October 10, 2005

Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

Re: Revised Exposure Draft of Proposed Amendments to FASB Statement No. 140 Relating to Transfers of Financial Assets (File Reference No. 1225-001)

Ladies and Gentlemen:

The American Securitization Forum is writing to comment on the exposure draft referenced above, which we refer to below as the “transfers exposure draft.” To make efficient use of our resources and reduce duplication in the comments received by FASB, the ASF has cooperated with a number of other trade associations in commenting on the transfers exposure draft and the related exposure draft on hybrids. As a result, the ASF is only submitting comments on the transfers exposure draft, and within the transfers exposure draft we are not providing detailed comments on the impact of proposed new paragraph 8A on the loan participation market. We agree with and endorse the comments in the October 7, 2005 comment letter submitted by ISDA on the hybrids exposure draft and the October 10, 2005 comment letter submitted by the Loan Syndications and Trading Association on loan participations.

The ASF appreciates FASB’s continued attempts to increase the transparency of financial statements and to clarify derecognition guidance. We recognize that this project has occupied a great deal of FASB’s time, including time spent on the August 2003 roundtable discussion of comments on the June 2003 exposure draft (which we refer to below as the “prior exposure draft”), the two roundtable discussions in May and June 2004 relating to participations and setoff issues and subsequent deliberations leading up to the issuance of the transfers exposure draft. We are also grateful that FASB has agreed to continue the dialogue with constituents at the October 17th forum, as we know the Board wants to finalize this statement in the near future.

The transfers exposure draft is an improvement over the prior exposure draft. It avoids most (though not all) of the unintended consequences that we identified in our comments on the prior

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1 The American Securitization Forum (the “ASF”) is a broadly-based professional forum of participants in the U.S. securitization market. Among other roles, the ASF members act as issuers, underwriters, dealers, investors, servicers and professional advisors working on securitization transactions. This comment letter was developed principally in consultation with the ASF’s Accounting and Tax Subcommittee, with input from other ASF members and committees. More information about the ASF, the Accounting and Tax Subcommittee and their respective members and activities may be found at www.americansecuritization.com.
exposure draft. It would also improve GAAP by deleting some of the unnecessary restrictions on derivatives that may be held by a qualifying SPE. We strongly support those deletions.

However, we believe that some of the proposed changes result in inherent inconsistencies, further complicate the guidance and are not aligned with the overall objectives of the derecognition requirements. Accordingly, we continue to have substantial objections to many of the proposed changes. Our most fundamental comments are:

- The requirement that paragraph 9(b) be satisfied at each step of a multi-step transaction is conceptually inconsistent with the essential nature of most multi-step transactions. This comment is discussed in Part I.A. below, beginning on page 4.

- The new transferability requirement under paragraph 9(b) for transferor’s beneficial interests (1) is not necessary in order to isolate financial assets or transfer their control and (2) creates problems for numerous transactions. This comment is discussed in Part I.B. below, beginning on page 5.

- The proposed new guidance on transfers of portions of financial assets would require transferors to use qualifying SPEs in transactions where all of the current requirements of paragraph 9 can be met without them and where the qualifying SPE will not enhance isolation from the transferor. This clearly is an issue for transactions that rely on participations or undivided interests that do not meet the requirements of proposed new paragraph 8A, which are discussed in Part II.A. below, beginning on page 6. The transfers exposure draft could also be misinterpreted to require a qualifying SPE in some transactions where entire financial assets are contractually transferred. We request clarification to avoid this misinterpretation in Part II.B. below, beginning on page 8.

- The proposed requirement to impute agreements and arrangements of a transferor’s consolidated affiliates to the transferor for purposes of the isolation requirement under paragraph 9(a) is inconsistent with legal standards. This comment is discussed in Part III.A. below, beginning on page 11.

- The effective date should be revised so that the changes are not effective until the beginning of the first fiscal quarter beginning after the quarter in which the final statement is issued. This and another comment on the effective date provisions are discussed in Part V, beginning on page 17.

We also have more technical comments on some of the other new guidance on isolation (Part III.B. beginning on page 13) and changes relating to qualifying SPEs (Part IV, beginning on page 14).

In many cases, we have provided examples to illustrate our comments. As to each example below, we provide our analysis under current GAAP (without giving effect to the transfers exposure draft) and discuss how the proposed changes would alter the analysis. We do not think that these changes clarify the guidance, reduce the complexity of the standard or enhance fair representation. The examples are meant as illustrations and in most cases are not the only types of transactions that would be affected by the provisions on which we comment.
October 10, 2005
Page 3

Unless otherwise indicated, all paragraph references in this letter refer to paragraphs of Appendix C to the transfers exposure draft, except that paragraph references beginning with an “A” refer to paragraphs of Appendix A to the transfers exposure draft.

I. Comments on Changes to Paragraph 9(b).

To establish some common ground and show the broad scope of our initial two comments, we illustrate them using a very typical, commonly used structure: a two-step transfer to a qualifying SPE. The facts are set out below, and Attachment 1 is a diagram of the transaction.

Example 1 – Two-Step Transfer to a Qualifying SPE

Facts: An auto finance company (“Sponsor”) sells a pool of retail automobile installment contracts in a two-step transfer with the following characteristics:

- Contractually, the entire financial assets are transferred in each step. The first transferee (“BR Sub”) is a bankruptcy-remote, consolidated subsidiary of Sponsor. The second transferee (“Issuer”) is a qualifying SPE.

