October 12, 2005

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

Dear Sir or Madam:

The Independent Community Bankers of America (ICBA) welcomes the opportunity to comment on the amendments to Statement 140, Accounting for Transfers of Financial Assets, proposed by the Financial Accounting Standards Board (FASB).

FASB has concluded that Statement 140 does not provide straightforward guidance on whether a qualifying special purpose entity (SPE) is required for a particular transaction and that amending the guidance on when a qualifying SPE must be used would (a) improve comparability, (b) simplify the guidance on activities of qualifying SPEs and (c) improve consistency in the application of Statement 140. FASB also decided to examine whether the existing guidance for applying paragraphs 9(a) and 9(b) of Statement 140 are sufficient for transactions involving portions of financial assets and other aspects of Statement 140 that needed to be addressed. FASB intends that the proposal provide guidance for determining whether financial assets must first be transferred to a qualifying SPE in order to derecognize any portion of those assets.

ICBA Comments
Loan participations are a key part of community banking and play an important economic role by enabling banks, large and small, to reduce concentration risk and increase credit availability. Loan participations are particularly important to community banks that, due to their relatively small size, may be constrained by lending limits in meeting the credit needs of their business customers. Many community banks also buy loan participations

Letter of Comment No: 46
File Reference: 1225-001

ICBA Comments
Loan participations are a key part of community banking and play an important economic role by enabling banks, large and small, to reduce concentration risk and increase credit availability. Loan participations are particularly important to community banks that, due to their relatively small size, may be constrained by lending limits in meeting the credit needs of their business customers. Many community banks also buy loan participations

---

1 The Independent Community Bankers of America represents the largest constituency of community banks of all sizes and charter types in the nation, and is dedicated exclusively to representing the interests of the community banking industry. ICBA aggregates the power of its members to provide a voice for community banking interests in Washington, resources to enhance community bank education and marketability, and profitability options to help community banks compete in an ever-changing marketplace.

With nearly 5,000 members, representing more than 17,000 locations nationwide and employing over 260,000 Americans, ICBA members hold more than $611 billion in insured deposits, $778 billion in assets and more than $493 billion in loans to consumers, small businesses and the agricultural community. For more information, visit ICBA’s website at www.icba.org.

---

October 12, 2005

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

Dear Sir or Madam:

The Independent Community Bankers of America (ICBA) welcomes the opportunity to comment on the amendments to Statement 140, Accounting for Transfers of Financial Assets, proposed by the Financial Accounting Standards Board (FASB).

FASB has concluded that Statement 140 does not provide straightforward guidance on whether a qualifying special purpose entity (SPE) is required for a particular transaction and that amending the guidance on when a qualifying SPE must be used would (a) improve comparability, (b) simplify the guidance on activities of qualifying SPEs and (c) improve consistency in the application of Statement 140. FASB also decided to examine whether the existing guidance for applying paragraphs 9(a) and 9(b) of Statement 140 are sufficient for transactions involving portions of financial assets and other aspects of Statement 140 that needed to be addressed. FASB intends that the proposal provide guidance for determining whether financial assets must first be transferred to a qualifying SPE in order to derecognize any portion of those assets.

ICBA Comments
Loan participations are a key part of community banking and play an important economic role by enabling banks, large and small, to reduce concentration risk and increase credit availability. Loan participations are particularly important to community banks that, due to their relatively small size, may be constrained by lending limits in meeting the credit needs of their business customers. Many community banks also buy loan participations

---

1 The Independent Community Bankers of America represents the largest constituency of community banks of all sizes and charter types in the nation, and is dedicated exclusively to representing the interests of the community banking industry. ICBA aggregates the power of its members to provide a voice for community banking interests in Washington, resources to enhance community bank education and marketability, and profitability options to help community banks compete in an ever-changing marketplace.

With nearly 5,000 members, representing more than 17,000 locations nationwide and employing over 260,000 Americans, ICBA members hold more than $611 billion in insured deposits, $778 billion in assets and more than $493 billion in loans to consumers, small businesses and the agricultural community. For more information, visit ICBA’s website at www.icba.org.
in order increase their loan portfolio and to diversify risk that often is concentrated in a limited geographic area.

During FASB’s earlier discussions of amendments to Statement 140, community bankers were very concerned that proposed changes would prohibit them from continuing to buy and sell loan participations, shutting down an activity that is vitally important to them and their customers. Requiring the use of a qualified SPE for these transactions would be cost prohibitive for community banks. We greatly appreciate the work that FASB and its staff has done working with ICBA members and others in the industry to find ways to enable the sale of participations outside of a qualified special purpose entity. Community banks have long used loan participations and we are not aware of any situations where they have used these transactions to “hide” assets or liabilities or otherwise mislead investors or the public about the true nature of transactions.

While FASB has made a great deal of progress in making the proposed changes to Statement 140 workable, we have some concerns about several issues in the Exposure Draft that we urge FASB to address as discussed below.

