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July 31, 2003

Mr. Lawrence W. Smith
Director of Technical Application and Implementation Activities
Financial Accounting Standards Board
401 Merritt 7
Norwalk, Connecticut 06856

Letter of Comment No: 39 File Reference: 1200-001 Date Received: 07/31/03

Re: File Reference No. 1200-001

Proposed Statement of Financial Accounting Standards, Qualifying Special-Purpose Entities and Isolation of Transferred Assets, an amendment of FASB Statement No. 140 (the "Exposure Draft")

Dear Mr. Smith:

Toyota Motor Credit Corporation ("TMCC") welcomes the opportunity to comment on the Financial Accounting Standards Board's ("Board") Proposed Statement of Financial Accounting Standards on Qualifying Special-Purpose Entities and Isolation of Transferred Assets – an amendment of FASB Statement No. 140 ("Exposure Draft") dated June 10, 2003.

TMCC was incorporated in the state of California in 1983, and is an indirect wholly-owned subsidiary of Toyota Motor Corporation ("TMC"). TMC, headquartered in Toyoda City, Japan, is the world's second largest automaker. TMCC provides retail and wholesale financing, retail leasing and certain other financial products and services to authorized Toyota and Lexus vehicle dealers, and to a lesser extent other domestic and import franchised dealers and their customers in the U.S. TMCC also provides retail, lease, and wholesale financing to industrial and other equipment dealers throughout the U.S. TMCC is among the ten largest U.S. finance companies as measured by net receivables, with over \$41 billion in assets managed as of June 30, 2003.

We support the Board's objective of preventing derecognition by transferors that may continue to retain effective control of transferred assets by providing financial support other than a subordinated retained interest or making decisions about beneficial interests. Our concern is that the Exposure Draft as currently drafted, if applied to certain securitization transactions, may produce unintended consequences. Based on our understanding of the Exposure Draft and discussions with industry participants, we wish to comment on several points noted as follows.

Please note that TMCC is a member of the American Financial Services Association and has participated in the comment letter dated July 31, 2003, submitted to the Board jointly by this organization. We support the positions and recommendations presented therein.

# TMCC's History as a Participant in the Securitization Market and Use of QSPEs to Achieve Sale Treatment of Transferred Assets

TMCC has been an active participant in the securitization market since 1993, securitizing over \$15 billion in consumer receivables backed by retail auto finance contracts and closed-end leases. Securitization accounts for roughly 15-25% of TMCC's annual funding volume and provides TMCC with a cost effective alternative source of capital to fund its growth and ongoing business operations.

TMCC's preference is to structure its securitizations as off-book financing transactions through the use of a two-step transfer of assets from TMCC, to a special-purpose entity ("SPE"), and finally to an issuing trust, which meets the requirements of a qualifying special-purpose entity ("QSPE") under the provisions of Statement of Financial Accounting Standards No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities ("FAS 140").

# Overview of Potential Accounting Treatment Under the Exposure Draft

Our overall concern with the Exposure Draft is that it introduces a risks and rewards model similar to that used in FASB Interpretation No. 46, Consolidation of Variable Interest Entities ("FIN 46"), while FAS 140 is based on control. While we sympathize with the Board's dilemma in marrying FIN 46 and FAS 140, we believe that the risks and rewards model introduced in the Exposure Draft would violate the financial components approach outlined in the conceptual framework within FAS 140.

## **Prohibition on Transferor Derivatives**

During the Board's deliberations, the initial decision was to preclude the use of total return swaps and other similar derivatives that shifted substantially all of the risk of the QSPE to the transferor. We agreed with the Board's proposal for such a restriction, as we understand that a total return swap shifts substantially all of the risk back to the transferor. Such a derivative may also violate the financial components approach because the legal isolation of the assets is not achieved.