- Sponsor obtains a true sale opinion relating to the transfer of the entire financial assets from Sponsor to BR Sub and an opinion that Sponsor and BR Sub would not be substantively consolidated. None of Sponsor’s affiliates (other than BR Sub) has any involvement with the transaction that is relevant to the legal opinions, under either current GAAP or the changes proposed in the transfers exposure draft.

- No arrangements that violate paragraph 9(c) exist.

- Issuer issues the following beneficial interests: asset-backed notes, which are sold to unaffiliated investors who have the unrestricted right to pledge or exchange them; and a subordinated residual certificate, which is retained by BR Sub and may or may not be subject to transfer restrictions.

Analysis Under Current GAAP: Paragraph 9(a) is satisfied in the manner permitted by paragraph 83, and there are no agreements that violate paragraph 9(c). The only interpretive issue is whether paragraph 9(b) is satisfied. On one hand, BR Sub actually does transfer the receivables, so it clearly has the right to do so. However, that sale was pre-programmed in a way that arguably provides a more-than-trivial benefit to Sponsor. Because this type of pre-programming is inherent in virtually any two-step transaction of the type described in paragraph 83, preparers and auditors have concluded that the transaction satisfies paragraph 9(b). Therefore, under current guidance, Sponsor derecognizes the receivables in its consolidated financial statements (which include BR Sub but not Issuer).

Also, it seems reasonable to conclude that the important transfer for purposes of paragraph 9(b) is the one that moves the assets outside of the original transferor’s consolidated group. Ordinarily, transactions among consolidated affiliates have no impact in the consolidated financial statements. Paragraph 83 makes a special exception to that rule by permitting legal isolation to be accomplished in a two step structure, where the true sale occurs in the first step,
between consolidated affiliates. We support that exception, because it is consistent with the legal analysis of the transaction.

A. The requirement that paragraph 9(b) be satisfied at each step of a multi-step transaction is conceptually inconsistent with the essential nature of most multi-step transactions.

The proposed new final sentence in section 9(b), which explicitly requires that paragraph 9(b) be satisfied at each step in a multiple step transaction, heightens the tension that has always existed between paragraph 9(b) and paragraph 83. We request that FASB change paragraph 9(b) in the final statement to avoid this heightened tension. Our recommendation would be simply to delete the new sentence, as we think it is clear that 9(b) applies to each transfer of financial assets, with the limited exceptions referenced above and in the next paragraph. Alternatively, if the Board wishes to retain the new sentence, then the Board should provide additional guidance indicating that the requirement in the new sentence is deemed to have been met if the transferee has in fact transferred the financial assets that it obtained (so that it has no continuing ability, as a legal matter, to pledge or exchange them again), and that it is not necessary to consider whether the transfer was pre-programmed for the benefit of the initial transferor.

If FASB leaves in the new sentence but provides the additional guidance we have requested, then it is important that the additional guidance also cover the following situation. Some very large credit card securitization programs operate through two trusts. A beneficial interest (often called a “collateral interest”) issued by one qualifying SPE (a certificate-issuing trust) is placed into a second qualifying SPE, which issues beneficial interests (generally in the form of notes) in the collateral interest. This dual trust structure evolved as a way for credit card banks (which often had large portions of their portfolios committed to certificate-issuing trusts) to transition to a note-issuing platform (which investors prefer), when tax changes and the non-consolidation rule for qualifying SPEs made that possible.

 Constituents have reasoned that in these transactions the current language of paragraph 9(b) permits them to look through to the holders of the beneficial interests issued by the second qualifying SPE in applying paragraph 9(b) to the first qualifying SPE. If FASB adopts the proposed new sentence in paragraph 9(b), it should expressly permit preparers to continue this look through analysis.

In Appendix A’s discussion of background information and the Board’s basis for conclusions, the proposed new final sentence in paragraph 9(b) is discussed in paragraph A21, immediately after the discussion (in paragraphs A18-A20) of the Board’s deliberations about the differences between undivided interests and beneficial interests. This suggests that the Board sees this change as linked to its decisions about transfers of portions of financial assets. As discussed in connection with examples 2 and 3 below, we oppose those changes. Even if the Board retains some or all of those changes, we hope that this first example makes it clear that the proposed new final sentence of paragraph 9(b) is not operational, for even the most commonplace transactions.
B. The new transferability requirement under paragraph 9(b) for transferor’s beneficial interests (1) is not necessary in order to isolate financial assets or transfer their control and (2) creates problems for numerous transactions.

In example 1 above, the residual certificate issued by Issuer is retained by BR Sub (which is consolidated by Sponsor). Under the transfers exposure draft, this certificate would be classified as a “transferor’s beneficial interest” and measured at fair value. In addition, under the proposed changes to paragraph 9(b), the transferor must have the right to pledge or exchange it. Our comment relates to this new transferability requirement.

We have been unable to identify the rationale for the new transferability requirement relating to transferor’s beneficial interests in Appendix A. We do not believe there is any logical connection to the existing control paradigm of Statement No. 140. The point of the existing transferability requirement in paragraph 9(b), which relates to the rights of transferees, is to assure that the transferor has not maintained control of the transferred financial assets (including transferred beneficial interests) 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. It is hard to see how restrictions on a transferor’s rights to pledge or exchange transferor beneficial interests could be seen as showing that the transferor still has control of the underlying assets. If anything, the existence of constraints on a transferor’s rights to pledge or exchange its beneficial interests strengthen the conclusion that the transferor has surrendered control.

