



KPMG LLP  
757 Third Avenue  
New York, NY 10017

Telephone 212-909-5600  
Fax 212-909-5699  
Internet www.us.kpmg.com

October 30, 2008



LETTER OF COMMENT NO. 5

Technical Director – File Reference No. 1610-100  
Financial Accounting Standards Board  
401 Merritt 7  
PO Box 5116  
Norwalk, Connecticut 06856-5116

**RE: Proposed FASB Statement, *Accounting for Transfers of Financial Assets - An Amendment of FASB Statement No. 140* (File Reference No. 1610-100)**

Dear Technical Director:

We appreciate the opportunity to respond to the proposed FASB Statement, *Accounting for Transfers of Financial Assets - An Amendment of FASB Statement No. 140* (the “proposed Statement”). We support the Board’s efforts to improve financial reporting related to transfers of financial assets and to address practice issues and financial statement user concerns related to FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (“Statement 140”). We agree with the Board’s stated objectives to improve the relevance, representational faithfulness, and comparability of the information that a reporting entity provides in its financial reports about a transfer of financial assets; the effects of a transfer on its financial position, financial performance, and cash flows; and a transferor’s continuing involvement in transferred financial assets. Overall, we believe the proposed Statement, when considered in conjunction with the proposed amendments to FASB Interpretation No. 46 (revised December 2003), *Consolidation of Variable Interest Entities* (“FIN 46(R)”), achieves the Board’s stated objectives and is an improvement to the current accounting guidance under Statement 140.

While we support the issuance of the proposed Statement, we believe that certain aspects require additional consideration and clarification by the Board prior to the issuance of a final Standard. Our general observations and specific comments on the proposed Statement are set forth below.

***Removal of QSPE Concept***

We support the Board’s decision to remove the concept of a qualifying special purpose entity (QSPE) in its entirety from the proposed Statement and to eliminate the associated scope exceptions in paragraphs 4(c) and 4(d) of FIN 46(R). We believe the elimination of the QSPE concept in Statement 140 is an improvement in financial reporting that will



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reduce complexity and will result in a more objectives-based standard related to the transfer of financial assets.

### ***Definition of a Participating Interest***

Given the Board's extensive deliberations over time regarding accounting for transfers of portions of financial assets as well as the significance of this new concept to the proposed Statement, we believe that the Board should clarify certain provisions of the proposed amendments to ensure consistent interpretation and application of the definition of a participating interest. We appreciate the guidance provided in paragraph 8B of Statement 140, as added by the proposed Statement; however, we are concerned that this guidance does not adequately address the following key issues, which will likely cause inconsistency in practice or unintended consequences if they are not addressed by the Board:

- **Set-off rights** – Based on the guidance in the proposed Statement, we believe that financial assets subject to set-off rights would not meet the definition of a participating interest. The proposed Statement only addresses the concept of set-off rights as they relate to legal isolation. However, we understand that set-off rights between the borrower and the transferor could create seniority for a transferor's interest in a participation that would cause the arrangement to not meet the definition of a participating interest under paragraph 8B(c) of Statement 140, as added by the proposed Statement.

For example, assume that a transferor originates a loan for \$100,000 and transfers a portion of the loan (representing a 50% interest in the loan - \$50,000) to a third party. In addition, assume that the borrower has a deposit with the transferor of \$100,000. The loan and the deposit are subject to set-off rights. If the transferor entered bankruptcy, the borrower would be able to set-off its deposit with the transferor against the \$100,000 loan and would not be required to make any further payments to the transferor. In this example, the transferor would not receive cash on the settlement (via set-off) of the loan, but also would never be required to repay the deposit. The set-off causes the third-party transferee, which becomes an unsecured creditor of the transferor, to be in a subordinate position to the transferor and would cause the transfer of a portion of the financial asset to not meet the definition of a participating interest.

We understand that these types of set-off rights are common and in many instances exist as a matter of law. We do not believe that the Board intended for such set-off rights to preclude a transferred portion of a financial asset from meeting the definition of a participating interest. Therefore, we suggest that this issue be explicitly addressed in the proposed Statement.



