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Re: File Reference No. 1200-001
Proposed Statement of Financial Accounting Standards, *Qualifying Special-Purpose Entities and Isolation of Transferred Assets*

Ladies and Gentlemen:

ABN AMRO in North America (ABN AMRO) is a provider of diversified financial services including commercial, investment and retail/consumer banking; brokerage and trust services; and investment management. Although we currently use qualifying SPEs only to securitize certain residential mortgage loans, we have a substantial role in many securitization markets that will be affected by the Financial Accounting Standards Board's (FASB or Board) Proposed Statement of Financial Accounting Standards, *Qualifying Special-Purpose Entities and Isolation of Transferred Assets* (the Proposed Statement). As both a user and an issuer of financial statements, ABN AMRO is pleased to present our views regarding the Proposed Statement.

ABN AMRO has significant concerns regarding the consistency and complexity of the Proposed Statement, as well as certain specific provisions. We believe that a successful accounting standard must set forth clearly its underlying principles and objectives and must follow those principles consistently. Instead, the Proposed Statement attempts to eliminate narrow instances of perceived abuse, and does so with broad statements and restrictions that extend far beyond the perceived problems that the Board has deliberated. The resulting definition of a qualifying SPE is complex and inconsistent. Further, we believe that there is little chance that an average financial statement user will understand when an SPE is qualifying and therefore exempt from consolidation, or when an entity is not an SPE and is evaluated under other standards.

In our view, the Board has focused too narrowly on the abuses it perceives are possible, and too little on the concept of a qualifying SPE. The original idea of a qualifying SPE had some conceptual merit, and was consistent with the control-based foundation of Statement of Financial Accounting Standards No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (Statement 140). The concept of a qualifying SPE was to identify those entities where control of the transferred assets was less important than the control of the related beneficial interests. The focus on control, rather than risks and rewards, was entirely consistent with the foundation of Statement 140. No

similar unifying concept exists in the Proposed Statement's definition of a qualifying SPE. The Proposed Statement's smattering of detailed restrictions on the activities of a qualifying SPE are unlikely to stand the test of time because they are not based in any cohesive concept or well-articulated objective.

ABN AMRO encourages the Board to reconsider the broad nature of the proposed restrictions, and develop guidance that is consistent with the overall framework of Statement 140.

Financial Guarantee Counterparties

The Proposed Statement would prohibit a transferor to a qualifying SPE from providing liquidity commitments, financial guarantees, and other commitments to deliver additional cash or assets to the SPE or its beneficial interest holders. Paragraph A12 indicates that these restrictions "result from concerns about the potential for enterprises to execute transfers that do not change their economic position in any essential way but that significantly change their financial statements." This reasoning is much more aligned with a risk and rewards model (economic position) than the control-based model that is the foundation of Statement 140. This restriction mixes the two models and results in an incoherent and inconsistent standard. We believe the restriction draws an inappropriate distinction between cash and synthetic instruments, and prohibits too broad a range of guarantees and commitments.

Distinction between Commitments to Deliver Cash and Retained Interests

One example of this inconsistency is the distinction that the Proposed Statement draws between subordinated retained interest (which may be held by the transferor – up to 90% of the total beneficial interests issued), and guarantees or other commitments to deliver cash. While this distinction has always existed in Statement 140, there is not a substantial difference in the accounting and measurement of those items. Retained interests are recognized at allocated fair value under paragraphs 10(a) and (b), and guarantees or other commitments are recorded as a reduction of proceeds under paragraph 11(b). However, the Proposed Statement results in a dramatic difference in accounting, potentially the difference between recognizing a sale and recognizing a secured borrowing.

The Proposed Statement treats credit enhancements differently whether they are funded and accounted for as retained interests (such as cash collateral accounts, subordinated retained interests) or unfunded and accounted for as a reduction of proceeds (such as financial guarantees or other commitments). In reality, the economic difference between a retained interest and a commitment to deliver cash is minimal, and does not merit such a stark difference in accounting treatment.

Consider Transaction A, in which an entity transfers a financial asset with a value of $100 to an SPE. The SPE issues a senior beneficial interest to a third party for $80, and the transferor retains the residual interest. Assuming other conditions are met and ignoring gain on sale issues, the transferor may record a sale for $80, and its retained interest for $20. In contrast, consider Transaction B, in which an entity transfers a financial asset with a value of $100 to an SPE along with a guarantee to absorb the first $20 of loss. The SPE issues a beneficial interest to a third party for the full $100.