This new requirement is also unclear, as there are some inconsistencies on related points within the transfers exposure draft. First, as noted above, paragraph 9(b) itself says that the transferor’s rights to pledge or exchange may not be constrained by a condition that provides more than a trivial benefit to the transferor, which is a somewhat confusing concept. In other words, we understand the reason why a more-than-trivial benefit that accrues to the transferor is problematic when the constraint is imposed by the transferor on the transferee, but fail to understand how, or why, that should be the case when the constraint is imposed on the transferor. Another inconsistency is in paragraph 29, which continues to speak of the transferability requirement only in reference to transferees.

For the purposes of this letter, we assume that the Board viewed the new requirement as logically consistent with the move to measuring transferor beneficial interests at fair value. However, we do not think it is necessary to add this new transferability requirement. Instead, to the extent that a transferor’s rights to pledge or exchange a beneficial interest are constrained, those constraints can be taken into account in determining the fair value of the beneficial interest (just as the Board has indicated in paragraph 59 that any subordination of the transferor’s beneficial interests must be considered in valuing those interests). They should not, however, impact the derecognition analysis.

We are concerned about this proposed requirement because it impacts many common types of transactions. In many transactions, the transferor (or its bankruptcy remote subsidiary, which receives interests of this type) has the right to transfer beneficial interests, but in many transactions those rights are restricted. For instance, in many credit card master trusts, the
transferor is required to maintain some minimum ownership interest. Also, real estate investment trusts (REITs) that securitize mortgage loans are required to retain residual interests.

Therefore, we request that the Board delete the new requirement that transferor’s beneficial interests be transferable, as it is not necessary in order to achieve the Board’s objectives, is inconsistent with current practices and is not operational for many common transactions.

II. Comments on Guidance Relating to Transfers of Portions of Financial Assets.

A. The proposed new guidance on transfers of portions of financial assets would require transferors to use qualifying SPEs in transactions that transfer participations or undivided interests that do not meet the requirements of proposed new paragraph 8A, even where all of the current requirements of paragraph 9 can be met without them and where the qualifying SPE will not enhance isolation from the transferor.

We oppose the new guidance on transfers of portions of financial assets. In many cases (including bank loan participations), the current derecognition criteria can be satisfied for a portion of a financial asset that is transferred without using a qualifying SPE. We do not believe that the restrictions imposed by paragraph 8A or the arbitrary requirement to otherwise use a qualifying SPE further the objectives of Statement No. 140.

Appendix A suggests two possible reasons for the changes relating to transfers of portions of financial assets. We discuss each of these reasons below and do not believe that either of them provides a sufficient basis for these sweeping changes. (If there are other reasons, it would be helpful if the Board could elucidate them, so that we could consider them as well.)

The first possible reason is contained in paragraphs A18-A20, which discuss some confusion in practice as to the differences between “undivided interest” and “beneficial interest,” particularly in the application of paragraph 9(b). Paragraph A19 says that the Board decided that undivided interests and beneficial interests are “not sufficiently different to warrant different accounting”, so the Board has proposed various changes to harmonize the accounting treatment of the two. The Board does not, however, give any indication that it looked at the merits of actual transactions in which undivided interests (other than loan participations) are currently being derecognized in reaching its decision. The May and June 2004 roundtables focused almost exclusively on loan participations.

The second possible reason is contained in paragraph A24, which indicates that the Board members who approved exposing paragraph 8A and related changes “do not believe that an asset has been isolated from the transferor unless the entire asset has first been placed in a qualifying SPE or otherwise segregated.” Neither Appendix A nor the Board’s prior deliberations on these issues provide any reasons for this belief, which is inconsistent with both the information received by the Board on this issue and other provisions of the transfers exposure draft. By far the majority view of lawyers participating in the 2004 roundtables was that there can be a true sale of a portion of a financial asset, and the Board has recognized that this is possible in the case of participating interests.
In the 2004 roundtable discussions, the only incremental isolation risk identified for transfers of portions of financial assets, as opposed to transfers of entire financial assets, was some additional setoff risk. That incremental risk is situation-specific. It does not apply equally to all transfers of portions of financial assets. For a number of reasons, the existence of incremental setoff risks for some transfers of portions of financial assets does not provide a satisfactory basis for the proposed changes:

- As noted in paragraph A13, "the existence of setoff rights is not considered by a court when assessing whether a transaction would be deemed a true sale."

- Paragraph A14 states that the Board "decided that setoff rights would not be an impediment to meeting the isolation requirement."

- The proposed new requirements do not distinguish between circumstances where this incremental risk is or is not present.

Although we identified a number of different types of transactions that would be affected by the predecessors to these changes in our comments on the prior exposure draft, the Board's public deliberations on these issues (including the two roundtable discussions in May and June 2004) focused almost exclusively on bank loan participations and related setoff rights. While we appreciate the fact that the Board decided to permit continued derecognition of bank loan participations (through paragraph 8A), we do not understand why the Board has decided that these other categories of transactions require a qualifying SPE. We believe that there is currently a consistent approach on how to apply the existing guidance to transfers of portions of financial assets, and we are not aware of any abuses.