We do not understand, however, the decision to expand this restriction to include all derivatives between the transferor and the QSPE, including passive, "plain vanilla" derivatives. As the transferor, TMCC cannot exert any control over the QSPE through passive, "plain vanilla" derivatives. Further, we do not agree that a passive derivative enhances a transferor's return.

As a practical matter, TMCC will issue floating rate securities from a QSPE in order to take advantage of market conditions and diversify its investor base. In such instances, the QSPE will typically enter into a passive, plain vanilla interest rate swap in order to match the interest rates on the underlying assets and securities issued. Because of TMCC's high

credit ratings of AAA and Aa1 for its senior debt, and A-1+ and P-1 for its short-term debt, by Standard & Poor's ("S&P") and Moody's Investors Service, respectively, TMCC can act as the swap counterparty to the trust in a more cost effective manner than with an unaffiliated third party.

The sole purpose of such swaps is to protect the trust (the QSPE), and therefore securityholders, against the interest rate mismatch between the fixed rate consumer obligations (the trust assets) and the floating rate security obligations (the trust liabilities). Such swaps do not enable TMCC to exert control over the transferred assets, or enhance TMCC's (as the transferor) return as the holder of the subordinated beneficial interest in the trust. It should be noted that whether the derivative is provided by the transferor or a third-party, the cash flows allocated to the transferor's retained subordinated interest remain unchanged. In fact the interest rate swap is a requirement of the rating agencies to ensure that the swap in place protects senior securityholders from adverse interest rate changes. Without a swap in place TMCC would be unable to secure the AAA and Aaa credit ratings by Moody's and S&P required for the issued securities.

Precluding such passive, plain vanilla swaps would have a significant impact on TMCC's funding costs and, we believe the securitization market as a whole. TMCC would either have to avoid issuing floating rate securities altogether, or engage a non-affiliated party to serve as the swap counterparty to the trust. Both cases will result in increased funding costs to TMCC, which may cause TMCC to eliminate the issuance of floating rate securities. This ultimately would limit the number of such floating rate investment alternatives available to the capital markets. We therefore feel that the language currently contained in the amendment poses unintended consequences that will impact the efficiency of the securitization market and to TMCC directly.

We propose that the restriction on transferor derivatives should be modified to allow passive, plain vanilla derivatives in which substantially all of the risk of the QSPE is not transferred back to the transferor. In this instance, interest rate swaps, basis swaps, caps, and floors would qualify. FAS 140 already provides limitations on derivatives and we continue to believe that such limitations are sufficient for QSPE status. FAS 140, paragraph 11(b), states that transferors should "recognize all assets obtained and liabilities incurred" including "swaps (for example, provisions that convert interest rates from fixed to variable)." Additionally, Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities, would require derivatives to be recognized at fair value, allowing for transparency to the transferor's financial statements. In fact, in TMCC's case, all such derivatives have significant financial statement impact as such derivatives are unassociated and not entered into for specific hedging purposes on a particular underlying instrument.

# Prohibition on Transferor Commitments to Provide Cash or Other Assets

The prohibition on transferors supplying commitments to provide cash or other assets to a QSPE as specified in the amendment in paragraph 35(e), especially when the QSPE is

involved with static, discrete pools of assets, seems to be at odds with the financial components approach adopted in FAS 140. FAS 140, paragraph 11(b), discusses how a transfer of assets would be recognized as a sale and that "guarantees or recourse obligations" would be recognized as liabilities.

FAS 140 already provides language requiring guarantees from a transferor to be recorded as liabilities upon the transfer of assets. Additionally, FASB Interpretation No. 45, Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others, requires the guarantor to recognize a liability for the fair value of the guarantee obligations. Therefore, in the event a guarantee or liquidity commitment does represent a liability to a transferor, the liability would be recorded as such and disclosed in the transferror's financial statements.

We have identified several areas where adoption of these specific terms within the Exposure Draft will have an adverse impact on TMCC's securitization program as noted below.