	Transaction A	Transaction B
Cash Received	$80	$100
Retained Interest	20	0
Maximum Recourse Liability	(20)	(20)
Minimum value from transfer	$80	$80

Transactions A and B are economically the same: the transferor absorbs the first $20 of losses. However, the SPE in Transaction B would fail qualifying status, and would likely be consolidated by the transferor – resulting in a secured borrowing, rather than the sale recognized in Transaction A.

We believe that there is little conceptual distinction between retaining risk exposure through a cash instrument (such as a retained interest), and a synthetic instrument such as a guarantee or derivative instrument. Therefore, we disagree with the Proposed Statement's conclusion that these transactions, although economically similar, should be accounted for differently.

Broad Definition of Guarantee

The basis for conclusions indicates that the Board was focused on transfers with terms that do not change the transferor's economic position. The proposed restrictions on guarantees, however, apply to a much larger population of transactions. In particular, we are concerned that the Proposed Statement's focus on commitments to deliver additional cash is too broad, and would preclude many types of commitments that are fundamental to common transfers of financial assets.

In virtually every sale of financial assets, the seller makes certain representations and warranties to the buyer. In the event that these representations and warranties prove false, the agreement allows for repurchase or other remedies. The Proposed Standard appears to restrict *all* commitments to transfer cash to a qualifying SPE, regardless of whether those commitments are contingent, and regardless of whether the commitment is a substantive credit enhancement.

Similarly, the servicer of financial assets typically provides indemnification for servicer errors or omissions (for example, failing to perfect interests in collateral supporting the transferred assets). If the transferor of assets to an SPE acts as servicer, it appears that the Proposed Standard prohibits the SPE from being qualifying, and therefore the transferor may be required to consolidate the entire SPE.

A third example of this issue arises in mortgage reinsurance activities. We originate mortgages, and then sell them through a variety of structures, including whole loan sales and through securitizations involving

a qualifying SPE. In addition, we are involved in mortgage reinsurance activities, where third parties provide mortgage insurance to borrowers, and we reinsure a portion of the risk borne by these third parties. Thus, if a borrower defaults on its loan and the collateral value is below the insured value, we bear a risk of loss under the reinsurance contract, and have a responsibility to advance funds to the third party insurer, who then makes required payments to the qualifying SPE. Thus, mortgage reinsurance activities may be viewed as an indirect commitment to transfer cash to the qualifying SPE, and may preclude the SPE from achieving qualifying status.

We do not believe that these sorts of commitments -- contingent repurchase agreements, servicer indemnification, or mortgage insurance arrangements -- cause, in any material amount, the economic risk issue with which the Board is concerned. We have previously stated that we do not believe that the risk retention concern is consistent with the framework of Statement 140 at all, but at a minimum, we encourage the Board to reconsider and narrow the scope of the prohibition on financial guarantees and other commitments to transfer cash.

Derivative Instrument Counterparties

The Proposed Standard prohibits all derivative instruments between a qualifying SPE and any transferor. We understand that this restriction evolved from an initial concern regarding total return swaps. The expansion of this concern from total return swaps to even plain vanilla interest rate swaps is unwarranted. Unlike total return swaps, many derivative instruments transfer only a portion of the risk of financial assets held by a qualifying SPE and are not used to maintain the transferor's pre-transfer economic position. In addition, because the derivative instruments, whether plain vanilla or a total return swap, are recognized at fair value under Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities* (Statement 133), we fail to see any issues regarding the transparency of these transactions in current practice.

Because the prohibition on derivative instruments is written so broadly, we believe that it may have further unintended consequences. For example, many securitization transactions include removal of account provisions (ROAPs), which allow the transferor to reclaim certain assets subject to certain restrictions. Most securitization transactions include a clean-up call provision that allows the servicer (often the transferor) to repurchase the remaining financial assets when the amount of outstanding assets or beneficial interests falls to a specified level. Depending on the type of financial assets subject to these call options, ROAPS and clean-up calls may meet the definition of a derivative instrument in Statement 133. The broad prohibition on derivative instruments between the transferor and a qualifying SPE may actually prohibit ROAPS and clean-up calls, even though they are specifically addressed in Statement 140 and present no problem in current practice. We believe that the prohibition on derivative instruments needs to be narrowed, at a minimum, to continue to allow for ROAPS and clean-up calls between a qualifying SPE and its transferor.

