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Mr. Ron Lott
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Financial Accounting Standards Board
401 Merritt 7
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Re: Comments on Proposed Standard, *Qualifying Special-Purpose Entities and Isolation of Transferred Assets*, an amendment of FASB Statement No. 140 (File Reference No. 1200-001)

Dear Ron:

PricewaterhouseCoopers LLP appreciates the opportunity to comment on the proposed Standard, *Qualifying Special-Purpose Entities and Isolation of Transferred Assets*, an amendment of FASB Statement No. 140 (the "ED"). We generally support the issuance of guidance to clarify the permitted activities of a QSPE, however, we have significant concerns regarding the ED as currently drafted, which are discussed below.

General

Based upon our continuing discussions with the FASB staff, we understand that the Board's intent in requiring that the second step of a two-step transaction be to a qualified special purpose entity ("QSPE") is to limit sale accounting when credit enhancements are provided to a QSPE, or other vehicle, by the transferor in a form other than a retained interest. That is, a retained interest will be the only acceptable form of credit enhancement allowable from the transferor. We do not believe the ED is clear as to that intent, as currently drafted. We believe that this is a fundamental shift in the FASB Statement 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, a Replacement of FASB Statement 125*, ("FAS 140") model and that the Board's intent should be clarified in the Basis for Conclusions.

We have also seen a variety of securitization structures that contain several multiple intermediate steps utilizing bankruptcy remote entities (BREs) with the end result being a "transfer" into a QSPE. Each of these intermediate steps often serve as a credit enhancement to the structure. The BREs are consolidated by the transferor. Is the Board's intent to prevent this practice? We believe that the Board should clarify this point as it pertains to its intent as discussed above.

Paragraph 3 (Amendment of paragraph 9(a))

We suggest that the proposed revised wording in paragraph 9(a) conform with that in paragraph A16 of the ED. We believe the language in paragraph A16 is clear and concise and, by including that language in paragraph 9, should lead to more consistent interpretation.

Paragraph 4 (Amendment to Paragraph 35(1))

We understand that the ED does not allow a QSPE to hold an equity instrument. However, the ED does not clarify the definition of an “equity instrument”. As a result, we are unclear if a QSPE would be allowed to hold mandatorily redeemable preferred stock, puttable common stock, convertible debt, or an equity investment or residual interest in another special purpose entity. We suggest the FASB define equity instruments in the ED using a model consistent with that in FASB Statement 115, *Accounting for Certain Investments in Debt and Equity Securities*, or a model consistent with FASB Statement 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*.

In addition, the ED is also unclear as to whether a QSPE would be allowed to temporarily hold an equity instrument as a result of an underlying financial asset defaulting. For example, what would be the implication if a QSPE temporarily held an equity investment as a result of a foreclosure (equity of a legal entity that solely holds property subject to the loan)?

Paragraph 5 (Addition of Paragraph 35(e))

Representations and Warranties

The ED amends FAS 140 such that the transferor cannot provide liquidity commitments to the QSPE. As currently drafted, it appears that contingent obligations to repurchase ineligible assets provided for in standard representations and warranties indemnifications (“Reps and Warranties”) may be considered commitments to deliver cash and, therefore, are no longer permitted. This would result in very few QSPEs since these Reps and Warranties are included in many, if not all, transactions. The primary reasons for these standard Reps and Warranties are to protect the investor against purchasing an interest in an asset with an undisclosed condition that existed at the transfer date. Reps and Warranties generally do not protect investors from events occurring after transfer. We would suggest modifying the language of paragraph 5 of the ED to allow standard Reps and Warranties in situations that protect an investor from adverse undisclosed conditions existing at and before the transfer date.

Servicer Indemnifications

We also understand that many transactions include servicer indemnifications. A servicer has a fiduciary responsibility under the law to perform servicing on behalf of the investors or beneficial interest holders in a QSPE (“BIs”). Many agreements contain provisions such that if the servicer does not perform according to the terms of the contract (e.g., fails to perfect interests in collateral) or intentionally creates an adverse condition that materially affects the BIs then a payment would be made or a remedy provided. In most circumstances, the servicer is the transferor. We recommend that the Board modify paragraph 35(e) such that servicer indemnifications are excluded, as we believe this is not really a commitment by a transferor as contemplated by paragraph 5. Rather, it is a guarantee of the servicer’s own future performance.

Underwriting

Some transferors have captive broker dealers that participate in the underwriting of the transferor’s securitization on a fully committed basis. Under FAS 140, the amount underwritten on a fully committed basis would not qualify for sale accounting because the securities underwritten would be retained interests. Sale treatment is allowed only when the securities are sold to third parties. We believe this type of commitment should not be a violation of paragraph 35(e) since sale treatment is not allowed for the purchased interests retained and after the purchase by the broker dealer affiliate is executed the commitment is expired. We suggest that the Board clarify that a “commitment” should be ongoing and not part of the initial transfer.