## Liquidity Facilities Provided by the Transferor

Currently, TMCC sells discrete, static pools of receivables to a trust (via a two-step process where the trust qualifies as a QSPE by getting legal isolation and bankruptcy remoteness), and then issues senior and subordinated securities backed by the cash flows associated with the discrete receivables pool.

To minimize issuance costs, since 1993, TMCC has taken advantage of its strong credit ratings and replaced the cash reserve funds with revolving liquidity notes as a form of credit enhancement. In certain securization structures, revolving liquidity notes are used in lieu of reserve funds to provide credit enhancement to the senior securities. Under these revolving liquidity notes, investors may draw upon the notes to cover any shortfall in interest and principal payments. Prior to the use of liquidity facilities, TMCC would deposit approximately \$7 million dollars in a cash reserve fund.

Draws on the liquidity notes are triggered automatically by conditions specified in the transaction documents and are thus clearly out of the control of the transferor. The draws are funded by TMCC and repayments of the liquidity notes are subordinated to principal and interest payments due on the securities, and in certain circumstances, may require deposits into a reserve fund. This structure results in reduced issuance costs for TMCC, thus making securitization funding more cost effective. This form of limited guarantee requires TMCC as the transferor to make payment(s) up to a predetermined maximum amount as a function of conditions that are beyond the control of the transferor. Therefore, these payments are clearly passive in nature and beyond the transferor's control.

Furthermore, TMCC's liquidity notes are comparable, from an economic perspective to other forms of credit enhancement (such as subordination of iunior securities or cash

reserve funds) by TMCC's transaction counsel, TMCC's underwriters and underwriter's counsel, the rating agencies, and investors. The liquidity commitments currently represent up to 0.50% of the total size of the principal balance securitized – equal to the cash amount required to be funded under a cash reserve fund. Clearly, neither transfer of control nor economic substance of the sale is altered whether the required 0.50% credit enhancement requirement is in the form of a cash reserve fund, additional assets, or a limited guarantee.

We believe that liquidity notes as noted above for static pools, when a QSPE does not reissue beneficial interests, are adequately addressed in FAS 140 and FIN 46, and therefore, we propose that the Board refine the existing language to allow for such passive guarantees to continue without penalty to QSPE status. The economic substance of the credit enhancement and the related transfer of control and transfer of risk, should be the determining factors to warrant legal isolation, rather than the form of the credit enhancement provided.

#### Other Transferor Commitments

If revolving liquidity notes are disallowed for static QSPEs where beneficial interests are not reissued, TMCC would be forced to create cash reserve funds to satisfy credit enhancement requirements. Amounts on deposit in these reserve funds are meant to be very liquid in nature and thus are usually invested in short-term commercial paper. We prefer to retain the flexibility of structuring transactions to provide for the investment of reserve funds in TMCC's commercial paper. Investing in TMCC commercial paper would result in a more cost effective transaction for the securityholders, and the economic risk associated with liquidity support, whether the provider of the support is TMCC or a third party, is identical since the risk is associated with the credit rating of the provider. The language in paragraph 35(e), however, appears to preclude such a transaction. We do not understand how such investments would demonstrate control over the transferred assets and thus violate the QSPE status. We would like the Board to clarify the language so that benign transactions of this nature may continue.

#### Representations and Warranties

It is customary in securitization transactions for the transferor to make and provide certain representations, warranties and indemnities concerning the transferred collateral unrelated to the credit performance of the collateral and to be required to repurchase any collateral for which the representations and warranties were untrue. A literal application of the Exposure Draft would lead one to conclude that these standard provisions present in virtually all securitization transactions would be prohibited to retain QSPE status. These types of provisions do not provide the transferor with any ability to control the assets

If the Board intends these provisions to come within the scope of the Exposure Draft, issuers will incur substantial costs to have a third-party provide replacement

indemnifications and other protections for investors' benefit. The additional issuance cost of doing this could be prohibitive for many issuers. We are concerned if these provisions are simply eliminated with no third party replacement, investors in securitization transactions under FAS 140 would be afforded less protection than those who purchase assets directly (where these same provisions are also standard), thereby imposing a disadvantage to FAS 140 securitizations as investments and placing issuers of such transactions at a distinct funding disadvantage.

