!@#

r Phone: (212) 773-3000 www.ey.com

August 1, 2003

Letter of Comment No: 48 File Reference: 1200-001 Date Received: 08/01/03

Director of Technical Application and Implementation Activities Financial Accounting Standards Board 401 Merritt 7 P.O. Box 5116 Norwalk, CT 06856-5116

> Proposed Statement, Qualifying Special-Purpose Entities and Isolation of Transferred Assets, an amendment of FASB Statement No. 140 (File Reference Number 1200-001)

We appreciate the opportunity to comment on the above referenced Exposure Draft. Although we support the project overall, we believe that certain of the Exposure Draft's provisions are not warranted and will lead to an unnecessary constriction of the activities of a qualifying SPE. In addition, we believe the Exposure Draft requires a considerable amount of clarification before it should be issued as a final Statement that could be consistently applied. Finally, we believe the Board should take the opportunity presented by this amendment to reconsider the accounting treatment for mortgage servicing rights.

Each of these concerns and suggestions are discussed further in this letter.

There is no question that guidance is needed to clarify the provisions in Statement 140 addressing the characteristics of a qualifying SPE and the interplay between this guidance and the provisions of FASB Interpretation No. 46, Consolidation of Variable Interest Entities (Interpretation 46). We believe the conceptual basis for providing qualifying SPEs a different accounting treatment as compared to the accounting treatment provided to variable interest entities (VIEs) should be clear and that any guidance issued should be able to be applied consistently by preparers and auditors. We also believe that this guidance should be transparent enough to distinguish between entities that qualify to be evaluated for consolidation pursuant to Statement 140 and those that do not.

Transferor Involvement with Qualifying SPEs

The proposed changes to the definition of a qualifying SPE and its involvement with the transferor would unnecessarily restrict the activities of a qualifying SPE and are inconsistent with the financial components approach upon which Statement 140 is based.

Statements 140, and its predecessor, Statement 125, are based on a financial components approach, which analyzes financial assets by examining the components of assets and liabilities that exist after the transfer (See paragraphs 140-142 of Statement 140 for a further discussion of the basis for conclusions of Statement 140). The proposed prohibition against agreements that commit a transferor to deliver additional cash or other assets to the SPE as a result of the performance of the assets of a qualifying SPE is inconsistent with the conceptual underpinnings of Statement 140. Further, the Exposure Draft provides no conceptual basis for this wholesale departure from the financial components approach.

It is common for the transferor to enter into plain vanilla interest rate or foreign currency derivatives with a qualifying SPE or to guarantee the performance of previously transferred assets. Generally, these arrangements are not explicitly documented but are present in the residual interest retained by transferors. For example, consider a transfer of \$1,000 of 7 percent fixed-rate, 5-year loans to a qualifying SPE that issues \$800 of 5-year senior beneficial interests to third parties at an interest rate of LIBOR while the transferor retains a residual interest. As LIBOR increases, the transferor's future cash flows decrease and as LIBOR decreases the transferor's future cash flows increase. The transferor's retained interest includes derivative features that alternatively could have been documented as an interest rate swap contract. We do not understand why the Board would prohibit this separately documented agreement without prohibiting the same arrangement when it is embedded in a residual interest. It seems illogical to us that the form of the arrangement in this example would preclude an entity from being a qualifying SPE when the substance is synonymous.

In addition, because the Exposure Draft uses broad terminology to describe the transferor commitments that are prohibited, and because that terminology is inconsistent with the underlying principles of Statement 140, we are concerned that the requirement would not be clearly understood and, therefore, would be inconsistently applied. For example, it is common for transferors and their affiliates to provide representations and warranties regarding the transferred assets and to indemnify the SPE or beneficial interest holders for certain contractual breaches. It is also common for transferors to be required to repurchase transferred assets that become or are ineligible or for the transferor, as servicer, to have a clean-up call. If the prohibition on agreements with a transferor is retained, much more clarity as to its breadth of applicability is required.

If the Board chooses to prevent the transferor from entering into derivatives with a qualifying SPE, the Exposure Draft should also consider the transferor's ability to enter into back-to-back derivatives with another party that issues a derivative or holds a beneficial interest in the SPE. Some believe that in this case the bank entering into the derivative with the qualifying SPE would be acting as an agent for the transferor. Accordingly, it presumably would seem logical that these types of arrangements would also be prohibited. It would be helpful if the final Statement clarified its application to these arrangements.

Similarly, we believe the prohibition of a qualifying SPE from holding equity instruments is also an extreme position in light of the Board's objective. We concur, as already indicated in paragraph 39 of Statement 140, that a qualifying SPE should not be permitted to hold an equity investment that gives it the ability to control or exert significant influence over the investee. However, in situations where an equity position is not capable of exerting control or significant influence, we believe the voting right is merely another financial component of the security that should be dealt with within the overall financial components framework of Statement 140. Accordingly, we agree that an equity instrument is not passive if the qualifying SPE can exercise its voting rights and is permitted to choose how to vote. However, we believe that if a qualifying SPE is not permitted to choose how to vote (because the votes have been assigned to another party or have been predetermined) then the equity investment could be a passive financial asset and should continue to be a permissible investment for a qualifying SPE.

Reissuance of Beneficial Interests

We do not understand or agree with the analysis presented in paragraphs A11 – A13 to address control over a qualifying SPE through the ability to have both a concentration of risk and decision-making authority over the reissuance of beneficial interests. Although we acknowledge that an entity may exert control over a qualifying SPE through its ability to direct the issuance of beneficial interests, we think it is adequate to prohibit an entity that either has a commitment to deliver assets to a qualifying SPE or that holds its subordinated beneficial interest from making decisions about reissuing beneficial interests. We believe the proposed addition of paragraph 35(f)(3) accomplishes this objective. However, we do not understand the Board's reasons, and do not think it is necessary, to limit the types of commitments to receive assets in the future or the counterparties to those commitments that a qualifying SPE that can reissue beneficial interests can engage in. As a result, we would suggest that proposed paragraphs 35(f)(1) and 35(f)(2) be eliminated from the final Statement.