Compensating Interest

Many, if not all, mortgage-backed and asset-backed securitizations contain “compensating interest” clauses. Generally, the servicer is required to advance an entire month’s interest to the BIs, even in the event that the assets are prepaid. The advance is not limited to recoveries from the underlying assets but is generally capped at an amount no greater than the servicing fee. As currently drafted, we are not clear whether the ED would consider these advances “servicer advances” or a guarantee. We believe that they should be considered servicing advances, consistent with those discussed in footnote *, subject to our comments below, because they are essentially servicing related.

In addition, footnote * indicates that if servicing advances are discretionary then they are not a commitment for purposes of paragraph 35(e). We understand that servicers of “agency” paper are required to make servicing advances. However, we believe those types of advances should also be excluded from the definition of a commitment under paragraph 35(e) by including them in the footnote * exclusion.

Paragraph 5 (Addition of Paragraph 35(f))

Decision-making

We find the meaning unclear of paragraph 35(f), footnote +. We are unsure what the Board meant in “decisions implies discretion”. We believe that the degree of discretion should be limited to the amount that meets the conditions of paragraph 35(b). If this is not the intent of the Board, we suggest that this footnote be clarified to describe the amount of discretion that would be permitted. For example, what would be the implication if the transferor did not solely control decisions made regarding reissuance but shared some involvement in these decisions with other parties?

Definition of Reissuance

As currently drafted, we believe questions will arise regarding what is meant by “reissuance”. For example, in a master trust arrangement, we believe that cash received from the issuance of new beneficial interests to fund the obligations of maturing beneficial interests would be considered a “reissuance” and therefore would be subject to the limitations in the paragraph. In contrast, if new assets are transferred to the trust and new beneficial interests are issued to fund the new transfers, this would not be considered reissuance. However, in many revolving structures currently considered to be QSPEs, the issuance of new BIs and the reissuance of BIs are blurred. We suggest that the Board provide a definition of reissuance to clarify its intent.

Most Senior Priority

In many, if not all, securitization transactions, a servicer is entitled to receive his servicing fee prior to the distribution of cash to the most senior beneficial interest holders. This “distribution” is also usually senior to third party credit enhancers who provide commitments to deliver cash, but legally, in some cases, may be pari-passu. Since the servicing fee is paid prior to any cash distributions to the BIs, this could be construed as the “most” senior priority. We are not sure that the Board intended servicer fees to be construed as the most senior priority and suggest that paragraph 35(f)(3) be clarified to exclude servicing fees.

Paragraph 7 (Amendment of Paragraph 45))

The ED clarifies that an asset sold upon termination of the QSPE or maturity of the beneficial interests is permitted if the “manner” of disposition is specified at the QSPE’s inception. We suggest that the FASB clarify what is meant by “manner”, and include a discussion regarding the level of specificity that must be included in the governing documents regarding disposal actions.

Paragraphs 9, 10, 11 (Amendments to Paragraphs 80 through 84))

The proposed changes in paragraphs 80-84 of FAS 140, currently entitled “Isolation of Transferred Assets in Securitizations,” appear to broaden the scope of these paragraphs beyond securitizations by changing all of the current references of securitizations to “transactions resulting in the issuance of beneficial interests” or simply “transactions.” The proposed changes appear to result in the inclusion of undivided interests within the scope of beneficial interests, as that term is used throughout paragraphs 80-84 of FAS 140.

Undivided interests have long been viewed within FAS 125 and FAS 140 as being distinctly different from other forms of beneficial interests. Undivided interests represented legal ownership interests in the assets themselves (either pro rata or non-pro rata) while beneficial interests widely represent a debt-type instrument that is collateralized by those assets. Transactions, which were described as a sale of an undivided interest and met the sales criteria of paragraph 9 of FAS 140, were treated as a transfer and sale of the assets themselves and not the issuance of debt or a debt like instrument collateralized by those assets. The proposed change would appear to scope all transactions that result in the transfer or sale of an undivided interest into the transactions that result in the issuance of beneficial interests. If that is correct, the change would also scope in common commercial transactions such as loan participations.

We also believe that the sentence at the end of paragraph 83, which generally deals with two-step transactions, adds confusion:

However, isolation is only one of the requirements in paragraph 9, and unless the transfer described in paragraph 83(b) is to a qualifying SPE, the transfer shall be deemed not to meet the requirement in paragraph 9(b) that the transferee has the right to pledge or exchange the transferred assets.

This sentence, while referencing the second “transfer” in a two step transaction, could be broadly interpreted to apply to all transfers that result in the issuance of undivided interests and would fail to meet the paragraph 9(b) sales criteria unless the assets are first transferred to a QSPE.

