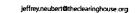
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July 31, 2003

Mr. Lawrence Smith
Director of Technical Application and Implementation Activities
Financial Accounting Standards Board
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File Reference No. 1200-001

Dear Mr. Smith:

The New York Clearing House Association L.L.C. ("The Clearing House")1 appreciates the opportunity to comment on the Exposure Draft of the 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). The Exposure Draft states that FASB issued this Exposure Draft to prevent certain entities from converting into qualifying special purpose entities (OSPEs) to avoid consolidation and to provide specification of QSPEs' powers to reissue beneficial interests. The Clearing House does not specifically disagree with the FASB's reasons for issuing the Exposure Draft, but our members do have significant concerns with both the overall model of the Exposure Draft and certain specific provisions of the document. The Clearing House disagrees with the erosion of the control-based framework in FASB No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, a replacement of FASB Statement No. 125 (FAS 140), and the rule-based nature of the Exposure Draft as these rules are not applied in a consistent manner nor are they based on any overriding principle. The Clearing House believes that the broad language regarding transferor restrictions and proposed changes to paragraph 83 of FAS 140 in the Exposure Draft will have unintended consequences for a wide number of securitizations. The Clearing House further believes that additional consideration should be

The members of The Clearing House are: Bank of America, National Association, The Bank of New York, Bank One, National Association, Citibank, N.A., Deutsche Bank Trust Company Americas, Fleet National Bank, HSBC Bank USA, JP Morgan Chase Bank, LaSalle Bank National Association, Wachovia Bank, National Association, and Wells Fargo Bank, National Association.

given to the reissuance restrictions, transition provisions and effective date, as the Exposure Draft would make sweeping changes to current GAAP. Our comments are detailed below.

#### Erosion of FAS 140's Control Framework

Extensive deliberations undertaken by previous FASB members gave full consideration to developing a theoretically sound accounting model that could be consistently applied. These deliberations resulted in a derecognition and non-consolidation model based on the transferor's control. The Exposure Draft's additional restrictions on OSPEs in certain instances are based on concepts of risk concentration and risk dispersion. In paragraph A10 of the Exposure Draft, the FASB states that it did not subject QSPEs to the requirements of FASB Interpretation No. 46, Consolidation of Variable Interest Entities, an Interpretation of ARB No.51 (FIN 46) because of the different bases of FAS 140 and FIN 46. However, the Board did in fact introduce the risks/ rewards approach of FIN 46 in the general restrictions on the transferor and the restrictions on structures that reissue beneficial interests. This results in a hybrid model that crodes the original control-based framework of FAS 140 and its predecessor FASB No. 125, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities. For instance, a transferor can retain a 90% beneficial interest in the OSPE and still be subject to evaluation under FAS 140's original control model but if the transferor retains an insignificant amount of risk through a fixed to floating interest rate swap, it is subject to the risk and reward provisions of the amendment and cannot obtain OSPE status even though the transferor does not have effective control

The Clearing House is particularly concerned about the erosion of this model due to the brief deliberation period leading to the Exposure Draft and the broad changes to current practice the Exposure Draft requires. Our members believe that the FASB could have retained a pure control-based framework and still address its objectives. The consequences of a hybrid model include potential inconsistency in practice, particularly when structures evolve as a result of this amendment, as well as a lack of comparability in financial statements of entities which are in the same position economically but may have different financial statement results because one entity is subject to the control provisions of FAS 140 and the other is subject to the risk/reward provisions. The introduction of risk and reward provisions will inappropriately result in structures failing to obtain QSPE status although no effective control is retained. The Clearing House urges the FASB to reconsider the Exposure Draft's model and develop additional guidance using underlying control concepts to achieve its objectives. Therefore, neither a broad range of securitizations would be jeopardized nor consistency or comparability issues would be created.

If the FASB decides to continue with a hybrid model, we believe that the related changes proposed in the Exposure Draft should not mandate that any specific type of contract or arrangement with an entity causes an automatic consolidation requirement. Instead, an economic threshold should be established before requiring consolidation. For example, FAS 140 establishes an economic threshold of 10% with respect to third party beneficial ownership interests to determine when a special purpose entity is considered "demonstrably distinct" from

the transferor. We believe such a threshold can be established for other contractual arrangements such as derivatives and liquidity arrangements. For example, a total return swap would taint qualifying special purpose entity status since the transferor would no longer be demonstrably distinct from the special purpose entity (i.e., the economic substance of all transactions between the transferor and the special purpose entity does not transfer at least 10% ownership interest to third parties). In this regard, we do not believe that solely hedging interest rate risk on behalf of third party beneficial interests holders should taint qualifying special purpose entity status.