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- Servicing compensation – Paragraph 8B(b) of Statement 140 as added by the proposed Statement states that “Cash flows allocated to a servicer as compensation for servicing activities, if any, shall not be included” in determining whether a transferred portion of a financial asset meets the definition of a participating interest. If this language is interpreted broadly, any amount paid to the servicer that is contractually designated as servicing compensation would not preclude the transferred portion of the financial asset from meeting the definition of a participating interest. Such an interpretation could be considered consistent with the current definition of *Contractually specified servicing fees* in paragraph 364 of Statement 140, which explicitly acknowledges that servicing fees “may include some or all of the difference between the interest rate collectible on the asset being serviced and the rate to be paid to the beneficial owners of those assets.” However, we believe that it would be inconsistent with the objectives of the amendments to include a senior interest for the servicer through the amount paid as servicing compensation. Therefore, we suggest that the language in paragraph 8B(b) limit any allocated servicing fee to compensation that is commensurate with the level of effort required to provide the services.
- Scope of instruments that meet the definition of a participating interest – We suggest that the Board provide additional explanation on why the transfer of a portion of an equity, derivative, or hybrid financial instrument would not meet the definition of a participating interest.

In addition, the Board should clarify whether the term “equity instrument” as used in paragraph 8B(a) of Statement 140, as added by the proposed Statement, is intended to include interests that are equity in legal form, interests that would be classified as equity for accounting purposes, or both. As many securitized instruments have characteristics of both debt and equity, the Board should clarify whether it intends for interests in securitizations to be excluded from the scope of instruments that may meet the definition of a participating interest. For example, would a “seller’s interest” in a credit card securitization trust (which is in the form of a debt security) meet the definition of a participating interest, whereas a residual interest in a trust that has certain characteristics of an equity instrument would not meet the definition of a participating interest?

- Proportionate ownership interest in an entire individual financial asset - The proposed Statement indicates that the Board a participating interest is a proportionate ownership interest in an entire individual financial asset. However, the proposed Statement does not address the effect of third-party guarantees (including SBA loans) and interest-only and principal-only allocations. The Board should clarify the effect of guarantees and specific allocations (such as interest- or principal-only) in determining whether an ownership interest is proportionate.



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Additionally, the Board should clarify what would constitute an individual financial asset. For example, under the proposed Statement it is unclear whether an entity would be able to participate a portion of a residual interest (the B piece) that it holds in a commercial mortgage securitization (assuming that a residual interest is within the scope of instruments that meet the definition of a participating interest discussed above). Based on the guidance in paragraph 8B(a) of Statement 140, as added by the proposed Statement, we are uncertain whether the term “individual financial asset” refers to the residual interest held by the entity or to the securitized assets underlying the residual interest. We believe that the guidance related to participating interests should apply to the financial assets that are recognized for accounting purposes. For example, a beneficial interest in a securitization is a financial instrument that should be eligible to be a participating interest even though it represents a share of the assets underlying the beneficial interest. Depending on the final guidance provided in the amendment to FIN 46(R), this could be a significant issue as many holders of residual interests may transfer a portion of their residual interest so that they do not hold a majority of the expected losses of a variable interest entity if the quantitative primary beneficiary test is retained in FIN 46(R).

***Application of Revised Guidance in Paragraph 9 to Transfers between Parent and Subsidiary***

We are concerned that the revisions to paragraph 9 of the proposed Statement would preclude all transfers from a parent to a subsidiary from being accounted for as a sale. Paragraph 9(a) has been revised such that transferred financial assets are legally isolated only if “...the transferred financial assets would be beyond the reach of the powers of a bankruptcy trustee or other receiver for the transferor or any of its consolidated affiliates included in the financial statements presented.” This paragraph also clarifies that a bankruptcy remote SPE is not considered a consolidated affiliate when applying the legal isolation analysis.

We believe that the guidance in paragraph 9(a) implies that a consolidated subsidiary that is not structured as a bankruptcy remote SPE would be considered a consolidated affiliate under paragraph 9(a), and would therefore have to be considered in performing the legal isolation analysis. Consequently, a transfer from a parent to a consolidated subsidiary that is not a bankruptcy remote SPE would not be accounted for as a sale, as it is likely that a conclusion could not be reached that the transferred assets would be beyond the reach of the transferor or its consolidated affiliates.

