



LETTER OF COMMENT NO. 8

909 Third Avenue
New York, NY 10022

October 30, 2008

Mr. Russell G. Golden
Technical Director
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, Connecticut 06856-5116

File Reference No: 1610-100
Proposed Statement, *Accounting for Transfers of Financial Assets*—an amendment of FASB Statement No. 140

Dear Mr. Golden,

Citigroup appreciates the opportunity to comment on the proposed FASB Statement, *Accounting for Transfers of Financial Assets—an amendment of FASB Statement No. 140* (proposed Statement). We believe that the Board should continue deliberations in conjunction with the International Accounting Standards Board (IASB) in an effort to issue a single, converged standard. Transfers of financial assets are pervasive in financial markets and frequent changes to the accounting principles applied to such transfers are very costly to financial statement preparers and confusing for financial statement users. We believe a deliberate, collaborative effort with the IASB represents the most likely opportunity for an enduring accounting standard.

We have presented our suggestions for and concerns with the proposed Statement, including comments on participating interests, restrictions on transferred financial assets, the ability to bid on transferred financial assets, and new disclosure requirements. Appendix A provides Citigroup's response to specific questions asked by the Board in the proposed Statement.

This letter is best read together with our comment letters on Proposed FASB Staff Position FAS 140-e and FIN 46(R)-e, *Disclosures about Transfers of Financial Assets and Interests in Variable Interest Entities*, and Proposed Statement, *Amendments to FASB Interpretation No. 46(R)*.

Participating Interests

The concept of a participating interest adds unnecessary complexity to the proposed Statement, which we believe is unwarranted. We recommend that this concept be eliminated from the proposed Statement and, instead, require transfers of both entire financial assets and portions of a financial assets to meet the same criteria for sale accounting. It would be helpful to understand why the Board considers it necessary to evaluate transfers of a portion of a financial instrument differently than the transfer of an entire financial asset. We are not

clear as to what it is about the transfer of a portion of a financial asset that requires additional restrictive criteria that must be met in order to achieve sale accounting. We believe that the application of the requirements in paragraph 9 to all transfers of financial assets, including transfers of a portion of a financial asset, should be conceptually consistent and should not result in two economically identical transactions being accounted for differently.

As an example, a reporting enterprise could transfer a subordinate 25 percent interest in a loan or transfer the entire loan to a newly established SPE and take back a senior 75 percent interest in the SPE. Assume that the reporting enterprise would be able to obtain a true sale opinion for both transfers and that the reporting enterprise does not maintain effective control of the transferred asset. The reporting enterprise should be economically indifferent between those two options. However, under the proposed Statement, the first transaction would require the reporting enterprise to recognize the entire loan and a payable that is equal to the cash received for the subordinate 25 percent of the loan, while the second transaction would allow the transferor to recognize a sale and record only its interest in the senior 75 percent of the loan.

If the concept of participating interests is retained in the final Statement, it is not clear why two-class participations should not meet sale requirements if all cash flows are passed through to participants and participants in each class are pari passu with the participants in their respective classes. For example, if an entity originates a loan and transfers a senior 80% undivided interest in the loan to a third party (Party A) and shortly thereafter transfers the junior 20% undivided interest in the loan to another third party (Party B), the proposed Statement reads to require that the parties (the originator, Party A, and Party B) each account for the transactions as a secured borrowing or secured lending, notwithstanding the fact that the originator has no continuing economic interest in the asset and notwithstanding the fact that Party A and Party B may have no knowledge of the involvement or form of the other participation. Is it the Board's intention that each transfer be considered a secured borrowing or secured lending or should the transfers be collectively evaluated and considered a sale once the originator no longer has a continuing economic interest in the asset? Further, if the concept of participating interests is retained in the final Statement, we do not see the conceptual merit in excluding a transfer of equity instruments, derivative instruments, and hybrid financial instruments from classification as a participating interest when they would otherwise meet the requirements to be classified as a participating interest. Those limitations had some merit when the Board originally considered this concept in connection with QSPEs, which could only hold passive financial assets, but with the elimination of QSPEs, it seems to be a restriction without a justifiable purpose. Moreover, we see no reason to treat the transfer of a pari passu interest in a hybrid debt instrument any different from the transfer of a debt instrument that does not contain a bifurcated embedded derivative. However, if the Board proceeds with including special accounting for transfers of a portion of a financial asset, we ask that the Board expand the scope of the definition of participating interests to include such instruments or clarify why it makes conceptual sense to exclude those instruments.