# Rule-Based Nature of the Exposure Draft

The Clearing House believes that the FASB should reconsider not only the erosion of the control-based framework of FAS 140, but also the rule-based nature of the Exposure Draft. Since the additional restrictions on transferors and structures that reissue beneficial interests were not based on FAS 140's control principles, the Exposure Draft creates specific rules that are only applied in certain instances and are not based on an overriding principle. These rules increase the complexity of an already sophisticated model and the possibility of inconsistency and lack of comparability in financial reporting. Additionally, the rules do not improve financial reporting, as contended on page ii of the Exposure Draft, because the rules do not address effective control retained by a transferor but rather address risks or rewards retained by a transferor. The rules do not provide additional specification on making decisions about beneficial interests. The Clearing House recommends that the FASB further interpret FAS 140 to clarify the underlying control concepts so that there will be consistent application for all structures and where only structures in which the transferor retains direct or indirect control of the assets will be prevented from attaining OSPE status.

## Broad Restrictions on Transferors, Affiliates and Agents

During the Board's public deliberations on this project, the Board indicated its concerns regarding structures where the transferor sold assets into the structure and then entered into a total return swap with the structure. As the FASB Staff was drafting the Exposure Draft, the wording appeared to change from restrictions on total return swaps to restrictions on swaps which passed back substantially all the economics to the transferor and, ultimately, to a broad restriction against any derivative between the transferor and the QSPE in paragraph 4 of the Exposure Draft. The Clearing House does not believe that the final language is consistent with the Board's public deliberations, particularly since the basis for conclusions indicates that "risk transfers from a qualifying SPE to a transferor through derivatives are prohibited," which is a different threshold than prohibiting all derivatives. For instance, a contingent call option or clean-up call would not be permitted under the wording in paragraph 4 (assuming the option met the definition of a derivative) but would be permitted under the language in the basis for conclusions.

In paragraph 5 of the Exposure Draft, a transferor is restricted from entering into any agreement with a QSPE that would commit the transferor, conditionally or unconditionally, to deliver additional cash or assets to the QSPE or its beneficial interest holders. One common

provision of nearly all securitizations is a requirement that the transferor repurchase assets to indemnify the trust if a breach of the standard representations and warranties occurs. These warranties are critical to the transfer of assets and are designed to protect the purchaser from fraud in the origination of a receivable, incomplete documentation or currently delinquent receivables. If this standard provision would disqualify an entity from QSPE status because the indemnification is a conditional commitment to deliver cash to the QSPE, then nearly all securitizations, including traditional mortgage securitizations, would be subject to the consolidation provisions of FIN 46. We believe this is an unintended consequence of the Exposure Draft as the Board states its decision in paragraph A10 against subjecting all QSPE structures to FIN 46 since this would make the QSPE provisions of FAS 140 ineffective. We also note that the Exposure Draft does not amend paragraph 11 of FAS 140, which states that a transferor should record all assets obtained and liabilities incurred resulting from a sale of assets, such as put and call options held or written. This shows clear contemplation of the transferor retaining derivatives or entering into contractual commitments associated with the transaction.

Broad restrictions would fundamentally impact the securitization market since clean up calls and indemnities are integral to numerous structures. A broad restriction on any derivative would create significant practice concerns in properly and consistently evaluating whether certain financial instruments meet the definition of a derivative as the focus will generally be on whether the underlying assets are readily convertible to cash, a concept which is still debated several years after the issuance of the underlying framework for derivatives. Additionally, the resolution of the tentative guidance in DIG Issue B12, Embedded Derivatives: Beneficial Interests Issued by Qualifying Special Purpose Entities could increase the complexity and cost of determining whether a transferor holds a derivative instrument.

Our members request that the FASB revise its restrictions on derivatives and other commitments provided by the transferor. We are strongly opposed to a broad restriction on these financial instruments and contractual commitments as these provisions do not violate the effective control concepts of FAS 140. Furthermore, many of these instruments or commitments result in a small amount of exposure from a risk/reward perspective particularly when compared with the 90% economics a transferor may retain through a beneficial interest. The restrictions also indicate a preference for retaining a significant amount of exposure through a cash instrument such as a beneficial interest over allowing any exposure through a synthetic instrument. We believe the amount of allowable exposure retained should be the same through either a cash or synthetic instrument since the retention of this risk does not impact FAS 140's control concepts. Since the Board has allowed a 90% retention of economics through a cash instrument, we believe the transferor should be allowed to retain up to 90% of the economics through a synthetic instrument as long as control is not present. We believe "other commitments" should only be restricted if they are within the transferor's control and/or unconditional

## Changes to Paragraph 83 of FAS 140

The FASB has effectively created a requirement, through the addition to paragraph 83 of FAS 140, that any two-step securitization issuing beneficial interests must have a transfer to a QSPE in order for that transaction to fully meet the criteria in paragraph 9b of FAS 140. We are unclear as to the FASB's objective regarding the addition to paragraph 83. This requirement confuses the criteria for derecognition of assets (paragraphs 9a-c of FAS 140) with the criteria for establishing a QSPE and achieving non-consolidation of the assets in the QSPE. If this requirement is not changed, it appears sale accounting will not be achieved by numerous two-step structures even though those structures meet the current requirements regarding isolation, ability to transfer, and effective control. We do not believe this is appropriate as the criteria for achieving sale should be distinct from the criteria for establishing a QSPE. Furthermore, structures that achieve sale accounting but do not establish a QSPE are subject to the provisions of FIN 46. We recommend the FASB change this language to remove the requirement that a two-step transfer resulting in beneficial interests utilize a QSPE in the second step.