Example 2 below illustrates an important type of market transaction that does not appear to have received adequate consideration in the Board's deliberations on transfers of portions of financial assets. Example 2 illustrates a situation where isolation is possible in a single step transfer. In some other situations a two-step transaction is used to isolate an entire financial asset in a bankruptcy remote entity, which issues a senior participation or other undivided interest.

**Example 2 - GSE Mortgage-Backed Securities**

**Facts:** Mortgage companies originate residential mortgage loans and transfer them to one of the Government-Sponsored Entities ("GSEs")\(^\text{2}\), which pools them and issues participation certificates in the pools into the capital markets as follows (and as diagrammed on Attachment 2):

- Mortgage companies sell mortgage loans to the GSE for cash in transfers that satisfy all requirements of paragraph 9.

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\(^{2}\) This example is drawn from one of Freddie Mac's purchase programs. Other programs offered by Freddie Mac or one or more of the other GSEs may have similar issues.
The GSE involved in the transaction does not use state law trusts or other distinct legal entities to issue the participation certificates.

The participation certificates represent undivided beneficial ownership interests in underlying pools of mortgage loans. They also carry the GSE’s guarantee of timely payment of interest and principal, for which the GSE generally receives a negotiated management and guarantee fee, payable over the life of the participation certificates from cash flows on the underlying mortgage loans.

The GSE has obtained legal evidence indicating that the mortgage loans that back the transferred participation certificates are legally sold and would be beyond the reach of the GSE and its creditors.

Buyers of the participation certificates have the right to pledge or exchange them.

**Analysis Under Current GAAP:** The mortgage company derecognizes the mortgage loans at the time of their transfer to the GSE. The GSE treats the transfer of participation certificates to third parties as a sale of the underlying mortgage loans and also recognizes a retained interest in the form of a management and guarantee fee receivable.

**Changes Under Transfers Exposure Draft:** It is likely that the participation certificates (a) would be viewed as representing portions of the underlying mortgage loans, since they represent beneficial ownership interests (as opposed to individual mortgage loans in their entirety), and (b) would not meet the transfer exposure draft’s definition of participating interests, since (at a minimum) the GSE guarantee would be viewed as recourse that is incompatible with the provisions of paragraph 8A(c). As a result (and taking into account paragraph A23), it appears that the GSE would have to change its program to use qualifying SPEs in the future in order to continue to derecognize the mortgage loans when it issues participation certificates. It is hard to see any reason for this requirement, since legal isolation is already achieved without using qualifying SPEs.

In light of all of the foregoing, we strongly agree with the statement in paragraph A49 that the Board has not demonstrated that the benefits of this new guidance outweigh its costs. We strongly prefer that the Board retain the current guidance on transfers of portions of financial assets.

**B. The transfers exposure draft could also be misinterpreted to require a qualifying SPE in some CDO transactions that currently use variable interest entities as issuers. We request additional guidance to avoid this misinterpretation.**

If the Board includes the proposed new guidance on transfers of portions of financial assets in the final changes to Statement No. 140, then we request clarification of its intended scope. The transfers exposure draft repeatedly indicates that sale accounting can be achieved “by transferring an entire financial asset or group of financial assets to a qualifying SPE or other
entity that is not consolidated with the transferor and the entire transferred financial asset(s) must meet the conditions of paragraph 9 of Statement 140 as amended. The proposed changes to paragraph 83 specifically indicate that the transferee can be a variable interest entity, so long as the transferor determines that the variable interest entity should not be consolidated with the transferor. Based upon these very clear statements, we believe that under the changes proposed in the transfers exposure draft it should still be possible for transferors to achieve sales treatment in collateralized debt obligation ("CDO") transactions using a non-consolidated variable interest entity as the transferee and issuer of the CDOs.

The only possible cause for confusion on this point lies in the fact that, under current GAAP, transferors are sometimes treated as having a "retained interest" in financial assets, even when the entire financial assets have been contractually transferred. Many non-cash assets received (or retained) by a transferor in consideration of a transfer of financial assets are currently categorized as "retained interests." The phrase "retained interests" could be viewed as implying that, for accounting purposes, the entire financial assets have not been transferred (since a portion is treated as "retained"). That in turn could be viewed as suggesting that, if a transferor receives any securities backed by the transferred financial assets (retained interests, under the old terminology) as part of the purchase consideration, then a transaction of this type does not transfer entire financial assets and must be analyzed under paragraph 8A (assuming it does not involve a qualifying SPE).

The example below illustrates this issue in the context of a single step transaction, but it could also arise in multiple-step transactions or other single step transactions besides the one described below.

Example 3 – CDO Issued by a Variable Interest Entity.

Facts: A transferor sells a portfolio of debt securities to an SPE in a single step transfer with the following characteristics (which is diagrammed on Attachment 3):

- Legally, the entire financial assets are transferred.
- Paragraph 9(a) is satisfied in that the transferor obtains a true sale opinion relating to the entire financial assets, taking into account all factors required under all relevant portions of Statement 140, including the proposed paragraphs 9(d) and 9(e).
- Paragraph 9(b) is satisfied in that the SPE has the right to pledge or exchange the assets, and that right is not constrained in any manner that provides more than a trivial benefit to the transferor.
- No arrangements that violate paragraph 9(c) exist.

Paragraph 2(d) (emphasis added). See also paragraphs A22-A24, which indicate that the Board members who approved this new guidance believed that isolation could be achieved by segregating entire financial assets in ways other than transferring them to a qualifying SPE.
October 10, 2005
Page 10

- The SPE is not a qualifying SPE, but in an analysis under FIN 46R the transferor is not the primary beneficiary.