In any case, the provisions of the Exposure Draft that address the limitations of a qualifying SPE when it has the ability to reissue beneficial interests may be difficult to apply in certain master trust situations. The Exposure Draft summarizes the issue with respect to a securitization structure in which the assets are longer-term and the beneficial interests are shorter-term as follows:

"When the initial beneficial interests mature, they are paid from the proceeds of issuing new beneficial interests instead of from the cash inflows from the pool of assets. The transferee SPE is effectively pledging and repledging the transferred assets, which, as discussed in paragraph 9(b), satisfies one of the three criteria that determine whether the transferor has surrendered control of those assets. The ability to pledge and repledge assets raises questions about consolidation and effective control of transferred assets."

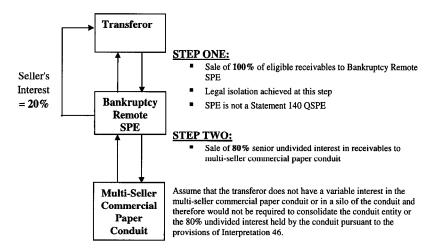
This discussion seems to indicate that the reissuance of new beneficial interests upon the maturity of existing beneficial interests occurs when the proceeds of the new issuance (rather than the collections from the SPE's assets) are used to pay the initial beneficial interest holder.

The application of this concept in revolving master trust securitization structures is more ambiguous. These structures, which are commonly used for securitizing trade accounts receivables and credit card receivables involve the periodic transfer of new receivables into them as well as the periodic issuance of beneficial interests. It may not be practical to determine the source of funds used to repay the previous beneficial interests. It is not practicable, in these types of structures, to match up the maturity of the beneficial interests with the maturity of the assets because of the volume of transactions and the revolving nature of the arrangements. In light of the large number of transactions with these characteristics, the Board should provide additional guidance for addressing what activity constitutes the ability to "reissue beneficial interests." For example, the Board might want to indicate that the transfer of assets in an amount exceeding the amount of new beneficial interests within a reasonable time period of the issuance of the beneficial interests (e.g., 7-10 days) would be indicative that the beneficial interests issued were new beneficial interests rather than the reissuance of previously issued beneficial interests.

Two-step transactions

The requirement that the second step of a two-step transfer involve a qualifying SPE is overly broad and conflicts with the current application of existing guidance in Statement 140. To better illustrate our concerns consider the following illustrative example:

Typical Accounts Receivable Securitization Structure



As illustrated, a two-step transfer is used to achieve legal isolation of the transferred receivables and the arrangement effectively results in a portion of the receivables (the 80 percent senior undivided interest sold in Step Two to the Multi-Seller Commercial Paper Conduit) being sold to an enterprise that is not consolidated by the transferor. This type of structure is commonly used to achieve legal isolation and sales treatment for trade account receivables.

The Exposure Draft seems to indicate that the Multi Seller Commercial Paper Conduit, in the above structure, would have to be a qualifying SPE for the transferor to derecognize the transferred assets.

We believe it would be more appropriate to indicate that the second transfer should be to an entity that is not included in the consolidated financial statements of the transferor. The exclusion could be because either the entity that receives the assets in the second transfer is a qualifying SPE or is not consolidated with the transferor because of the application of Interpretation 46 or Statement 94. Although it is not currently perceived to be required, we would not object to the Board providing that the bankruptcy remote entity that receives the assets in the first transfer should be a qualifying SPE.

Reconsideration of the Accounting for Mortgage Servicing Rights

A Statement 140-related financial instruments accounting issue worthy of reconsideration by the Board is the accounting for recognized mortgage servicing rights (MSRs). In the aftermath of several Derivatives Implementation Group discussions of some of the unique problems facing mortgage bankers who seek to achieve hedge accounting for mortgage servicing rights, the Board agreed in 2001 to reconsider the current cost based accounting model for this asset. The bulk of these discussions were related to Statement 133 Implementation Issue F8, Hedging Mortgage Servicing Right Assets Using Preset Hedge Coverage Ratios, and DIG Agenda Item 15-8 (from March 2001), Separation of Risks in an Embedded Prepayment Option. At the time, the Board was sympathetic to the idea of challenging the accounting model for MSRs because a change to a fair value model with changes recorded in carnings would better reflect the economic substance of owning this highly volatile asset. Such reconsideration would also remove the need for bankers wishing to hedge MSRs to achieve fair value portfolio hedge accounting, a quite difficult and demanding endeavor.

Since 2001, we have noted emerging diversity in practice as the mortgage banking industry struggles to interpret how to apply Statement 133's fair value portfolio hedging guidance, and in particular, the guidance surrounding how to bookkeep and assess effectiveness for a hedge of the benchmark interest rate risk, without benefit of the FASB staff being able to issue interpretive guidance for their industry. Said in the simplest way, hedges of mortgage servicing rights are classic macro-hedges that the industry must "squeeze" into micro-hedging strategies. Every bank does it in a different way and routinely reports failures to achieve hedge accounting for MSRs. But still there is diversity in views, due to a lack of industry-specific interpretive guidance, as to when the hedge effectiveness criteria are met. A decision to account for MSRs on a full fair value basis would alleviate the need to achieve hedge accounting and eliminate the diversity in practice.

We would be pleased to discuss any of these specific concerns with you, the Board members or other staff, at your convenience.

Very truly yours.

Ernst + Young LLP