#### Reissuance Restrictions

The Exposure Draft contains several restrictions on structures that can reissue beneficial interests due to the perception that reissuance creates control. Paragraph A6 of the Exposure Draft states "the ability to pledge and repledge assets raises questions about consolidation and effective control of transferred assets." In fact, structures that reissue beneficial interests such as commercial paper are not repledging the assets as the assets are continuously pledged to the class of commercial paper holders. Changing the commercial paper holder is no different with respect to control of the asset from a secondary market sale of a beneficial interest from one investor to another. Additionally, the FASB appears to view all structures that reissue beneficial interests as similar to the multi-seller conduits with respect to discretion and decision-making. In many instances, an entity facilitating the reissuance of beneficial interests is analogous to a broker filling a market purchase order. As an alternative to the reissuance restrictions contained in the Exposure Draft, the FASB could design parameters based on control principles to ensure that QSPEs, which reissue beneficial interests, are simply executing instructions in an administrative manner instead of making decisions regarding type, tenor, and priority of the beneficial interests.

Should the reissuance restrictions be retained, one of the restrictions is applicable only if a structure makes decisions in reissuing beneficial interests, as stated in paragraph 5. However, the Exposure Draft does not provide guidance to determine whether any party associated with the structure is actually making decisions. As no conclusion to this issue was reached under EITF Issue No. 02-12, Permitted Activities of A Qualifying Special Purpose Entity in Issuing Beneficial Interests under FASB Statement No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, we believe further guidance is necessary. We also believe further guidance is necessary to determine when a "reissuance" occurs and is subject to the Exposure Draft's restrictions, particularly with respect

to master trust securitizations. Furthermore, we believe that the conventional master trusts should not be considered a reissuance entity because new issuances of beneficial interests are not used to retire maturing beneficial interests held by parties other than the transferor, its affiliates, and agents. The new issuances are made as a reduction of the transferor's retained interest, which Paragraph 79 of FAS 140 describes as an acceptable method to achieve a revolving-period securitization.

### **Transition Provisions**

The Exposure Draft's transition provisions provide a grandfathering for current QSPEs which do not acquire new assets that were not previously contracted for and that do not issue new beneficial interests. The impact to existing structures that are not grandfathered and that no longer qualify to be QSPEs is an immediate application of the consolidation provisions of FIN 46. We believe modifications to the transition provisions are necessary to clearly indicate to the investor community that the new guidance is a change to existing GAAP and to clearly grandfather all structures that fully complied with FAS 140 or arc in the process of complying by obtaining investor consent to convert to a two-step transfer no later than June 2005. The FASB must provide fair grandfathering provisions for constituents who in good faith relied on the provisions of FAS 140 as the Exposure Draft is quickly and significantly changing the framework for QSPEs. While the FASB believes entities can restructure vehicles to meet the provisions of the Exposure Draft (as stated in paragraph A4), a transferor does not have the unilateral ability to change the contractual documents governing a QSPE (otherwise the entity would not currently be a QSPE). Should the transferor fail to meet the new OSPE requirements because of a derivative relationship, the transferor will face additional significant difficulties in restructuring the derivative due to the restrictions in paragraph 40a of FAS 140. As such, we recommend that the FASB include specific provisions in the final standard to grandfather current structures which enter into new derivatives to replace derivatives whose counterparties are not acceptable under provisions of the amendment. We also recommend grandfathering structures that issue new beneficial interests solely in response to a reduction in the seller's interest, an asset sale that was previously contracted for, or a requirement in the governing documents that new beneficial interests be issued to repay maturing ones until the asset pool matures.

### **Effective Date**

The Exposure Draft contains an effective date that is the first day of the first fiscal period following the issuance of the final standard. Constituents may readily determine whether certain structures violate the new QSPE limitations but the reissuance restrictions will require a documentation review for each securitization because these restrictions apply to any structure with the ability to reissue beneficial interests, not just any structure that does reissue beneficial interests. Given the potentially sweeping changes to current structures, the ambiguity around the intent of transferor derivative and commitment restrictions, the inability of constituents to unilaterally modify their structures, and the documentation reviews that constituents must perform, we recommend the FASB extend the effective date a minimum of six months after the issuance of the final standard. We believe that this extension is warranted as

constituents are still dealing with practice questions regarding FIN 46, another rule-based standard, six months after its issuance.

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In summary, we are concerned with the erosion of FAS 140's control-based framework and the resulting inconsistencies and lack of comparability in financial reporting that may result. We believe the Exposure Draft as written has the unintended consequence of preventing nearly all structures from achieving QSPE status or even achieving sale treatment. Furthermore, due to the fundamental changes to current GAAP, The Clearing House requests that the transition provisions and effective date be reconsidered. The Clearing House would welcome the opportunity to assist the FASB in the resolution of the issues raised in this letter. If you have any questions, please contact Norman R. Nelson at (212) 612-9205.

Sincerely yours,

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