October 17, 2005

Technical Director
File Reference No. 1225-001
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5166

Dear Sir:

The Financial Reporting Committee (FRC) of the Institute of Management Accountants is writing to provide its views on the three Exposure Draft ("ED") of proposed amendments to Statement of Financial Accounting Standards No. 140 Accounting for Transfers of Financial Assets (the "Statement") and No. 133 Accounting for Derivative Instruments and Hedging Activities ("FAS 133").

We are not certain that the changes proposed are improvements to the securitization model. We believe that it would be more productive for the Board to work jointly with IASB on revisions to FAS 140 and the derecognition provisions of IAS 39 that would move the two standards closer together.

Overall Observations

The guiding principles of the financial components approach under FAS 140 are that derecognition of assets should occur when an entity has surrendered control and that the transferor should recognize assets and liabilities it retains. The previous ED introduced risk and rewards provisions that were incompatible with the control-based framework. The current EDs are generally more consistent with the control-based framework. However some of the new provisions contained in the current EDs appear to mix risk and rewards concepts into this control-based framework.

We believe the Board has not addressed the issues raised in EITF Issue No. 02-12, "Permitted Activities of a Qualifying Special-Purpose Entity in Issuing Beneficial Interests under Board Statement No. 140," ("EITF 02-12"), i.e. what is meant by "significantly limited" and "entirely specified". These phrases are the core of the issue that the Board seeks to address with the
proposed paragraphs on rollovers of beneficial interests and issues that are currently being raised by market participants with respect to permitted servicing activities.

It is clear from the Board’s public meetings that there is a lack of consensus on many of the proposed amendments to the statement. We question whether it makes sense to proceed with these amendments in the absence of a clear consensus that change is appropriate.

We note that the EDs do not advance the goal of converging international financial reporting standards, which we believe should be a fundamental concern when considering change to existing generally accepted accounting principles.


We believe that the current ED is a significant improvement from the July 2003 ED and that the Board has addressed some of the significant concerns raised by its constituents in the comment period on that ED. However, we continue to have the following key concerns:

- We disagree with the proposed amendments that affect the accounting for transfers of portions of financial assets. Paragraph 9 of the existing Statement and the ED provide adequate guidance, which allows the transfer of a portion of an asset to be recognized as a sale. We believe that if a transfer of a portion of a financial asset meets all of the criteria listed in paragraph 9, isolation should be left to a legal analysis based on the facts and circumstances in each jurisdiction. There should be no further requirement to use some type of custodial arrangement. It is unhelpful and inappropriate to require the use of a QSPE to achieve sale treatment for transfers of assets that do not meet the definition of a “Participating Interest”.

- We believe the proposed amendments clarifying legal isolation require further attention.

- We disagree with the proposed amendment that would require that each transferee in a multi-step transaction have the right to pledge or exchange assets received. Each step in a multi-step transaction is intended for one purpose, to effect the transfer of the financial assets to the ultimate transferee and it is for this reason that we believe the Board should focus on the right to pledge and exchange on the ultimate transferee and the holders of beneficial interests in that entity only.

- We disagree with the proposed amendment that would apply the “right to pledge and exchange beneficial interests” test, to the transferor’s beneficial interests. There are many valid commercial reasons why a transferor may accept limits on its rights to pledge and exchange its transferor’s beneficial interests. Limits the transferor has agreed to related to its retained interests should not be a factor in determining whether
the transferor has given up control over the transferred assets. Constraints on the ability to pledge and exchange a transferor's beneficial interests should be reflected in the fair value at which the transferor records its asset.

- The proposed amendments that would apply to rollovers of beneficial interests by a qualifying SPE represent a fundamental change. We believe that the status of a qualifying SPE has nothing to do with the hypothetical contractual rights and rewards of the parties associated with the qualifying SPE, but should continue to be evaluated in a control-based framework. The proposed amendment leaves unanswered the original issues posed in EITF 02-12 on the nature and limits of the discretion associated with the reissuance of beneficial interests. We also do not believe that this guidance is operational.

- The ED changes the timing of revenue recognition for a transferor from the point in time that beneficial interests are issued to third parties to the point at which a transfer of financial assets occurs. We believe that this may lead to abuses of the standard as it permits earnings recognition in the absence of a transaction with a third party.

Sales of portions of Financial Assets

We disagree with the proposed amendments that affect the accounting for transfers of portions of financial assets. The proposed amendments on transfers of portions of financial assets would require a transferor to use qualifying SPEs to recognize a sale of financial assets regardless of whether those assets have been deemed to have been isolated from the transferor by virtue of meeting the isolation tests contained in paragraph 9. The proposed amendments, which significantly change the requirements to recognize a sale on a transfer of a portion of a financial asset, are unnecessary and do not enhance the isolation of transferred financial assets from the transferor.