Proposed Paragraph 8A
The proposal adds a new paragraph to Statement 140 (paragraph 8A) that identifies certain characteristics of a participating interest:

a. It represents an ownership interest in an individual financial asset other than an equity instrument and certain derivative financial instruments.

b. All cash flows received from the asset are divided among the participating interests (including any interest retained by the transferor, its consolidated affiliates, or its agents) in proportion to the share of ownership represented by each, except for servicing fees representing adequate compensation and, if applicable, a share of the contractual interest representing all or a portion of the transferor’s gain on sale received by the transferor as consideration related to the sale of the participating interest. The ownership shares remain constant over the life of the original financial asset.

c. Participating interest holders have no recourse to the transferor (or its consolidated affiliates or agents) or to each other, and no participating interest is subordinate to another. That is, no participating interest holder is entitled to receive cash before any other participating interest holder. The rights of each participating interest holder (including the transferor if it retains a participating interest) have the same priority, and that priority does not change in the event of bankruptcy or other receivership of the transferor, the original debtor, or any participating interest holder.

d. Neither the transferor (or its consolidated affiliates, its agents, or a bankruptcy trustee or other receiver for the transferor, its consolidated affiliates, or its agents) nor any participating interest holder has the right to pledge or exchange the entire financial asset in which they own a participating interest.
Constant Ownership Shares
In paragraph 8A(b), FASB proposes to add language that would require that ownership shares remain constant over the life of the original financial asset. This would prohibit the use of “Last In, First Out/First In, First Out” or “LIFO/FIFO” loan participation transactions. Community banks frequently use LIFO/FIFO arrangements in participations for customer relationship management, pricing or other purposes. For example, a bank may sell loan participations to stay within its credit limits to a borrower. Later, the borrower may reduce its debt or the bank is able to increase its limit to the borrower. To lower administrative costs, the bank may choose to repurchase some of the loan that it has sold. Most likely it would be cost prohibitive to repurchase an equal amount from all owners; the more cost effective and administratively efficient way of accomplishing this would be to repurchase one portion.

We urge FASB not to prohibit these arrangements that are commonly used in banking and that facilitate credit availability and lower borrowing costs. Community banks have not been engaged in the practices conducted by Enron and other companies that led FASB to embark on these proposed changes. We urge that the requirement that shares remain constant over the life of the original financial asset be removed.

Also, in paragraph 8A(b), FASB would require that all cash flows received from the assets be divided among the participating interests in proportion to the share of ownership represented by each, except servicing fees. Community bankers have told ICBA that this may preclude them from using some borrower fees, such as loan origination fees, as a pricing adjustment on some participations, taking away some pricing flexibility. Also, there may be other fees, besides servicing fees paid by the transferor to a transferee or other fees from the borrower to the transferor, all of which are reasonable fees that are not typically divided proportionately to all transferees. While some of these fees are generated at origination, the transferor may receive some during the term of the loan. We ask FASB to provide clarification that there may be reasonable fees, other than those strictly tied to servicing that do not need to be divided proportionally based on share of ownership.

Sales of Guaranteed Loans
We are very concerned that provisions of paragraph 8A(b) would prohibit the sale of loans guaranteed by agencies of the government, such as the Small Business Administration. Such loans are typically split between the guaranteed and unguaranteed portions when sold. Because of the differences in the risk characteristics of the sections, they are sold at different rates that reflect that risk—rates that are different than on the original loan. Consequently all cash flows cannot be divided proportionately based on the proportion of share ownership. Community banks sell these loans to obtain liquidity that is used to provide more credit in their communities. If these transactions are not considered true sales, the result would be higher credit costs and less credit availability, negatives that far outweigh the benefits of the proposed change. We urge FASB to clarify that such transactions would continue to receive sales treatment.
Federal Home Loan Bank of Chicago Mortgage Partnership Finance Program
It is our understanding that language in the Exposure Draft would require that a qualified SPE be used for sales of mortgage loans (which involve whole loans with credit enhancements) to the Federal Home Loan Bank of Chicago's Mortgage Partnership Finance Program (MPF) in order for them to qualify as true sales. According the FHLB of Chicago, the term "ownership interest" in Paragraph 8A needs clarification to limit its use to the legal definition of ownership interest. The nature of the transactions involving certain MPF products involve the sale of a whole loan but would seem to be treated as a transfer of a portion of an asset by the Exposure Draft. We concur with the comments submitted to FASB by the FHLB of Chicago on this Exposure Draft and urge FASB to clarify that a qualified SPE would not be needed for these transactions.

The MPF program has been an important residential secondary market alternative for community banks. The MPF provides smaller lenders easier, more competitive access to the secondary market making them better able to compete against the largest mortgage lenders. Requiring the use of a qualified SPE for these transactions because of disproportionate shares of transferred assets would not be economically feasible and would shut community banks out of this important secondary market program.