- The purchase price received by the transferor consists of a combination of (a) cash, which the SPE raises by issuing securities to investors that are not affiliates or agents of the transferor, and (b) securities issued by the SPE that the transferor receives, records at fair value and classifies as available for sale or trading, as appropriate. The securities issued by the SPE are tranched as to sequence of payment and coverage of credit losses, so the securities sold to investors would not be valid participating interests within the meaning of proposed paragraph 8A, if they had to be analyzed under that paragraph.

**Analysis Under Current GAAP:** All of the conditions in paragraph 9 for derecognition are satisfied, and the transferee is not consolidated with the transferor. As a result, the transferor should derecognize the transferred financial assets. The securities received by the transferor should be treated as part of the purchase price for purposes of computing gain (or loss) on sale.

**Possible Confusing Factors Under Transfers Exposure Draft:** We do not think that the proposed new guidance on transfers of portions of financial assets changes the result in this example. Transferor has contractually transferred entire financial assets; paragraph 8A does not apply, and the transaction still meets all the requirements for derecognition.

However, some minor wording changes proposed in the transfers exposure draft could be misinterpreted as supporting a different result. Under current GAAP, the securities taken back by the transferor would be recognized as retained interests. The transfers exposure draft seems to eliminate that term. It has been globally replaced by "transferor’s beneficial interests," but that new term only applies to qualifying SPEs (see, for example, the definition of "beneficial interests" in the Glossary in paragraph 364). We believe this was a drafting short-hand or oversight and that the securities received by the transferor in this example should be viewed as "other assets obtained" for purposes of paragraph 11(b). However, this global change could be misinterpreted as suggesting that the transaction amounts to an attempted (and unsuccessful) transfer of portions of the financial assets because the transferor has retained something that would be called a "transferor’s beneficial interest" but is not issued by a qualifying SPE.

Also, in a meeting between FASB staff and representatives of the ASF, The Bond Market Association and ISDA on March 3, 2005, FASB staff indicated that a qualifying SPE might be needed in a transaction of this type. We disagreed with that view in a follow-up letter dated March 31, 2005 from the three trade associations to FASB staff. As indicated above, we think it is clear from the face of the transfers exposure draft that the Board did not mean to require the use of a qualifying SPE in a transaction of this type. Only the technical, conforming points mentioned above create any room for doubt on this point. Given the importance of the point, we are asking FASB to remove this last source of doubt.

Specifically, if the final statement includes guidance similar to paragraph 8A it should also include guidance that clarifies that situations like those described above are not transfers of portions of financial assets. Specifically, we request that the final statement include guidance along the following lines:
The determination of whether a given transfer should be considered as a transfer of entire financial assets or a transfer of portions of financial assets is to be based upon whether the transfer documentation by its terms covers entire financial assets or only portions. The fact that the consideration received by a transferor includes a security or other asset that is backed by cash flows from the transferred assets does not mean that less than the entire financial assets have been transferred or that paragraph 8A applies to the transfer.

The language of the transfers exposure draft needs conforming changes related to this issue in several places. For example, paragraphs 82 and 83(b) and Q&A 68 should be changed to retain some concept for "retained interests" that applies when the transferee is not a qualifying SPE. One idea would be to call them "transferor interests."

III. Additional Isolation Guidance.

The transfers exposure draft proposes a number of changes that provide additional, and somewhat inconsistent, guidance as to how the legal isolation requirement in paragraph 9(a) is to be applied. We have several comments on these proposed changes.

A. The proposed requirements to impute agreements and arrangements of a transferor's consolidated affiliates to the transferor for purposes of the isolation requirement under paragraph 9(a) are inconsistent with legal standards.

We oppose the requirement referenced in paragraph A17 for preparers and attorneys to impute agreements and arrangements of a transferor's consolidated affiliates to the transferor for purposes of the isolation analysis under paragraph 9(a) and related guidance. Paragraph A17 indicates that the Board meant to amend paragraph 9 to require that additional facts (when present) be considered by attorneys rendering true sale opinions that are relied upon to support derecognition. Specifically, it appears that the Board wants attorneys to make a hypothetical isolation analysis, in which they consider, and impute to some other person:

"(a) arrangements between the holders of beneficial interests issued by a qualifying SPE and a consolidated affiliate or agent of the transferor of financial assets and the transferee or (b) arrangements between a transferee and the consolidated affiliates or agents of the transferor."

While proposed new paragraph 9(e) may have been intended to implement part of the hypothetical isolation analysis requirement, it clearly does not implement clause (b) above and does not correspond exactly to clause (a) either. Nor have we found any other operative provision that implements clause (b). Because of the inconsistencies between paragraph A17 and the proposed operative provisions, we are not sure exactly what the Board intended to do. At any rate, we request that the final statement delete:

- paragraph 9(e);

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4 Paragraph A17.
• the first two sentences of paragraph A17 – except that we do not object to the final portion of the second sentence, under which the Board would “explicitly require that the isolation analysis include consideration of whether the transferred financial assets are also isolated from the consolidated affiliates of the transferor, other than a consolidated bankruptcy-remote entity”; and

• any new operative provision that would implement the first two sentences of paragraph A17 – with the same exception as immediately above.

We are requesting these deletions because we believe that the proposed hypothetical isolation analysis goes beyond legal isolation, which has previously been the sole requirement under paragraph 9(a).