We have always interpreted paragraph 9 to adequately address the accounting for a transfer of a portion of a financial asset. The existing Statement allows transfers of a portion of an asset if all the tests in paragraph 9 are met. Isolation should be left to a legal analysis based on the facts and circumstances in each jurisdiction. We also believe that the need for physical segregation of assets should not be the Board's determination if a servicer is responsible for allocating cash flows to the holders of beneficial interests.

Participating interests are defined in proposed paragraph 8A as an ownership share of a financial instrument that, among other things, represents a proportionate interest in cash flows of the asset and provides for no recourse to the transferor. A transfer of an ownership share of a financial instrument that does not meet the definition of a participating interest would be accounted for as a secured borrowing.

This is clearly an issue for transactions that rely on participations or undivided interests that do not meet the definition of a Participating Interest contained in the proposed paragraph 8A. The
ED can also be read to require the use of a qualifying SPE in some transactions where entire financial assets are contractually transferred.

The approach may have unintended consequences for certain sales of whole loans. We understand that the intent of the Board in drafting the proposed paragraph 8A was to describe a traditional bank loan participation, in which the originator sells less than 100% of the notional amount of the loan to third parties. In a whole loan sale with servicing retained, the originator sells 100% of the notional amount of the loans, retaining only a servicing fee that generally reflects a market rate. This type of transaction has not traditionally been considered a loan participation. However, because the originator retains a servicing fee, we are concerned that it would not meet the definition of the sale of a financial asset in its entirety and would thus have to be evaluated to determine whether it meets the definition of a participating interest.

Proposed paragraph 8A(c) states that participating interest holders may have no recourse to the transferor or to each other. While this concept may be appropriate for traditional bank loan participations, it would be unduly restrictive in the context of whole loan sales with servicing retained, particularly those involving pools of loans that typically provide for adjustments to the purchase price due to defects in documentation or failure to comply with eligibility criteria. Sales of whole loan pools may also include a limited amount of recourse for credit losses or prepayments. Given the broad definition of recourse in the Statement, sales of whole loan pools with servicing retained would not generally meet the definition of a participating interest.

We recommend that the Board allow for the sale of whole loans with servicing retained to be accounted for as the sale of financial assets in its entirety. If the Board does not accept this recommendation, we suggest that the prohibition against recourse of any kind in paragraph 8A(c) be eliminated.

Legal Isolation

We are supportive of the Board's efforts to provide additional guidance on the legal isolation requirement. However we believe that there are still areas in the ED that require attention.

The second sentence of proposed paragraph 27B suggests that a nonconsolidation opinion is often required if the transfer is to a qualifying SPE. The applicable current audit guidance requires that a nonconsolidation opinion be obtained only in the case of transfers to an affiliated entity. The Board should remove the references to qualifying SPEs so as to conform the second sentence of paragraph 27B to current practice.

The proposed paragraph 27A(a) states that a transfer is considered to have isolated the transferred assets only if, among other things, a legal analysis would support the conclusion that the transfer is legally a sale. This is not necessarily the case in countries not subject to U.S. jurisprudence. Secondly, within the U.S., a legal analysis may conclude that the assets conveyed in a transfer other than a sale are legally isolated from the original owner, even though the transfer is not legally structured as a sale. The Board should revise the proposed amendment to
note that, depending upon facts and circumstances, legal isolation may be achieved even though a transfer is not legally a sale.

Proposed paragraph 9(d) should be clarified to state that the isolation analysis required is an ongoing analysis and that agreements made at any time in connection with transferred asset will require a reassessment of the status of the qualifying SPE.

Proposed paragraphs 9(e) and A17 require that the legal isolation analysis for assets transferred to a qualifying SPE include an evaluation of arrangements between the transferor and beneficial interest holders as if the same arrangements had been made between the transferor and the qualifying SPE itself. While we agree that such arrangements should be considered in the legal isolation analysis, we do not agree that the legal opinion should be based upon theoretical circumstances rather than the actual facts of the transaction. We also believe that is inconsistent with legal standards. We suggest that the language in paragraph 9(e) be clarified to require that only actual arrangements be explicitly considered in the legal isolation analysis.