Setoff Rights
In a letter to FASB dated May 19, 2004, ICBA urged that the existence of setoff defenses should not preclude the use of sales treatment for a loan participation, particularly when the participation evidences a clear intent by the originating bank/transferor to sell a beneficial interest in the loan. A setoff right is a common law right of a party that is both a debtor and a creditor to the same counterparty to reduce its obligation to that counterparty if that counterparty fails to pay its obligation. In the case of a failed bank, the Federal Deposit Insurance Corporation would have setoff rights that would allow it to set off the entire amount of the loan (including the part that the originating bank sold to the participating bank) from any money that the debtor had on deposit with the originating bank. Also, the debtor would have the right to setoff a loan with the failed/originating bank. We applaud FASB for concluding that setoff rights would not be an impediment to meeting the isolation requirement (paragraph A14).

True Sales Legal Opinions
In the Exposure Draft, FASB proposes adding the following language to paragraph 27 of Statement 140: “A legal opinion is not required if a transferor has a reasonable basis to conclude that the appropriate legal opinion or opinions would be given if requested. For example, the transferor might reach a conclusion without consulting an attorney if it had experience with other transfers with the same facts and circumstances.”

ICBA greatly supports FASB’s efforts to clarify that a true sale legal opinion is not required for every transaction, but believes then need to be taken a step further. We recognize that different states and countries have different criteria as to what constitutes a true sale and transactions covered by this Statement have varied characteristics. Thus, providing a very specific list of true sales criteria in an accounting statement is not practical. While FASB proposes language to suggest that a legal opinion is not require for each and every transaction, we remain concerned that auditors and bank examiners
may err on the side of caution and require legal opinions more often than FASB intended. As we have communicated to FASB previously, it would be economically unfeasible for community banks to obtain a legal opinion for each participation arrangement and the resulting unnecessary legal costs would lead to higher lending costs. Thus, it would be helpful for FASB to provide some additional guidance on characteristics of true sales that bankers may rely on in determining a legal opinion is not needed in a particular case.

Effective Date and Transition
ICBA urges FASB to provide a longer transition period than proposed in the Exposure Draft. The provisions of paragraph 9(a) as amended would be applied by both public and nonpublic entities upon issuance of the Statement. If the transferor, its consolidated affiliates, or its agents have any remaining commitments related to the transferred financial assets to deliver additional cash or other assets, the provisions also would be applicable to transfers occurring prior to the effective date of the proposed Statement. ICBA believes that applying this requirement retroactively could be disruptive to credit flows. These transactions would have been negotiated under current accounting rules and transitioning to new isolation tests may result in disruption in the transaction.

A public entity would apply all other derecognition provisions to transfers of financial assets occurring after the end of the first fiscal quarter beginning after the issuance of the final Statement. Both public and nonpublic entities would apply the measurement provisions of paragraphs 10 and 11 of the proposal at the earlier of fiscal years beginning after December 15, 2005 or fiscal years beginning during the quarter in which the final Statement is issued. For a public or nonpublic entity with a calendar year-end, if the final Statement is issued in February 2006, those provisions would apply to transfers beginning as of January 1, 2006.

If an entity has a continuing obligation in connection with a transaction and that obligation does not meet the amended general condition related to isolation (paragraph 9(a) as amended), that entity would be required to change its accounting for that transaction upon issuance of the final Statement. The effect of any changes in accounting for transactions reported in previously issued financial statements would be reported as the cumulative effect of an accounting change as described in paragraph 11 of the proposed statement. Otherwise, an entity may retain the accounting for previous transactions and formerly qualifying SPEs provided that certain conditions are met. We believe a transition period is needed for institutions to review and potentially revise documents after the issuance of the Statement.

We urge FASB not to require any retroactive application of requirement contained in the final statement. Existing participation arrangements were negotiated based on current accounting rules. It will take some time for community banks, their accountants and legal counsel to digest the new accounting requirements and make necessary changes to loan participation documents. This will be a complex process since the legal requirements of several states may need to be met to determine whether a transaction is a true sale. In our view, a one-year transition period would be more appropriate.
Summary
Buying and selling loan participations and guaranteed loans are key activities in community banking. These are not new activities, but have long been relied on to keep credit flowing in communities, particularly to businesses. While FASB has made a great deal of progress in ensuring that changes to Statement 140 do not disrupt this business by imposing costly new accounting requirements, we continue have concerns about aspects of the proposal. We urge FASB to permit banks to continue to use LIFO/FIFO arrangements to facilitate transactions, clarify that the sale of guaranteed loans might still qualify for sales treatment and provide more time to implement the accounting changes.

We appreciate the opportunity to comment. If you wish to discuss our comments further, please contact the undersigned at (800) 422-8439 or ann.grochala@icba.org.

Sincerely,

Ann M. Grochala,
Director, Lending and Accounting Policy