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Financial Accounting Standards Board ATTN: TA&I Director – Setoff and Isolation

PO Box 5116 Norwalk, CT 06856

Re: Setoff and Isolation

This e-mail message is in response to the FASB Staff Request for Information, published April 9, 2004, concerning FASB's project to amend FASB Statement No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities. NASCUS believes that credit unions, and the nature of the relationship between a credit union member and their credit union, are unique and deserve special consideration as FASB develops amendments to Statement No. 140.

The National Association of State Credit Union Supervisors (NASCUS) is the professional association of the 48 state and territorial government regulatory agencies which supervise the nation's 4,094 state-chartered credit unions. As Regulators, NASCUS members' primary responsibility is to ensure the safety and soundness of the financial institutions under their supervision.

1) Public Roundtable Discussion of Setoff Rights

FASB's request for information discusses a public roundtable of attorneys to address the issues of setoff rights and the isolation of transferred assets. To the extent that such roundtables are held in the future, NASCUS urges FASB to invite a representative from the State Credit Union Regulatory Agencies to participate. State regulators have a broad range of experience and expertise. In many cases, our state regulators are responsible for the examination of a wide range of financial institutions, including credit unions, banks, thrifts and other financial service providers. State regulators have worked with FASB in the past and would willingly contribute their expertise in the future.

2) Credit Union Share and Deposit Accounts: Unique Nature of Credit Unions

FASB has articulated a concern over the common law right of setoff. FASB's understanding of the common law right of setoff is as follows:

If one of the parties in a mutual debtor-creditor relationship transfers all or a portion of its financial asset (the amount receivable from the other party) to a third party, the right of setoff between the first two parties may not be eliminated. That is, the original debtor/creditor relationship may continue to exist for setoff purposes in spite of the transfer. If the setoff rights are not eliminated by the transfer, the transferred financial asset is not isolated from the transferor as required by Statement 140.

FASB's understanding of the common law may be correct. However, the unique organization of credit unions renders the above analysis inapplicable to some credit unions. In order to properly analyze the impact of offset rights, FASB must distinguish between share accounts offered by credit unions and deposit accounts offered by some credit unions and other financial institutions.

Credit unions only make loans to members. Therefore, any credit union loan that is "participated out" will be a loan made to a member.

Credit unions, whether chartered by the National Credit Union Administration (NCUA) or by 48 state and territorial regulatory agencies under their state law are cooperatives owned by their members. Federal credit unions and credit unions in many states offer "share" accounts rather than the traditional deposit accounts offered by other financial service providers. Credit union share accounts are ownership of the institution and under the Federal Credit Union Act and many state credit union laws, place their holders in an equity position rather than a creditor position. Credit union share account holders would receive a pro rata distribution of what is left after payments to creditors. In these cases then, the right of offset would not apply.

In order to exercise the right of setoff, there must be a mutuality of obligation between the credit union (in this case) and the member. The equity aspect of a share account does not create the necessary mutuality of obligation required for the exercise of the right of setoff. FASB should address this in the Statement and allow true sale treatment for loan participations originated by credit unions that offer share accounts.

In some states, state credit unions do offer deposit accounts in addition to share accounts. While the deposit account holders would also have share accounts and be members, their deposit accounts do establish a creditor relationship as they would in any financial institution. In these credit unions, the deposit account holders would be able to exercise the right of setoff. However, NASCUS urges FASB to create a more workable isolation of assets model for credit unions that allows these institutions to diversify risk and serve their members through loan participations.

3) Elimination of Offset Rights

The proper accounting for a loan participation is an issue of importance to all regulatory agencies. However, in the case of credit unions, the essential role played by loan participation in diversifying risk and the unique structure of credit unions make the creation of Qualified Special Purpose Entities (QSPE) impractical for most credit unions.

QSPEs make sense for loan securitizations and large loan syndications. Most credit unions, however, engage in individual loan participations. The requirement of a QSPE would render this tool for diversification of risk too expensive for many credit unions while providing very little in the way of creditor protection that FASB seeks to address.

NASCUS recommends that FASB consider allowing credit unions to seek waivers from deposit account holders in order to eliminate setoff rights. Credit unions also invest in Credit Union Service Organizations (CUSOs). FASB may consider allowing loan CUSOs to serve as a QSPE for loan participation purposes.

NASCUS would welcome an opportunity to discuss the state regulator perspective on Statement 140. To the extent that FASB requires more information, please do not hesitate to contact Brian Knight of my staff (703:528-8689) or myself at (703) 528-8688.

Sincerely,

Mary Martha Fortney

NASCUS President & CEO

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