The definition of Consolidated Affiliate should be clarified to address whether it also is meant to include the parent (and its consolidated affiliates) of a transferor, as the definition is unchanged from the existing Standard

**Ability to Pledge and exchange**

We believe that the requirement that the transferee in a series of transfers designed to achieve derecognition have the right to pledge or exchange its interest in the financial assets is unnecessary and inconsistent with the framework of most multi-step transactions.

The most common form of multi-securitization structure involves a two-step transfer, in which assets are transferred first from the transferor to a wholly owned, bankruptcy-remote special purpose entity ("BRSPE") and then to a qualifying SPE. This structure is designed to isolate the transferred assets from the transferor and its creditors and has been widely used by the financial services industry for many years. A two-step transfer using a BRSPE as described above is designed to achieve legal isolation. In other transactions, a series of transfers involving multiple SPEs may be required to meet tax or regulatory requirements.

In the case of a series of transfers, the only reason that the BRSPE receives the financial assets is to effect the transfer to the ultimate transferee. A typical BRSPE will contain provisions designed to make it bankruptcy remote, usually removing decision-making powers to prevent it from taking actions that could trigger bankruptcy. The freedom to pledge or exchange is unnecessary absent the ability to make such decisions.

We continue to believe that the test should be whether the ultimate transferee or ultimate beneficial interest holder have the ability to pledge and exchange the received beneficial interests or the underlying financial assets. We believe that an analysis of the BRSPE's activities should not be required.
We believe that the requirement of the proposed paragraph 9(b) should be met if the transferee has, in fact, transferred the financial assets that it obtained and that it is not necessary to consider whether the transfer was pre-programmed for the benefit of the initial transferor.

**Transferor Beneficial Interests**

The proposed requirement under paragraph 9(b) that there are no encumbrances on the transferor to exercise its ability to pledge or exchange a transferor's beneficial interest is not necessary to isolate financial assets or to transfer their control. Moreover we believe these provisions will create problems for a number of different types of transactions.

A proposed change to paragraph 9(b) would require that the transferor has the ability to pledge or exchange its transferor beneficial interests, absent significant constraints that also provide more than a trivial benefit to the transferor. We believe that there are sound commercial, regulatory and tax reasons that require a transferor to impose limits on their ability to pledge or exchange their transferor beneficial interests when they set up a securitization platform. For instance, transferors may have restrictions on their ability sell a transferor beneficial interest, where it continues to service the transferred assets, due the other beneficial interest holders wanting the transferor to continue to have capital at risk.

The unencumbered freedom of the transferee to pledge and exchange is a crucial test to ensure that the transferor has not maintained control of the transferred financial assets by restricting the transferees' rights to pledge or exchange, and that the transferee has the ability to control the benefits of the assets by exchanging or pledging them. Restrictions on a transferor's rights to pledge or exchange transferor beneficial interests do not demonstrate that the transferor still has control of the underlying assets. Rather, they strengthen the conclusion that the transferor has surrendered control.

We continue to believe the key isolation test is whether beneficial interest holders other than the transferor have the freedom to choose what to do with the beneficial interest they have obtained. We do not believe that constraints on the transferor's ability to pledge or exchange retained beneficial interests should be a factor in determining whether the transfer of assets into a qualifying SPE is accounted for as a sale. The transferability of a retained beneficial interest may affect the fair value of the interest but should not be a factor in determining whether the transferor has given up control over the transferred assets.

**Permitted Investments of a qualifying SPE**

We support the changes that Board has proposed to paragraph 40(a), which would eliminate the prohibition against a qualifying SPE holding derivative instruments that pertain to beneficial interests retained by the transferor. However, given the amendments contained in the ED, Accounting for Certain Hybrid Financial Instruments, an amendment of Board Statement No. 133, we are unsure that paragraphs 40(b) and 40(c) are still required. The proposed amendment to FAS133, if finalized as written, will mean that a transferor will not be able to avoid
recognition of the volatility associated with holding derivatives by transferring them into a qualifying SPE and retaining a transferor beneficial interest. We can see no conceptual basis in restricting the volume of passive derivative financial instruments a qualifying SPE should be permitted to hold or the requirement that they hedge some risk associated with either the transferred financial assets or the beneficial interests.

We support the proposed paragraphs 35(c)(1) and 35(c)(5) prohibiting a qualifying SPE from holding equity instruments, unless those equity instruments were received as a recovery of collateral from a financial asset. However we believe that two scope exceptions may be required for pass-through certificates representing interests in financial assets that are in equity form (such as titling trust certificates) and shares of money market funds.

Rollovers of beneficial interests

We do not agree with the approach taken by the Board to deal with rollovers, which are defined in the ED as reissuances of beneficial interests to obtain cash or other assets to retire or otherwise settle existing beneficial interests held by parties other than the transferor.