Paragraph 9, as supplemented by paragraph 27, has always required reasonable assurance that transferred financial assets would be beyond the reach of the powers of a bankruptcy trustee or other receiver for the transferor or any consolidated affiliated of the transferor (other than a bankruptcy remote affiliate). In giving legal opinions that provide this assurance, attorneys would customarily take into account any material involvements of affiliates in the transaction (and we would not object to an explicit requirement that they do so). However, unlike GAAP, which generally views affiliates as a single economic unit, the law generally respects the separateness of discrete legal entities. Consequently, the impact on true sale or substantive consolidation analysis of a transferor’s affiliate having a particular obligation or other ongoing involvement with assets or a transaction may be materially different than if the transferor itself had that obligation or involvement.

We support the use of legal isolation as the litmus test under paragraph 9(a). However, we see no reason why FASB should require something more than legal isolation by mandating a hypothetical legal analysis that imputes the obligations and involvements of affiliates to a transferor.

If, notwithstanding our comments, the Board decides to implement clause (b) of paragraph A17 in the final statement and require that arrangements or agreements of a transferor’s affiliates be imputed to the transferor, it is important that the Board make a clear exception for bankruptcy remote affiliates. This exception would parallel the one that has always appeared in paragraph 27 and that now appears in the new language in paragraph 9(a): the transferred financial assets must be “beyond the reach of the powers of a bankruptcy trustee or other receiver for the transferor or any consolidated affiliate of the transferor that is not a special-purpose corporation or other entity designed to make remote the possibility that it would enter bankruptcy or other receivership . . . .” (emphasis added) Similarly, any recourse, subordinated interests or other involvements provided or held by a bankruptcy remote entity should not be imputed to the transferor. Otherwise the long-standing guidance in paragraphs 27 and 83, permitting isolation through two-step transactions, would be inoperative.

Attachment 4 to this letter shows how paragraph A17 should be revised to provide an appropriate exception for bankruptcy remote affiliates. A parallel exception should be made in any operative provision of the final statement that implements any remaining hypothetical isolation analysis requirement.
B. Other Comments on the Additional Isolation Guidance.

1. We request that legal true sale remain in its position under current guidance, as a factor that is usually required but may not always be.

Paragraph 27A seems to say that a legal true sale is required in order to satisfy the isolation requirement of paragraph 9(a). As stated above, we generally support an emphasis on the legal characteristics of the transaction as the litmus test for paragraph 9(a). However, to specifically require a legal true sale for derecognition would change existing practice in some circumstances.

Paragraph 27 has always stated that “whether a transfer would likely be deemed a true sale at law” is something that “may” be considered in deciding whether financial assets have been isolated (and the transfers exposure draft has not changed this text). That generally has entailed a true sale, but the ultimate conclusion that had to be reached was that “the available evidence provides reasonable assurance that the transferred financial assets would be beyond the reach of the powers of a bankruptcy trustee or other receiver for the transferor or any consolidated affiliate of the transferor that is not a special-purpose corporation or other entity designed to make remote the possibility that it would enter bankruptcy or other receivership.”

Existing practice recognizes at least two circumstances where the necessary conclusion can be reached without a true sale. One of these circumstances is specifically addressed in the auditing guidance on legal opinions relating to isolation (which the Board generally endorses in paragraph B4 of the transfers exposure draft). That guidance permits derecognition by FDIC-insured depository institutions without a true sale opinion if an alternative approved opinion formulation is delivered. The other circumstance relates to transfers in foreign jurisdictions, where isolation may sometimes be possible without a true sale.

On a related point, FASB should retain the current text in paragraph 27 that recognizes the relevance of “the kind of bankruptcy or receivership into which a transferor or SPE may be placed”.

2. Paragraphs 27A and 27B should not use the word “estate” or phrase “bankruptcy estate.”

The concept of an “estate” or “bankruptcy estate” is a feature of the Bankruptcy Code. These terms are not used in many other insolvency statutes that would apply in the insolvency of various types of transferors, including importantly the Federal Deposit Insurance Act, as amended, which governs FDIC receiverships of insured banks and other insured depository institutions. Consequently, many law firms are reluctant to use these terms in opinions relating to entities that are not eligible to be debtors in Bankruptcy Code proceedings. We think it would be best for the Board to be very general in these paragraphs, or to delete them and rely on the existing guidance in paragraph 27.

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5 Paragraph 27.
6 See AU SECTION 9336, Interpretation of AU Section 336, Using the Work of a Specialist, paragraph 1.14, example 2.
3. The second sentence of paragraph 27B goes beyond existing practice in suggesting that a nonconsolidation opinion is often required if the transfer is to a qualifying SPE or another SPE.

The existing audit guidance, which reflects current practice and extensive deliberations and discussions with legal specialists, indicates that a nonconsolidation opinion is required only in the case of transfers to an affiliated entity and “other situations as noted by the legal specialist.” The audit guidance goes on to say that a nonconsolidation opinion “usually will be required with respect to the transferee in the first step”.

The second sentence of proposed paragraph 27B could be read as expanding these customary requirements in at least two respects. First, commonly a qualifying SPE is the transferee in the second step of a two-step transfer, where legal specialists and market participants generally do not require a nonconsolidation opinion. Second, by referencing qualifying and other SPEs separately from affiliates, the sentence suggests that the opinion might be required in a sale to a non-affiliated SPE. This is also not customary, regardless of whether the SPE is qualifying or not and regardless of whether the transaction involves a single step or multiple steps. We request that FASB conform the second sentence of paragraph 27B to the current audit guidance.