However, the inability of a parent to account for a transfer to a consolidated subsidiary as a sale is a broader issue under paragraph 9 of the proposed Statement. As discussed further under Application of the “Transferee Benefit” Provision to Transfers between Parent and Subsidiary, given the revised guidance set out in paragraph 9(c) of the



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proposed Statement, if a parent transferred financial assets to a consolidated subsidiary, it seems likely that the parent would never be able to conclude that the constraint on the subsidiary is designed primarily to provide the subsidiary with a benefit. We believe that all consolidated subsidiaries, including bankruptcy remote SPEs, would be included in the analysis of paragraph 9(c) as no specific exception, like that included in paragraph 9(a), is provided. Accordingly, it appears likely that the provisions of proposed paragraph 9(c) would preclude all transfers from a parent to subsidiary from being accounted for as a sale.

Given that the accounting in Statement 140 is symmetrical for the transferor (the parent) and the transferee (the subsidiary), the fact that the parent could not derecognize the transferred assets (either due to the guidance in paragraph 9(a) and/or paragraph 9(c)) means that the subsidiary could not recognize those assets in its separate financial statements. The Board should consider revising paragraph 9 to permit parent to subsidiary transfers to be accounted for as sales and purchases of the transferred assets by the parent and subsidiary, respectively.

#### *Application of the “Transferee Benefit” Provision*

The proposed Statement revises paragraph 9(c) of Statement 140 to include two forms of continuing involvement that, in addition to the current guidance in paragraph 9(c) of Statement 140, need to be evaluated when assessing whether a transferor maintains effective control over the transferred financial assets. Specifically, paragraph 9(c)(3) states that a restriction on the transferee’s right to pledge or exchange the transferred financial assets it receives would not indicate that the transferor maintains effective control of the assets if the constraint is designed primarily to provide the transferee with a benefit. We believe that the Board needs to clarify this new requirement to allow constituents to better understand the Board’s reasons for making this change and provide for more consistent application.

Based on the guidance provided in the proposed Statement, it is unclear how the Board would assess whether a restriction placed on a transferee is designed primarily to provide the transferee, rather than the transferor, with a benefit. Paragraph A36 states that “...the Board concluded that in cases where a financial asset is transferred to a securitization entity, a constraint on the ability of the transferee to sell or exchange its assets is usually, but not always, necessary if the transferee intends to issue beneficial interests. Accordingly, such a constraint would not indicate that the transferor has maintained effective control.” It appears that the Board has provided specific guidance related to securitization entities, therefore, we assume that the Board’s concern about constraints on the transferee is primarily related to transfers to non-securitization entities (e.g., operating entities). One view is that a constraint could never be designed primarily to provide the transferee with a benefit if the transferee is not an SPE, as any restriction placed on a



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transferee would be expected to impact the price that the transferee paid or, said another way, the transferee receives fair value consideration for the constraint. Under that view, if the transferee receives fair value consideration, as in any value for value transaction, it cannot be said to “benefit” (consistent with the guidance on fair value call options not providing the transferor with more than a trivial benefit). However, we are uncertain whether the Board intended that constraints on non-securitization entities could not be designed primarily to provide the transferee with a benefit.

If transfers to securitization entities are assessed differently than transfers to non-securitization entities, different accounting results would be obtained depending on the structure of similar transactions. For example, an entity may first transfer the financial asset, with restrictions, to an SPE and then sell beneficial interests in that SPE, with no restrictions, to an operating entity. Given that the Board has specifically stated that securitization entities benefit from restrictions, this structuring step could result in a different conclusion than if the SPE was not inserted into the structure. We would support removing the provisions currently in paragraph 9(b) of Statement 140 altogether and not including any aspect of those provisions in paragraph 9(c) of the amended Statement. We do not believe those provisions are necessary to prevent inappropriate derecognition of financial assets given the proposed changes to FIN 46(R) to require consolidation of variable interest entities to be based on a qualitative assessment of power to control and the fact that transferors would be required in all cases to evaluate whether to consolidate the transferee.

#### ***Application of the “Transferee Benefit” Provision to Transfers between Parent and Subsidiary***

As previously discussed, given the revised guidance set out in the proposed Statement, if a parent transferred financial assets to a consolidated subsidiary, it seems likely that the parent would never be able to conclude that the constraint on the subsidiary is designed primarily to provide the subsidiary with a benefit. Accordingly, it appears likely that the provisions of proposed paragraph 9(c) would preclude all transfers from a parent to subsidiary from being accounted for as a sale. Given that the accounting in Statement 140 is symmetrical for the transferor (the parent) and the transferee (the subsidiary), the fact that the transferor (parent) could not derecognize the transferred assets means that the subsidiary could not recognize those assets in its separate financial statements.