The fundamental premise on which a qualifying SPE is established is that its activities are significantly limited and entirely specified in its establishing documents. EITF 02-12 focused on the issue of what those phrases mean in the context of rollovers of beneficial interests. Although the EITF was unable to resolve these issues they also remain unanswered by the ED.

Paragraph 45A of the ED introduces a risks and rewards analysis to this control-based standard to determine if a SPE that rolls over beneficial interests is a qualifying SPE. The proposed paragraph 45A concludes that qualifying SPE status will be lost if any party associated with a qualifying SPE has the opportunity to obtain more than a trivial incremental benefit by virtue of having more than one type of involvement with the entity. The types of involvement mentioned include an obligation to provide liquidity; an obligation to provide credit enhancement, which includes the right to receive subordinated cash flows, and the right to specify the terms of the beneficial interests that are rolled over.

It is wholly unrealistic to assume that the Transferor or any other party associated with a qualifying SPE has the ability to gain access to the information necessary to allow it to reach a conclusion about whether there are opportunities for hypothetical outcomes that may result in a more-than-trivial incremental benefit. Moreover, we do not understand why the test proposed in paragraph 45 should affect the determination of whether an SPE is qualifying, if the individual types of involvement are permissible limited activities of a qualifying SPE entirely specified in the documents that established the qualifying SPE. The only analysis that is relevant is that which is specified in paragraph 9: has the transferor retained control over the transferred assets? We question whether it is possible for a transferor to ever successfully demonstrate that it does not have the opportunity to obtain a more-than-trivial incremental benefit by virtue of having more than one type of involvement with the SPE. If the test is retained, which we do not support, we believe that the presumption should be that a qualifying SPE continues to have qualifying status.
until the occurrence of a rollover, at which time the analysis like that contemplated by paragraph 45 would be performed to determine whether a more-than-trivial benefit was actually obtained.

The proposed guidance states in part that "beneficial Interests issued by a revolving-period master trust are not considered rollovers if the proceeds are applied to reduce the transferor's interest." We believe that the inclusion of this language indicates a different reissuance standard for revolving-period master trusts. However, the definition of "Rollovers of beneficial interests" already extends an identical exception to all reissuances the proceeds of which are used to settle beneficial interests held by the transferor. Therefore, it is unclear what the exception language for a revolving-period master trust is intended to accomplish or to what extent it will be effective. It is also unclear whether the treatment afforded revolving-period master trusts changes once the revolving period ends.

We believe the Board should remove the guidance in proposed paragraph 45A and instead address the questions raised by EITF 02-12 as to the nature and extent of discretion inherent in reissuance of beneficial interests by a qualifying SPE, which is allowed to reissue beneficial interests as they mature. Practical implementation guidance is needed on the limits of such discretion rather than the proposed guidance, which in our opinion is not operational.

Revenue Recognition

The recognition of the fair value of assets received or liabilities incurred in a sale of financial assets is a logical consequence of the financial components approach. We are concerned the proposed change to paragraph 9, removing the phrase "shall be accounted for as a sale to the extent that consideration other than beneficial interest(s) in the transferred assets are received in exchange" in conj unction with changes to the calculation of gain on sale may lead to unintended consequences.

A transferor can now recognize a gain on sale solely by selling assets to a qualifying SPE issuing 10% of the beneficial interest to third parties and recording 90% of the beneficial interests as transferor beneficial interests. Financial assets sold into a Master Trust Structure, may be accounted for in total as additional Sellers Interest. The ED changes the point of revenue recognition for a transferor from the point in time that beneficial interests are issued to third parties to the moment when a transfer of financial assets occurs. This may lead to abuses of the Standard, as it provides the Transferor with the ability to produce earnings without entering into a transaction with a substantive third party.

Servicing Activities

The existing Statement focuses on valuation and recording of servicing assets and liabilities, but does not consider the nature of servicing itself. It appears that the existing Statement was written with a fundamental understanding of servicing, but did not contemplate the full range of actions necessary in the normal servicing of the myriad of financial assets the market finances in securitization transactions.
Paragraph 35 (c) (1) of the existing Statement allows a qualifying SPE to hold financial assets that are passive in nature. Paragraph 49 of the existing Statement defines passive as follows: “a financial asset or derivative financial instrument is passive only if holding the asset or instrument does not involve its holder in making decisions other than the decisions inherent in servicing.” Servicing activities range from allocating cash flows in simple pass through structures to the more active servicing that is required of assets in residential or commercial mortgage backed transactions. FAS 140 and the related Q&A provide guidance that appears to suggest that this broad range of activities is acceptable under the definition.