Restrictions on Transferred Financial Assets

We do not believe that paragraph 9(c)(3) and the related implementation guidance, as amended by this proposed Statement, is operational in its current form. We are concerned that the same implementation questions that are currently raised in practice by paragraph 9(b)

of Statement 140 will continue to be raised in the proposed guidance. Specifically, whether a restriction on the ability to pledge or exchange a transferred financial asset *primarily* benefits the transferee or some other party, including the transferor, is exceedingly subjective.

As an example, a reporting enterprise transfers financial assets to a newly established SPE that will issue beneficial interests backed by the transferred assets. The SPE is prohibited from pledging or exchanging the transferred assets. Such a restriction may be perceived to benefit the reporting enterprise, because the reporting enterprise has the knowledge of who has the financial asset and may block the financial asset from finding its way into the hands of a competitor, and also benefits the transferee, because it enhances the transferee's ability to market the issuance of securities backed by transferred financial assets to prospective beneficial interest holders, who also benefit because the restriction limits the transferee's ability to transform the nature of the risks assumed by the beneficial interest holders by replacing the transferred asset with another asset that has a different risk profile. Even with the examples provided in paragraphs 54A and 54B of the proposed Statement, we believe the Board has failed to present a principle that can be consistently applied.

We propose that the Board eliminate paragraph 9(c)(3). However, if the Board retains paragraph 9(c)(3), we believe that, in circumstances where a restriction provides a benefit to the transferee or the beneficial interest holders, sale accounting should not be precluded. We believe that this determination is less subjective than the current proposal, and will provide for more consistent implementation in practice.

The Ability to Bid on Transferred Assets

Paragraph 53 of the proposed Statement states in part, "[h]owever, a transferor has maintained effective control if it has such a right [the ability to purchase transferred assets prior to maturity] and also holds a residual interest in the transferred assets". We believe the Board's concern regarding the willingness of a transferor to pay any price for a transferred asset at auction is appropriate where the transferor holds 100 percent of the residual interest, but question the Board's assertion that if the transferor holds even an insignificant piece of the residual interest in transferred financial assets that it maintains effective control over the transferred assets.

As an example, assume that a reporting enterprise transfers a \$1,000,000 financial asset that will mature in 2020 to a newly established SPE that issues a senior \$900,000 interest and a subordinate \$100,000 interest. The SPE will hold the financial asset until termination of the SPE in 2015, at which point the financial asset will be sold at auction. The reporting enterprise retains \$100 of the subordinate interest. We understand that the reporting enterprise is assumed to maintain effective control, because it holds a piece of the residual interest and will therefore willingly outbid other parties. Assuming that the financial asset is worth \$1,000,000 in 2015 and that the reporting enterprise overbids by paying \$1,001,000, the reporting enterprise will receive an asset worth \$1,000,000 and \$101 from the redemption of its subordinate interest by the SPE. While \$1 of the \$1,000 excess was recovered by the reporting enterprise through its partial ownership of the subordinate interest, the reporting enterprise lost \$999 of the excess to the other residual holders; that is to say, from an economic perspective the reporting enterprise paid \$1,000,999 to third parties for an asset that is worth \$1,000,000.

In the above example, the reporting enterprise receives the transferred asset because of its willingness to pay third parties more than the asset is worth and not because the reporting enterprise can recover all excess amounts paid for the transferred asset (this would only occur when the transferor holds 100 percent of the residual interest of the SPE). We fail to see how this is any different than a transferor's willingness to pay more than the fair value of transferred assets where the transferor does not hold any piece of the residual interest, and believe that the Board has clarified that the willingness of a transferor to overpay for a transferred asset does not, by itself, result in the transferor maintaining effective control over the transferred asset.

If the Board decides not to amend the guidance in paragraph 53 we would ask that the Board better articulate why it believes the ability of the transferor to bid on assets in these circumstances is any different from a transferor's willingness to overpay for an asset in circumstances where the transferor does not hold a residual interest.