Unless specifically addressed by the Board, this issue could have implications for securitizations that utilize a bankruptcy remote entity that is a consolidated subsidiary of the transferor. For example, if the parent does not meet the derecognition criteria for the first step in a two-step securitization then it would be unable to derecognize the financial assets when the second transfer/step is analyzed. We recommend that the Board specifically address this issue.



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Alternatively, as previously indicated, we would support removing the provisions currently in paragraph 9(b) of Statement 140 altogether and not including any aspect of those provisions in paragraph 9(c) of the amended Standard.

### ***Legal Isolation***

Paragraph 8A of Statement 140, as added by the proposed Statement, provides clarification that when evaluating a transaction under paragraph 9 of Statement 140, an entity must consider all arrangements or agreements made contemporaneously with, or in contemplation of, the transfer, even if they were not entered into at the time of the transfer. We understand from this guidance that an entity would be required to consider the impact of arrangements or agreements related to the transferred financial assets that are entered into after the date of the transfer *only* if those arrangements or agreements were contemplated at the date of the transfer. If our understanding is not correct, the Board should clarify this guidance in the final Standard. If our understanding is correct, the Board should address how an attorney should identify and analyze arrangements or agreements contemplated at the date of transfer but not yet entered into as of that date for purposes of the legal isolation analysis.

In addition, the proposed Statement provides additional implementation guidance related to the legal isolation analysis in paragraph 27A of Statement 140. While it is helpful for the Board to provide additional guidance related to the legal isolation analysis, that guidance should be consistent with existing literature regarding legal isolation opinions, such as AU Section 9336, *Using the Work of a Specialist: Auditing Interpretations of Section 336* (AU 9336). We are concerned with the revisions in the proposed Statement because the last two sentences of paragraph 27A are not identical to the current requirements in AU 9336. We believe that this language should be removed from paragraph 27A of Statement 140 or revised to be the same as AU 9336 to eliminate differences from the current auditing guidance that could create significant implementation issues.

### ***Definition of Continuing Involvement***

We believe that the definition of *continuing involvement* added to Appendix E of Statement 140 by the proposed Statement is overly broad. The term is defined as “Any involvement with the transferred financial assets that permits the transferor to receive cash flows or other benefits that arise from the transferred financial assets or that obligates the transferor to provide additional cash flows or other assets to any party related to the transfer” and it includes as an example “...derivative instruments related to the transferred financial assets.” It is unclear whether this definition is intended to include any interest rate swaps entered into with an SPE by a transferor of financial assets to the SPE. Such derivatives could be viewed as unrelated to the transferred financial assets.



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The Board should clarify whether it intends for these types of instruments to constitute continuing involvement.

### ***Continuing Involvement Disclosures***

Paragraph A47 of the proposed Statement states that “Financial statement users told the Board that they need additional information about transferred financial assets when the transferor has continuing involvement in the transferred financial assets, regardless of whether the transferor accounts for the transfer of financial assets as a sale or as a secured borrowing. Financial statement users also told the Board that enhanced disclosures urgently are needed to improve transparency about the extent of continuing involvement a transferor has in transferred financial assets.” It is unclear from the proposed Statement why the continuing involvement disclosures included in paragraph 17(i) of Statement 140, as amended by the proposed Statement, are applicable only if the transferor has continuing involvement in financial assets that it has transferred to an SPE, rather than a non-SPE.

If the Board believes that the disclosures related to continuing involvement are only considered beneficial when continuing involvement relates to assets transferred to an SPE, we believe that the reason should be explained in the proposed Statement. We understand that if the scope of these disclosure requirements is broadened, the disclosure requirements may need to be specifically tailored to non-SPEs; however, it seems that any continuing involvement in transferred financial assets would be relevant information to financial statement users, irrespective of whether the transferee is an SPE.