There is also a wider range of activities that are necessary when the servicer is also the transferor. These are activities that are consistent with protecting the beneficial interest holders of a qualifying SPE and do not evidence ongoing control over the transferred assets and are primarily undertaken to maintain the transferor’s ongoing relationship with the borrower. Such activities may include responses to borrower requests for waivers, servicer activity on repossessed collateral and substitution of collateral. The Board may consider that such activities are already provided for under the phrases “significantly limited” and “entirely specified” provided the activities are contemplated by the legal documents establishing the QSPE. We would not support any effort by the Board to more narrowly define passive financial assets in an effort to limit the scope of permissible servicing activities.

We also recommend that the effective date be delayed to give companies the necessary time to study the final amendments and to implement the necessary procedures and controls.

Effective Date and Transition

We have a number of concerns related to the proposed effective date and transition provisions. We believe that all existing qualifying SPEs, except those reissuing beneficial interests, should be grandfathered.

The transition proposed for amendments to paragraph 9(a) requires retrospective application where the transferor has “remaining commitments to the transferred financial assets to deliver additional cash or other assets”. We interpret this provision to affect only commitments affecting transferred assets and not other arrangements that a transferor may have entered with a qualifying SPE contemporaneously with a prior transfer of financial assets. Such arrangements may include interest rate swaps, liquidity, and recourse. The Board should provide further guidance on which commitments are considered commitments to transferred financial assets and which are considered commitments to beneficial interests.

The transition date for amendments to paragraph 9(a) should be the same as that proposed for the other amendments affecting isolation. The implementation guidance contained in paragraph 27B requires that true sale opinions commonly obtained by transferors be evaluated to consider the provisions of paragraphs 9(d) and 9(e). We do not understand how a transferor could consider 9(a) without also applying 9(d) and 9(e).
We believe that both the amendments affecting derecognition and accounting measurement should be effective as of the same date. As currently written the amended accounting measurement provisions are effective on issuance, but the derecognition amendments would not be effective until six months later.

The transition provisions related to rollovers of beneficial interests are written in such a manner that an entity which used both short and long term beneficial interests to fund long term assets and fails to meet the conditions on paragraphs 35(e) and 45A of the ED would continue to be accounted for under the existing guidance if the short term beneficial interests requiring reissuances represented less than 50% of the capital structure.

**Exposure Draft on Accounting for Certain Hybrid Financial Instruments, an amendment of Board Statements No. 133**

We support the provisions of the ED on Accounting for Certain Hybrid Financial Instruments. However, we recommend that the Board provide specific practice guidance to illustrate how to identify and measure potential embedded derivatives associated with more common securitization structures that require bifurcation. For example, we believe that a retained interest that benefits from an interest rate swap inside of a qualifying SPE should not give rise to an embedded derivative requiring bifurcation.

We believe that the Board should clarify that the evaluation of a beneficial interest for embedded derivatives should occur at the date the beneficial interest is obtained. It should not be necessary for the beneficial interest holder to conduct an ongoing evaluation of a beneficial interest for an embedded derivative unless there is a change to the legal documents that create the beneficial interest, to which they were required to consent.

In a manner consistent with proposed FSP FAS 140-c, "Clarification of the Application of paragraphs 40(b) and 40(c) of FASB Statement No. 140, we believe that the Board should clarify that an embedded derivative is not created within a beneficial interest by virtue of assets becoming over or under hedged as a result of unanticipated prepayments or losses beyond those assumed at the time the swap contracts were entered by the qualifying SPE issuing the beneficial interest.

**Exposure Draft on Accounting for Servicing of Financial Assets, an amendment of Board Statement No. 140**

We generally support the provisions of the ED on Accounting for Servicing Assets

We observe, however, that there is no presumption that one method for subsequent remeasurement of a servicing asset or liability is preferred and that the ED permits a choice among alternatives. Given that, we do not understand why an entity with servicing assets or liabilities should be required to justify selecting one method over another. The disclosures related to risk and valuation and mitigation/management of that risk will make it clear why one
method or another was selected, to the degree that such selection is important. Such disclosure, coupled with the other information about servicing, makes the justification disclosure unnecessary.

We look forward to participating in the FASB's future deliberations on this topic in any manner that would be helpful to a successful resolution of these issues. We welcome the opportunity to discuss these views further at your convenience; I can be reached at (513) 983-3874.

Sincerely,

Teri L. List
Chair, Financial Reporting Committee
Institute of Management Accountants