To summarize, we believe that normal representations, warranties, and indemnities not related to the credit performance of the collateral, are not intended to, and in fact do not, provide the transferor with control over the collateral. We propose that the Board provide clarification that these standard provisions are allowable for OSPE status.

## **Additional Restrictions on Revolving Trusts**

At present, TMCC's securitization transactions involve discrete, fully amortizing pools of receivables. In the future, however, TMCC may seek to securitize revolving accounts associated with TMCC's wholesale light vehicle dealer network. The discussion below reflects our specific concerns regarding the proposed limitations on the activities of QSPEs as discussed in the Exposure Draft, paragraphs 35(e) and 35(f) as they relate to revolving trusts.

The transaction contemplated by TMCC for its dealer based wholesale loans would involve the issuance of securities whose terms are typically longer than those of the assets financed. As a result, the transaction would provide for a "revolving period" during which principal collected to pay securityholders is instead "reinvested" in additional assets for the master trust. A revolving loan securitization is treated as a sale of assets at the initial closing with smaller sales periodically during the revolving period as securityholders' principal collections are reinvested. These sales during the revolving period are "forward contracts" as referenced in the Exposure Draft, paragraph 35(e) which provides that, QSPE's "may not enter into an agreement (other than a forward contract in a revolving period securitization as discussed in paragraphs 77-79) with the transferor." In the typical transaction, the securityholders are not repaid out of the proceeds from the sale of new securities, or as referred to by the Board, from the reissuance of beneficial interests.

The transferor will designate certain dealer wholesale loan accounts prior to establishing a revolving trust. The revolving trust will own all of the receivables in the designated dealer wholesale loan accounts, which include the receivables that are outstanding as of the transfer date and any receivables created after the transfer date. These "add-on" receivables are transferred to the trust. The amount of "add-on" receivables is beyond the control of the transferor as the individual dealer determines the extent of the available credit line. The commitment for these "add-on" receivables is somewhat broader than forward contracts and we believe that the exception should be broadened correspondingly.

We are concerned with the proposed limitations on master trusts and similar structures used in the securitization of revolving receivables. Specifically, the proposed language to limit the reissuance of beneficial interests inadvertently targets standard operating procedures for dealer floorplan loan master trusts, where a subsequent issuance of a new series of securities from the master trust results not in a refinancing of long term assets, but instead a reduction in the transferor's interest and the sale of additional assets not previously derecognized.

It appears that the Board intended to impose restrictions on transactions where proceeds from the issuance of new beneficial interests are used to repay existing third-party beneficial interests as these transactions represent the sale of an asset that the transferor has already sold. Asset-backed commercial paper is provided as a specific example. However, it is not clear from the Exposure Draft if the Board intended to impose the same restrictions on transactions in which proceeds from the sale of new beneficial interests are used to repay a portion of the transferor interest, where the transferor had not previously recorded as a sale and derecognized the assets from the transferor's accounts.

We propose that the term "reissue," as proposed in paragraph 35(f), refer to the issuance of new beneficial interests where the proceeds from such issuance are used to repay existing beneficial interests that are owned by investors other than the transferor. Additionally, the issuance of new beneficial interests where the proceeds are used to repay a beneficial interest retained by the transferor that has not be previously derecognized should not represent a reissuance.

### Conclusions

We appreciate your attention to this important matter and would encourage you to contact Maura Mizuguchi, National Treasury Manager, at 310-468-5986 to provide additional or clarifying information.

Additionally, we would like to participate in the public roundtable discussion planned for August 28, 2003.

Sincerely,

/s/ John Stillo

John Stillo Vice President and Chief Financial Officer Toyota Motor Credit Corporation