Disclosures

Please refer to the comment letter we submitted on the proposed FSP FAS 140-d and FIN 46(R)-e for our comments on the proposed disclosures.

Specific Clarification Requests

- Paragraph 8(B)(a) states that a participating interest, "represents a proportionate ownership interest in an entire individual financial asset." Do proportionate ownership rights extend to the voting and management rights of a financial asset? It is not uncommon for the servicer of a participated interest to manage the rights of the financial asset on behalf of the participating interest holders. Does the fact that the voting and management rights of a financial asset are not proportionate violate this requirement?
- Paragraph 8(B)(c) states that one of the requirements that must be met in order to be classified as a participating interest is that, "no participating interest holder is entitled to receive cash before any other participating interest holders in its role as a participating interest holder." It is not uncommon for the servicer of a participated interest to receive and distribute cash to the other holders of the participating interests. Does the fact that the transferor, through its role as servicer, receives 100 percent of the cash before distributing that cash to the other participating interest holders violate this requirement?
- Paragraph 10(c) of the proposed Statement states that, "upon completion of a transfer of participating interest that satisfies the conditions to be accounted for as a sale, the transferor shall recognize and initially measure at fair value assets obtained or liabilities incurred." Apart from servicing assets and liabilities, it would seem inconsistent with the definition of a participating interest for there to be any assets obtained or liabilities incurred through the transfer of participating interests that is classified as a sale. An example of the types of assets or liabilities that the Board envisions would be helpful.
- The proposed Statement implies that consolidation guidance should be applied before derecognition guidance. However, this is not explicitly stated. If this was the Board's

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intent, this should be clarified. We would observe that such a requirement would prohibit a transfer from a parent to a subsidiary from being recognized as a sale on the stand-alone financial statements of the parent. Is this what the Board intended? We believe that the more logical approach would be to first analyze the transfer under the amended FAS 140 and then analyze the consolidation of the transferee entity, since that follows the order of the business activity.

In summary, rather than issue new guidance that will be effective for a short period of time, we believe that FASB should work alongside the IASB to develop a single standard.

We thank the Board for its consideration and would welcome the opportunity to further discuss our comments with Board members and their staff. Please do not hesitate to contact me at (212) 559-7721.

Very truly yours,

A handwritten signature in cursive script that reads "Robert Traficanti".

Robert Traficanti
Vice President and Deputy Controller
Citigroup Inc.

Appendix A – Response to Board Request for Comment on the Proposed Statement

Will the proposed Statement meet the project’s objective to improve the relevance, representational faithfulness, and comparability of the information that a reporting entity provides in its financial statements about (a) a transfer of financial assets, (b) the effects of a transfer on its financial position, financial performance and cash flows, and (c) a transferor’s continuing involvement in transferred financial assets?

- Overall, we believe that the proposed Statement is an improvement to existing guidance on transfers of financial assets and the effects of a transfer on a reporting entity’s financial statements.

Do you agree with the Board’s decisions to eliminate the qualifying SPE concept and to require that all securitization entities be evaluated for consolidation under applicable U.S. generally accepted accounting principles? If not, why not?

- We support the issuance of a single, converged standard by the FASB and the IASB.

Certain financial statement users suggested that the Board adopt a no-continuing-involvement model (that is, if there is any continuing involvement, sale accounting would not be permitted). The Board decided to continue to permit derecognition of financial assets with continuing involvement as long as the conditions in paragraph 9 of Statement 140, as amended by this proposed Statement, are met, with the addition of enhanced disclosure requirements about a transferor’s continuing involvement (see paragraph A28 of this proposed Statement). Do you agree with this decision? If not, why do you disagree and what approach would you recommend to meet the needs of financial statement users for additional information on transferred financial assets?

