problematic. The credit unions that entered into loan participation agreements with recourse certainly did so with the expectation that they could show the transaction on their balance sheets as sales. To retroactively change the accounting treatment on the books could cause the credit union’s balance sheet to suddenly be inflated; and the credit union would wind up with decreased net worth. Consequently, we encourage FASB to amend this provision so that the rule is effective prospectively and not retrospectively.

We understand that the final Statement could be effective as early as January 1, 2006. Should the proposed Statement contain the provision that would apply retroactively, we request a delay in the effective date of the final rule so that credit unions and other institutions are afforded a longer transition period to implement this provision. We encourage FASB to provide a one-year period between the issuance of the final Statement and the effective date for credit unions and other institutions to implement any other necessary changes, including time to set up SPEs if they so choose.

Thank you for the opportunity to share our comments. If you have questions about this letter, please feel free to contact me at (202) 508-6743.

Sincerely,

Catherine A. Orr
Senior Regulatory Counsel