### ***Transferors with No Continuing Involvement***

One of the Board’s stated objectives in the proposed Statement is to provide information about “a transferor’s continuing involvement in transferred financial assets.” However, the proposed Statement would amend paragraph 17(h)(2) of Statement 140 to require that an entity disclose “the characteristics of the transfer (including a description of the transferor’s continuing involvement with the transferred assets, *if any*), and the gain or loss from sale of financial assets, including quantitative information about how the gain or loss was determined” (emphasis added). We believe that a transferor with no continuing involvement should not be subject to the disclosure requirements in paragraph 17. However, if the Board intends to require those disclosures for transferors with no continuing involvement, then it should discuss the reasons why in the basis for conclusions.

### ***Quantitative Information About Gain/Loss Determination***

It would be helpful for the Board to provide an example (similar to those previously included in Appendix C of Statement 140) of the paragraph 17(h)(2) requirement to



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disclose “quantitative information about how the gain or loss was determined.” Since the gain or loss is the product of applying GAAP to the assets and liabilities recognized as a result of a transfer (and there is no discretion involved in its calculation), it is not clear what information this disclosure requirement is intended to elicit. Alternatively, if the Board intended to require *qualitative* information about how the gain or loss was determined, the requirement should be revised.

### ***Implicit Arrangements***

The proposed Statement would amend paragraph 17(i)(1) of Statement 140 to require disclosure of “qualitative and quantitative information about the transfer, giving consideration to both explicit and implicit arrangements...” Similarly, the proposed Statement would amend paragraph 17(i)(1)(c) of Statement 140 to require disclosure of the terms of any arrangements that could require the transferor to provide financial support to the transferee or its beneficial interest holders. Because the Statement 140 accounting model is based on explicit rather than implicit arrangements, we believe the Board should clarify what characteristics of arrangements would require disclosure under these provisions and how such arrangements would be identified.

As part of its additional guidance or within the basis for conclusions, the Board should clarify if implicit arrangements should be considered when determining whether a transfer meets the derecognition criteria. For example, the Board should clarify if implicit arrangements are expected to be considered in the analysis of legal isolation, as discussed in paragraph 9(a), and if so, the Board should provide further guidance regarding how an attorney would identify and analyze implicit arrangements in the context of the legal isolation criteria.

### ***Third Party Liquidity, Guarantees and Other Commitment Disclosures***

Paragraph 17(i)(1)(e) of Statement 140, as amended by the proposed Statement, requires an entity to provide disclosures related to liquidity, guarantees, and other commitments provided by third parties related to the transferred financial assets. We believe that this disclosure requirement is impractical for certain transferors that are not the sponsor or administrator of the transferee-SPE. For example, a transferor of trade receivables to a commercial paper conduit may not be able to obtain the details of the conduit’s liquidity facilities even though it has continuing involvement with the conduit.

In addition, we are concerned that it may not be possible for preparers to comply with this disclosure requirement in other circumstances. For example, assume that an investment bank is the counterparty to an interest rate swap held by an SPE, which is managed by an independent third party, and the same SPE purchases a debt security from the investment bank that it continues to hold at year end. Under the proposed Statement, the investment



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bank may be considered a transferor to the SPE that has continuing involvement with that transferred financial asset via the swap (refer to our earlier comment on whether the swap would be considered continuing involvement). Therefore, the investment bank may need to provide the disclosures required in paragraph 17(i)(1)(e), for which the information is unlikely to be readily available.

Although the Board may not have intended to require the disclosures in paragraph 17(i)(1)(e) of Statement 140, as amended by the proposed Statement, for the scenario described above, given the broad definition of continuing involvement and the current wording of the disclosure requirements, such disclosures may be required under the proposed Statement even though it may not be possible for preparers to provide them.

***Continuing Applicability of the Proposed FSP's Requirements***

To avoid confusion about the ongoing applicability of the disclosure requirements under proposed FASB Staff Position FAS 140-e and FIN 46(R)-e, "Disclosures about Transfers of Financial Assets and Interests in Variable Interest Entities" (the "proposed FSP"), we recommend that the Board clarify that upon an enterprise's adoption of the final Standard to amend Statement 140 the requirements of the proposed FSP cease to be applicable.

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We would be happy to further discuss the specifics of these issues in more detail at the request of the Board or the staff. If you have any questions about our comments or wish to discuss any of the matters addressed herein, please contact Mark Bielstein at (212) 909-5419, Kimber Bascom at (212) 909-5664, or Jason Jacobs at (212) 909-5565.

Sincerely,

**KPMG LLP**