- We are generally supportive of the Board’s proposed changes to Statement 140 and believe that the proposed changes reflect an improvement to existing guidance.
- We are not supportive of a no-continuing-involvement model as we believe that it fails to present the probable future economic benefits and obligations that a reporting enterprise is exposed to. For example, under a no-continuing-involvement model, if an entity transfers \$100 of financial assets to an SPE and enters into a plain-vanilla interest rate swap with the SPE, the entity would be required to recognize \$100 of assets and \$100 of liabilities when the reporting entity’s probable future benefit or obligation is limited to the interest rate swap.
- A *no-continuing-involvement model* is not consistent with the control model being presented by the Board in the proposed Statement. We strongly agree with the Board’s original reasoning in rejecting a no-continuing-involvement model.¹

¹ Excerpt from paragraph 166 of Statement 140: “Third, the Board could have precluded sale accounting for conditions not imposed by the transferor that constrain the transferee, unless the transferor has no continuing involvement with the transferred assets. The Board rejected that third possibility, even though it avoided the problems of the first two possibilities, because it seemed in conflict with the financial-components approach and would have required resolving numerous issues including whether some types of continuing involvement are so minor that they should not preclude sale accounting.”

- Please see our comment letter on FSP FAS 140-e and FIN 46(R)-e for a detailed explanation of our concerns with the proposed disclosures.

What costs do you expect to incur if the Board were to issue this proposed Statement in its current form as a final Statement? How could the Board further reduce the costs of applying these requirements without significantly reducing the benefits?

- The potential exposure to significant additional costs relates primarily to the scope of the additional disclosures proposed in paragraphs 17(h) and 17(i).
- Please see our comment letter on FSP FAS 140-e and FIN 46(R)-e for a detailed explanation of our concerns with the proposed disclosures.

The Board decided to establish specific conditions for reporting a transfer of a portion of a financial asset as a sale. A transfer of a portion of a financial asset as a sale is eligible for derecognition only for a pro rata portion that meets the definition of a participating interest. Do you agree with this decision? If not, why do you disagree? If you agree with the Board's decision to limit portions of a financial asset that are eligible for derecognition, do you agree with the definition of a participating interest? If not, what alternative definition do you recommend and why?

- See our commentary in the body of the comment letter.

Paragraph 9(c) of Statement 140 and the related implementation guidance as amended by this proposed Statement, require that the transferor (a) not maintain effective control over transferred financial assets to account for a transfer as a sale and (b) provide examples of effective control. The Board decided to incorporate many of the concepts from paragraph 9(b) of Statement 140 into paragraph 9(c), which results in the creation of the additional examples that are included in paragraphs 9(c)(3) and 9(c)(4). Do you believe that paragraph 9(c) of Statement 140 and the related implementation guidance, as amended by this proposed Statement, clearly explain how to determine if the transferor maintains effective control? If not, what additional guidance or examples are necessary? Do you believe that paragraph 9(c), as amended by this proposed Statement, is operational in its entirety in its current form? If not, what changes are necessary? Do you believe these additional examples of effective control in paragraphs 9(c)(3) and 9(c)(4) are operational in their current form? If not, what changes are necessary?

- See our commentary in the body of the comment letter.

Certain financial statement users strongly recommended that the Board provide disclosure principles and require certain specific disclosures for both transferred financial assets treated as sales and those that are treated as secured borrowings. Do you agree that additional disclosures about transferred financial assets are necessary and operational? If not, what changes would you make to the requirements? Do you believe that the revisions to the disclosure requirements are sufficient? If not, what additional disclosures do you believe are necessary?

- Please see our comment letter on FSP FAS 140-e and FIN 46(R)-e for a detailed explanation of our concerns with the proposed disclosures.

Appendix C includes significant amendments, primarily as a result of this proposed Statement, to related literature including (a) the FASB Special Report, *A Guide to Implementation of Statement 140 on Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, (b) certain Emerging Issues Task Force (EITF) Issues and Topics, and (c) certain AICPIA Audit and Accounting Guides. Do you agree that the related literature, as amended, is consistent with the proposed amendments to Statement 140? If not, why do you disagree and what changes would you make?

- The amendments to related literature are consistent with the proposed amendments to Statement 140.

Due to differences in financial statement user needs and cost-benefit considerations, should any differences exist for recognition, measurement, disclosure, transition, or effective date for private companies? If yes, please articulate what differences should exist and the reasons for those differences.

- Citigroup will be prepared to implement the proposed changes to Statement 140 for its fiscal year beginning after November 15th, 2009.