In addition, we do not understand the Board's concern regarding risk retention through a derivative instrument, when nearly the same level of risk may be retained through a residual interest (up to 90% of the beneficial interests issued). This apparent preference for cash instruments rather than synthetic instruments is not conceptually sound, and will become even more problematic when Derivatives Implementation Group Issue No. B12, "Embedded Derivatives: Beneficial Interests Issued by Qualifying Special Purpose Entities" is resolved, resulting in more derivative instruments bifurcated from beneficial interests. We recommend that the Board remove the restriction on derivative instruments between a qualifying SPE and its transferor, except for those derivative instruments that transfer greater risk than could be retained through a residual interest (90% of transferred assets).

Reissuance Decisions

Scope of Reissuance

The Proposed Statement includes several restrictions related to qualifying SPEs that have the ability to reissue beneficial interest, but does not define or discuss what the Board intends by "reissuance." As this issue was discussed in EITF Issue 02-12, "Permitted Activities of a Qualifying Special-Purpose Entity in Issuing Beneficial Interests under FASB Statement No. 140" the EITF discussed three types of reissuance:

1. Qualifying SPE issues new beneficial interests to raise cash to pay off existing third party beneficial interests at the contractual maturity date.

2. Qualifying SPE issues new beneficial interests to raise cash to pre-pay existing third party beneficial interests prior to the contractual maturity date.

3. Qualifying SPE issues new beneficial interests to raise cash to purchase new financial assets, or to reduce the transferor's retained interest.

We found this distinction helpful, and believe that the different types of reissuance may merit different restrictions. In particular, the third type of reissuance is a common transaction involving master trusts, where additional financial assets are transferred into the trust, merely increasing the transferor's retained interest until beneficial interests are issued to third parties at a later date. That issuance may trigger sale accounting for the transferor, and we believe it is entirely appropriate for the transferor to have control over the timing and terms of that issuance, and resulting sale of financial assets.

Decision-making

The Proposed Statement requires that "no party (including affiliates and agents) both makes decisions about reissuing beneficial interests and either enters into a commitment (or commitments) to deliver additional cash or other assets to fulfill the SPE's obligations to BIHs or holds beneficial interests other than the most senior in priority." The Proposed Statement further notes that "the ability or responsibility

to take action does not imply decision making for purposes of this Statement if the party taking the actions has no discretion."

It is not clear what sorts of decision making the Board intends to prohibit. In fact, this was the central question to be resolved in EITF Issue 02-12, and we do not believe it has been resolved. For example, does the selection of commercial paper maturity within certain restrictions imply "discretion" that would be prohibited? If the concept of decision-making is intended to be consistent with that concept in FASB Interpretation No. 46, *Consolidation of Variable Interest Entities*, where decisions are choices that significantly affect the net income of the SPE, then we encourage the Board to make than intention clear. If some different threshold is to be used, then that threshold should be clearly stated and supported.

Equity Instrument

We agree with the Board's decision to prohibit a qualifying SPE from investing in equity securities. However, a qualifying SPE that holds loans receivable may receive equity instruments in a troubled debt restructuring or other workout situation. We encourage the Board to allow a qualifying SPE to hold such securities temporarily for a reasonable period of time to dispose of such securities received. This treatment is consistent with the current restrictions on temporarily holding nonfinancial assets.

Transition

Certain existing qualifying SPEs may require significant amendments to maintain qualifying status under the Proposed Interpretations. In previous new pronouncements, including FASB Technical Bulletin No. 01-01 *Effective Date for Certain Financial Institutions of Certain Provisions of Statement 140 Related to the Isolation of Transferred Financial Assets*, the Board has acknowledged the administrative burden that is sometimes required to obtain the necessary approvals from independent beneficial interest holders to effect such changes. We encourage the Board to consider those issues and grant an extended transition period for existing qualifying SPEs, where there are active efforts to obtain the required approvals from beneficial interest holders.

In addition, it may be difficult to replace existing derivative instruments between the transferor and the qualifying SPE with similar instruments with independent counterparties. Because a qualifying SPE may enter into new derivative instruments only in limited circumstances, a qualifying SPE with an existing derivative instrument with a transferor is certain to lose its qualifying status either because (a) its existing derivative instrument will violate the restrictions in the Proposed Statement or (b) it obtains a replacement derivative instrument under circumstances that violate the existing requirements of paragraph 40(a) of Statement 140. This issue could easily be solved by grandfathering existing derivative instruments or by granting a special transition exemption from the requirements of paragraph 40(a) to obtain replacement derivative instruments with third parties.

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We appreciate your consideration of our comments on the Proposed Statement and hope our suggestions assist the Board in its decision with this matter. Should you have any questions or comments, please contact Bret Dooley at (312) 904-8276 or me at (312) 904-1221.

Very truly yours,

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