4. Proposed new paragraph 9(d) is redundant with existing paragraph 55 and should either be deleted or conformed to paragraph 55.

Proposed new paragraph 9(d) requires that the isolation analysis consider arrangements or agreements relating to a transfer that are not made at the time of the transfer. This seems similar to the requirement in paragraph 55 to re-recognize transferred financial assets if subsequent events bring them back within the transferor’s control. We find the formulation in paragraph 55 to be much clearer than in paragraph 9(d), in that paragraph 9(d) could be read as requiring that the isolation analysis take into account things that might happen in the future but have not been determined yet. We request that paragraph 9(d) be deleted as redundant with paragraph 55. If the Board wishes to emphasize this point by including it in the standard itself as part of paragraph 9, we request that the Board use language closer to that used in paragraph 55 for this purpose.

IV. Qualifying SPEs.

A. We support FASB’s elimination of limitations on derivatives that can be held by a qualifying SPE.

Among other things, this will eliminate the market-making issue that we discussed in our comment on proposed FSP No. FAS 140-c.

B. We do not support the new provisions relating to entities that can roll over beneficial interests.

We recognize, however, that the current proposal eliminates all or most of the ambiguities and unintended consequences that we identified in our comments on the prior exposure draft.

7 AU SECTION 9336, Interpretation of AU Section 336, Using the Work of a Specialist, paragraph 1.13.
Assuming that FASB is not open to reconsidering the necessity of these new provisions, we would request the following as further refinements to the approach.

1. **If an SPE is found not to be a qualifying SPE because of the existence of the types of synergistic benefits discussed in paragraph 45A, the effect of the “disqualification” should be limited in some circumstances.**

The party or parties that have one or more of the types of involvements described in paragraph 45A can change after an SPE has been established. All or most of the parties dealing with the SPE may have no way of knowing that some other party has acquired multiple involvements that enable that party to reap synergistic benefits. In the most extreme example, an unrelated party may hold interests that might render it the primary beneficiary of an SPE under FIN 46R but not know whether or not to consolidate the SPE. This is because the consolidation analysis would first depend upon whether or not the SPE is a qualifying SPE, which would in turn depend upon multiple involvements and benefits of an unrelated party that the potential primary beneficiary has no ability to control or even monitor. Consequently, we request that FASB limit the impact of disqualification under paragraph 45A to the party that has the multiple synergistic involvements, if the multiple involvements arise from events that occur after the closing of the transaction (and that were not contemplated by the parties at the time of closing).

2. **For currently qualifying SPEs, the analysis of possible synergistic values under paragraph 45A should only be required if rollovers actually occur, rather than simply being permitted.**

Under the proposed language, the analysis of possible synergistic values under paragraph 45A is required if an SPE’s governing documents permit rollovers of beneficial interests. Many existing SPEs (particularly master trusts) are not prohibited from rolling over beneficial interests, since they were established before the prior exposure draft was published. It is, at the least, an unnecessary expense to require that the governing documents for these SPEs be amended to affirmatively prohibit rollovers, when substantially the same objective could be achieved by disqualifying SPEs that actually rollover beneficial interests (after an appropriate transition period and assuming that more-than-trivial synergistic value is found in the paragraph 45A analysis). Given the existing constraints on changing the permitted activities of qualifying SPEs and the fact that many of these SPEs have numerous and widely dispersed beneficial interest holders, it may not always be possible to make any required change. New entities established in the future could include the prohibition from the time of their establishment.

3. **The test for disqualification due to synergistic values should be whether more-than-trivial incremental benefits are actually obtained.**

If an analysis of possible synergistic values is required, the proposed test for disqualifying an SPE is whether any party (including its consolidated affiliates and agents) has the opportunity to obtain a more-than-trivial incremental benefit by virtue of having more than one type of involvement with the SPE. While paragraph A34 indicates that the Board did not mean to establish a presumption, we believe that the “opportunity” standard is too subjective and in
practice would tilt the analysis to a virtual presumption of disqualification. It is always hard to prove a negative. It would be especially hard to prove the negative that a party would not, under any circumstances, have even an opportunity to obtain a more-than-trivial incremental benefit. A standard that looked for actual benefits, rather than just an opportunity, would be far more objective and operational.

4. The definition of rollovers of beneficial interests should exclude remarketing.

Finally, we request clarification that the concept of "rollover" does not include remarketing of existing beneficial interests. For instance, in municipal bond securitization programs, certificates representing a beneficial interest in a pool of municipal bonds are periodically remarketed by a designated remarketing agent. The remarketing agent resets the interest rate on the certificates at a market-clearing rate at the time of each remarketing. Because the same securities remain outstanding, this should not constitute reissuance. The remarketing activity is not treated as a new issuance for either tax or securities law purposes.

Specifically, we request the following additional sentence at the end of the definition of "Rollovers of beneficial interests":

Remarketing of existing beneficial interests, where those beneficial interests remain outstanding, also are not considered rollovers.

C. We request two exceptions to the prohibition on a qualifying SPE holding equity instruments.

We do not have any fundamental objection to FASB’s decision to prohibit qualifying SPEs from holding equity securities. In addition, we support the changes that FASB made to paragraph 41 since the prior exposure draft, permitting equity securities to be held temporarily as a result of collections and adopting the Statement 115 definition of equity instruments for this purpose. These changes are consistent with comments that we made on the prior exposure draft.

