BDO

BDO Seidman, LLP
Accountants and Consultants

233 N. Michigan Ave.
Chicago, IL 60601
Telephone: (312) 616-4661
Fax: (312) 856-9019

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Ms. Suzanne Q. Bielstein
MP&T Director
File Reference 1200-001
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Letter of Comment No: 29
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Dear Ms. Bielstein:

BDO Seidman, LLP is pleased to offer comments on the FASB Exposure Draft (ED), *Qualifying Special-Purpose Entities and Isolation of Transferred Assets, an Amendment of FASB Statement No. 140.*

We recommend that the Board not issue the ED as proposed. We believe that the ED attempts to meld the isolation/surrender of control principles of FASB Statement No. 140 with the exposure to losses/rights to residual returns principles of FASB Interpretation No. 46. Those principles are inconsistent and incompatible. The result is an amendment containing prohibitions on activities of qualifying special-purpose entities (QSPEs) and transactions between transferors and QSPEs that are arbitrary and illogical. In addition, we disagree with, and do not understand the rationale for, the portion of the amendment that would require the ultimate transferee in a two-step transaction to be a QSPE.

Inconsistent and Incompatible Principles

Statement 140, like Statements 77 and 125 before it, is based on principles of isolation and surrender of control. Financial assets are derecognized when the transferor loses control over them and isolates them from the claims of its creditors. Interpretation 46, by contrast, is based on principles of exposure to losses and rights to residual returns. Financial assets are derecognized when the transferor ceases to be exposed to a majority of the expected losses and loses the right to a majority of the residual returns. Those principles are in conflict. In many transactions accounted for as sales under Statement 140 (as well as previously under Statements 77 and 125), the transferor surrenders control and isolates the assets from its creditors but remains exposed to a majority of the expected losses through its retained beneficial interest or contractual recourse obligations. There is no way to reconcile these principles.

Arbitrary and Illogical Prohibitions

Statement 140 permits the transferor to retain a subordinated residual interest in receivables transferred to a QSPE and permits the transferor to service the transferred receivables. The proposed amendment would continue to permit these activities, and we concur that such activities should be permitted under the isolation/loss of control principles. Through those two permitted activities, the transferor typically retains substantial risk in the transferred receivables, substantial control over how much cash is collected from the transferred receivables, which protects or enhances the value of its retained interest, and a substantial economic interest in the transferred receivables. By comparison, many of the transferor's actions and transactions that the FASB proposes to prohibit are relatively less significant. It seems strange in this context, for example, that the FASB would prohibit the transferor from choosing whether a QSPE issues 30-day versus 90-day commercial paper or from providing liquidity in the unlikely event of a catastrophe in the commercial paper market.

Further, the FASB proposes to prohibit activities that seem economically interchangeable with permitted activities. For example, a transferor can retain credit risk through a retained subordinated beneficial interest, but could not retain credit risk through a recourse arrangement that would require the transferor to transfer assets in the future. That is, the transferor could sell a senior interest in a $100 pool of receivables for $90 and retain a $10 subordinated interest that will absorb the first $10 of credit losses, but it could not sell the entire pool for $100 with a liability to make payments of up to $10 to reimburse the buyer for credit losses. From the transferor's perspective, the substance of the economic exposure is the same regardless of the form. We don't understand why one form of recourse is acceptable and the other is not, and the ED provides no rationale. Strangely, too, the permitted form of recourse (a subordinated retained interest) generally is perceived as less risky to the transferees than the prohibited form (obligation to reimburse the transferees for credit losses), because the transferees are exposed to risk that the transferor will not perform under the prohibited form.

Another example of different treatment of similar transactions is the prohibition on derivatives between the transferor and the QSPE. The Board observes in Statement 140, paragraph 57, that if the transferred receivables have fixed interest rates and the QSPE's beneficial interests have floating interest rates, then the transferor's retained interest effectively contains an embedded interest rate swap. The embedded interest rate swap does not seem to preclude the transferee from being a QSPE, because the ED proposes no amendment to paragraph 57. But if the transferor enters into a freestanding interest rate swap, the transferee cannot be a QSPE. We do not understand the logic or the underlying principle. We would be equally perplexed, though for a different reason, if the Board were prohibiting the embedded interest rate swap illustrated in paragraph 57, because the swap does not affect the transferor's ability to isolate the receivables from its creditors and transfer control to the transferee(s).

Two-Step Securitizations

We do not understand why the Board proposes to require that in a two-step securitization, the transferee in the second step must be a QSPE. The Board simply states that the transfer is deemed not to meet the conditions of paragraph 9(b) of Statement 140, without regard to the terms of the transaction. We think this requirement is unnecessary. If the transferee is not a QSPE, then it most likely would be a VIE subject to the requirements of Interpretation 46. If the transferor is the primary beneficiary, it would consolidate the transferee and the accounting effects of the transfer would be eliminated in consolidation. If the transferor is not the primary beneficiary and the transfer meets all of the conditions of paragraph 9 of Statement 140, why should the transaction be deemed to fail paragraph 9(b) and be reported as a borrowing? What is the underlying principle? What is the Board's objection to sale accounting in this circumstance?

Portions of the Amendment With Which We Agree

We agree with two points in the proposed amendment—the proposed revision to paragraph 9(a) and the prohibition on QSPEs owning equity method investments.

- The proposed revision to paragraph 9(a) captures what we believe was the Board's intent in Statement 140 and the appropriate application of the isolation/control principles of Statement 140. Receivables should not be derecognized if any member of the transferor's consolidated group retains control of the transferred receivables or if creditors of any member of the consolidated group have access to the transferred receivables or their cash flows, with the exception in either case of bankruptcy-remote entities.
- We believe that equity method investments are fundamentally different from other financial assets, because of the potential for significant upside and because of the investee's potential relationship with the transferor's production or revenue-generating activities (as supplier or customer). An entity to which an interest in an equity method investment is transferred should not be eligible for QSPE treatment. The transferor should be required to evaluate the transferee in such transactions in accordance with Interpretation 46 and other consolidation guidance. While we believe the Board's focus should be on equity method investments, rather than all equity securities, we do not object strongly to extending the prohibition to all equity securities.

Our Recommendation

We recommend that the Board scrap the proposed amendment and start over with a narrower scope amendment of Statement 140. That amendment should identify types of transactions with QSPEs that truly give the transferor control over the transferred receivables or give the transferor's creditors access to the transferred receivables, and

should ignore whether the transferor retains exposure to losses or rights to residual returns. The accounting for transactions that transfer control and isolate receivables should not be affected, even if the transferor retains exposure to losses or opportunities to profit from the transferred receivables.

We do not believe that the FASB should amend the definition of a QSPE in Statement 140 to require that the lives of the beneficial interests match the lives of the transferred receivables, because such matching is not necessary to meet the conditions of paragraph 9 of Statement 140. However, if the Board continues to believe that the ability to roll over beneficial interests is contrary to the original intent of the idea of a QSPE, then we suggest a simple amendment to the definition to require that the lives of a QSPE's beneficial interests match the lives of its assets, rather than the arbitrary and illogical proposals in the ED.

We would be pleased to discuss our comments with the Board or the FASB staff. Please direct questions to Ben Neuhausen at 312-616-4661.

Very truly yours,

s/ BDO Seidman, LLP