We understand that the Board intended to address abusive transactions that utilized a beneficial interest that is not in the form of a security (i.e., an undivided interest versus one that is a beneficial interest). However, we do not agree with the view that the undivided interest does not represent an asset in and of itself that could be transferred and the transferor could get sale accounting. We believe the current wording leads one to conclude that a transferor could never sell an undivided interest in an asset to an “operating company” (an entity that would not qualify as a variable interest entity under FIN 46, *Consolidation of Variable Interest Entities -- an interpretation of ARB No. 51*) and be considered a sale since the ability to pledge and exchange beneficial interests can only meet the paragraph 9(b) test in

a situation when that beneficial interest is issued by a QSPE. Therefore, we believe the Board should clarify their intent as to what perceived abuse they are trying to overcome. If the Board continues to believe that sale treatment is only obtainable if a QSPE issues BIs, then we would propose the following wording so that everyday participations would not be prevented:

However, isolation is only one of the requirements in paragraph 9, and unless the transfer described in paragraph 83(b) is to a qualifying SPE **or the transaction is a sale of a pro rata undivided interest in the principal or interest components of a financial asset**, the transfer shall be deemed not to meet the requirement in paragraph 9(b) that the transferee has the right to pledge or exchange the transferred assets.

We also believe that FAS 140 currently contains ambiguous language regarding the meaning of transfer in the second step of a two-step transaction and the Board's seemingly synonymous reference to beneficial interests and undivided interests will only exacerbate that confusion. Currently, the definition of transfer contained in FAS 140 includes posting collateral as an example of a transfer. However, the reference to transfer in paragraphs 83(b) and 83(c) seem to imply a need to convey the whole assets. We believe the logic underlying those paragraphs is based on the notion that even though a bankruptcy trustee for the BRE theoretically could reach the assets transferred to the Trust, because there is only a remote possibility of there ever being a bankruptcy trustee for the BRE, the assets are deemed isolated at the Trust level.

Based on these conflicting references to "transfer", some in practice have interpreted that the second transfer could take any form, including the issuance of beneficial interests to the Trust where the assets are pledged to the Trust as collateral. Others in practice believe that the second transfer must be in the form of a conveyance of either the whole assets or undivided interests therein. Without such a conveyance, the BRE, which is consolidated by the transferor, would technically still have the assets on its balance sheet. Since the Board is amending FAS 140, we suggest that the Board take this opportunity to clarify the meaning of transfer under paragraphs 83(b) and 83(c).

We are also aware that in many jurisdictions outside the United States single step securitizations are common and legal isolation can be achieved in these transactions. While we don't believe that the ED changes the treatment for these transactions, we believe the language added to paragraph 83 has introduced confusion as to whether an operating company can ever be a transferee in transactions where there is a subordinated interest in the assets sold.

Other comments

Mortgage Servicing Rights and Mortgage Loans Held for Sale

Mortgage servicing rights (MSRs) are required to be accounted for under FAS 140 at a strata level at lower of cost or fair value (LOCOM). In addition, paragraph 4 of FASB Statement 65, *Accounting for Certain Mortgage Banking Activities*, requires that mortgage loans held for sale (MLHFS) be accounted for at LOCOM. Specifically, the requirement to carry these assets at LOCOM creates significant complexity in both the accounting and hedging of MSRs. IN many instances, the selection of a variety of accounting policies including similar asset testing, effectiveness testing, hedged risk identification and measurement, and ineffectiveness measurement in accordance with FAS 133; amortization; stratification; and other than temporary impairment are very complex, time consuming and represent a significant negative cost benefit. In addition, we believe that the selection of these various policies has lead to significant diversity in practice creating financial results that are driven both by economics as well as the selection of accounting polices and which leads to non comparability in financial reporting.

We believe that the Board should consider taking on a limited scope, fast track project that would consider a fair value model for MSRs and MLHFS with changes in fair value reported in earnings. Currently mortgage companies have reliable processes and controls in place for determining fair value at each reporting period. As a result, movement to a full fair value model would be expected to decrease the costs and risks associated with accounting compliance and provide additional transparency to a user of the financial statements. In addition, the use of a fair value model would allow these to hedge these assets in a more transparent manner and eliminate the need for compliance with the complexities of FAS 133. Further, a fair value model would lead to an increase in consistency in financial reporting, rather than the current model, which results in diversity and variances because of the different accounting policies selected for amortization, stratification and other than temporary impairment. Finally, fair value accounting would be consistent with the Board's belief that fair value is the best measure for financial instruments.

Approval of changes by Beneficial Interest Holders

We continue to receive questions on how to interpret 35(b) related to the approval of changes by a majority of BIs held by entities other than the transferor or its related entities. We believe that if amendments can be made that do not have to be approved by the BIs that are significantly affected and those amendments are not substantive, they should not affect the accounting. We believe that paragraph 35(b) should be amended to indicate that only the BIs holders that are affected by an amendment need to approve changes. Further, changes that do not require approval and are not substantive and should not have an affect on the accounting.



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We appreciate the opportunity to express our views in this letter. If you have any questions regarding our comments, please feel free to contact Woody Wallace at (646) 471-2850 or Tom Barbieri at (973) 236-7227.

Sincerely,

PricewaterhouseCoopers LLP