We made two other requests on this issue in our comments on the prior exposure draft, and we repeat those requests here. Specifically, although we support the use of the Statement 115 definition of equity instruments in this context generally, there are two types of instruments that we believe a qualifying SPE should be permitted to hold and that are or might be considered equity instruments under the Statement 115 definition. We request that FASB make exceptions to permit qualifying SPEs to hold these investments.

1. Shares of Money Market Funds.

As acknowledged in paragraph 35(c)(6), cash collected from financial assets that are held by a qualifying SPE is often invested in money market or other low-risk short term instruments pending the next date for distributions to beneficial interest holders. Shares in money market funds are a convenient and commonly used investment for this purpose, but they are equity instruments under the Statement 115 definition.
2. Titling Trust Certificates.

In order to securitize retail auto leases, auto finance companies devised a form of entity referred to as a titling trust. Titling trusts overcome a practical impediment to legal isolation of these assets, by titling the cars that are subject to the leases in the name of a trust. A certificate of beneficial interest issued by the titling trust and representing the specific leases to be securitized is transferred to an SPE that issues beneficial interests in the cash flows from the subject leases. The subject leases qualify as financial assets, in part because of residual value insurance obtained at inception. The certificate of beneficial interest transferred to the issuing SPE may be an equity instrument under the Statement 115 definition, but in substance it is simply a pass-through instrument representing the rights to cash flows from an identified pool of financial assets (the specific leases being securitized).


We request that FASB revise the parenthetical phrase at the end of paragraph 35(c)(1) to read:

(other than (i) those noted in paragraph 35(c)(5), (ii) shares in money market funds held as described in paragraph 35(c)(6) and (iii) pass through certificates representing the right to receive all or a pro rata portion of the cash flows from specified financial assets that are not themselves equity instruments)

V. Effective Date.

We request that the effective date be revised so that the changes are not effective until the beginning of the first fiscal quarter beginning after the quarter in which the final statement is issued. It is unreasonable to require preparers to reanalyze under the new guidance transactions that closed prior to the issuance of the final statement.

In addition, to the extent that the proposed new guidance on transfers of portions of financial assets is adopted, we understand that one or more of the GSEs, and possibly other affected constituents, may need a substantial transition period to incorporate qualifying SPEs into programs that are already complicated and operate at high volumes. We support relief of this type.

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October 10, 2005
Page 18

The ASF appreciates the opportunity to provide the foregoing comments. Should you have any questions or desire any clarification concerning the matters addressed in this letter, please do not hesitate to contact Esther Mills, Chair of the Accounting and Tax Subcommittee (212. 449.2048), Lisa Filomia-Aktas, Deputy Chair of the Subcommittee (212.773.2833) or George Miller, Executive Director of the ASF, at 646.637.9216.

Sincerely,

/s/ Esther Mills__________________  /s/ Lisa Filomia-Aktas__________________
Chair                                    Deputy Chair
Accounting and Tax Subcommittee             Accounting and Tax Subcommittee
American Securitization Forum                American Securitization Forum
Diagram of Example 1 - Two-Step Transfer to a QSPE

1st step transfer. True sale and non-substantive consolidation opinions.

2nd step transfer.

Attachment 1
Diagram of Example 2 - GSE Mortgage-Backed Securities

- Mortgage company
  - Cash
  - Mortgage loans
- GSE
  - Participation certificates
  - Legal isolation under applicable insolvency law.
- Investors
  - Cash
- True sale.
Diagram of Example 3 - CDO Issued by a Variable Interest Entity

Transferor (not primary beneficiary)

Cash and selected issuer securities

Issuer (VIE)

Cash

Issuer securities

Investors

True sale opinion.
Proposed Changes to Paragraph A17.

Note: As indicated in Part III.A. of our comment letter, we strongly prefer that the first sentence of paragraph A17 and much of the second sentence be deleted. The edits shown below make an important clarification that is required if the Board decides not to make our preferred deletions.

A17. The Board learned that attorneys rendering true sale and nonconsolidation opinions might not consider or even know of (a) arrangements between the holders of beneficial interests issued by a qualifying SPE and a consolidated affiliate or agent of the transferor of financial assets and the transferee\(^8\) or (b) arrangements between a transferee and the consolidated affiliates or agents of the transferor. The Board decided to amend paragraph 9 to require that all such arrangements be considered in the isolation analysis be conducted as if these any arrangements made between (a) holders of beneficial interests or a transferee of financial assets (including a transferee that is an SPE designed to be bankruptcy remote), on one hand, and (b) any consolidated affiliate or agent of the transferor (other than a consolidated bankruptcy-remote entity), on the other hand, had been made directly between the transferee (including a transferee that is an SPE designed to be bankruptcy remote) and the transferor and to explicitly require that the isolation analysis include consideration of whether the transferred financial assets are also isolated from the consolidated affiliates of the transferor, other than a consolidated bankruptcy-remote entity. The Board also decided to require that any arrangements made in connection with a transfer of financial assets or with the issuance of beneficial interests by a qualifying SPE be considered even if those arrangements were not entered into at the time of the transfer.

\(^8\) Our deletion of the phrase "and the transferee" is meant to avoid confusion, as it is difficult to understand the meaning of that phrase in this context, and we do not believe it adds anything.