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Mr. Russell G. Golden
FASB Technical Director
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

LETTER OF COMMENT NO. 47

File Reference No. 1610-100
Amendments to FASB Statement No. 140

Dear Mr. Golden:

McGladrey & Pullen, LLP is pleased to comment on the Exposure Draft of the proposed FASB Statement, *Accounting for Transfers of Financial Assets, an amendment of FASB Statement No. 140* (the proposed Standard or the Exposure Draft).

One of the objectives of the project related to FASB Statement No. 140, *Transfers of Financial Assets and Extinguishment of Liabilities* (FAS 140) is to improve the relevance, representational faithfulness and comparability of the information that a reporting entity provides in its financial statements. We believe the proposed Standard accomplishes this objective. However, in view of the fact that the International Accounting Standards Board (IASB) also has a project on its agenda to develop a new standard on derecognition, we believe that converged guidance on derocognition would further the objective of convergence. We therefore recommend that FASB's Exposure Draft be delayed to coincide with a converged derecognition standard with the IASB. We understand that the IASB project is also on a "fast track" and the IASB will bypass the Discussion Paper step and proceed directly to an issuance of an exposure draft in the near term.

We understand the FASB is under pressure to change some aspects of FAS 140 as soon as possible. However we believe that it would be better to require companies to make a single change to a converged accounting standard, rather than implementing this proposal and then undertaking a second implementation effort when a converged derecognition standard is later issued. Substantial costs will be incurred to implement these standards. Preparers will incur costs to learn the new standard, train employees, collect significant amounts of data not collected today, change reporting and consolidation systems, and make changes to systems and control structures to reflect the new requirements. Auditors will need to update practice aids, policies and tools and train employees on the new standard. Users will experience a similar learning curve. Therefore, we think it is unreasonable to ask entities to apply two sets of accounting changes within what we expect to be a short time frame.

If the Board proceeds to finalize the Exposure Draft before a converged standard is adopted, we believe it is important that FASB issue the standards on amendments FAS 140, and the amendments to FASB Interpretation No. 46(R), *Consolidation of Variable Interest Entities* (FIN 46(R)), concurrently. We believe that the two standards complement each other, since they both address what should be recognized on the balance sheet. Our comments in the balance of this letter should also be considered if the Board finalizes the proposed Standard.

Although we support delaying the issuance of this proposed Standard until a joint solution with the IASB can be achieved, we still support finalizing the enhanced disclosure guidance in the proposed FSP FAS 140-e and FIN 46(R)-e, *Disclosures about Transfers of Financial Assets and Interests in Variable Interest Entities.* We previously provided comments on the enhanced disclosures in our comment letter on the proposed FSP, which are applicable to this proposed Standard as well.

Limiting Changes

The proposed Standard not only includes the significant change of removing the concept of a qualifying special purpose entity (QSPE), but also made several other significant changes to the FASB Statement No. 140 model. All these changes increase the difficulty of initially applying the proposed Standard. As an indication of the impact of these changes on financial reporting and the complexity in their application, we observe Appendix C to the Exposure Draft, which shows the extent to which the proposed Standard would impact financial reporting. We suggest, limiting the changes to removal of the QSPE concept to make the transition less onerous.

Coordination with the Proposal to Amend FIN 46(R)

As we noted above, this proposal is presumably being issued simultaneously with the proposal to amend FIN 46(R), *Consolidation of Variable Interest Entities.* It is unclear to us whether to apply this Standard first and then the proposed FIN 46(R) or vice versa. For example, if the proposed amendment to FIN 46(R) were applied first, then a former QSPE for which the transferor is deemed to be the primary beneficiary would be consolidated and, thus, become a consolidated affiliate. Then, in applying the proposed amendment to FAS 140 to the transfer of assets to the former QSPE, proposed paragraph 9 sales criteria would not be met, because the assets were transferred to a "consolidated affiliate." However, if the proposed standard amending FAS 140 were applied first, sales treatment could potentially be achieved before the FIN 46(R) consolidation analysis was performed.

We believe the amendments to FAS 140 should be applied first, as it is usually the transfer of assets that leads to the transferor's attaining a controlling financial interest in the variable interest entity. We request the Board clarifies whether it intends that a "consolidated affiliate," as that term is used in paragraph 9(a) of the proposed amendments to FIN 46(R), would include a variable interest entity consolidated under FIN 46(R). We also recommend that the final Standard clarifies the intent of the Board with respect to the priority of application of both proposed Standards, because the order of applying the two standards could result in a significant difference in the standalone financial statements of the parent company and the special purpose entity.

Criteria for Sale Treatment

We agree with the amendments the FASB has made to the criteria for sale accounting in paragraphs 9(b) and 9(c). Particularly, we support the deletion of the "more than a trivial benefit" language, which has been difficult to apply and audit. However, we believe the requirement in paragraph 9(c)(3) should be changed to read, "... unless such constraint is designed to <u>significantly benefit the transferee (or investors in a transferee that is an SPE).</u>" The FASB should clarify that, where the transferee is an SPE, the investor may also be the beneficiary of a restriction on assets transferred and such restriction would not necessarily preclude sale accounting if such a constraint was not designed primarily to benefit the SPE transferee, but rather to benefit the ultimate investors. Such restrictions are often designed to assure investors there will not be significant changes to the risk characteristics of the pool of assets in which they invested through the SPE.

Additionally, determining whether a transferor, transferee or investor significantly benefits from the constraint would be very challenging because of the fact that a securitization transaction is a bargained exchange. All parties to the exchange presumably benefit from it and each party presumably gives up consideration commensurate with the benefit that it receives. Therefore, this provision is difficult to apply in practice.

We also would suggest the FASB clarifies the accounting by a subsidiary in a transfer of financial assets from the parent when the transfer does not meet sale accounting. Presumably, the parent would not account for the transfer as a sale. Since the parent has control over the subsidiary, it would be deemed to have effective control over the transferred financial assets. Therefore, it appears that such transfers would never be eligible for sale accounting. If symmetrical accounting for both the parent and subsidiary is achieved, the subsidiary could never account for the assets it received in the transfer in its standalone financial statements.

Participating Interests

We question the necessity of creating the guidance included in paragraph 8B in the proposed Standard for a "participating interest." We have not seen difficulty in practice related to participating interest sales, nor have we seen accounting results that did not reflect the economics of the transaction. This new guidance would make the proposed Standard much more difficult to apply and would significantly change practice. We believe the criteria specified to meet the definition of a participating interest are too restrictive and would cause many participation agreements that are widely used in practice to fail to qualify for sales treatment under the proposal.

In the event the FASB rejects our suggestion to eliminate paragraph 8B to the Exposure Draft, we believe several implementation issues need to be addressed. We would ask that the FASB consider eliminating or clarifying the requirement in paragraph 8B(b) that the transferor's ownership shares must remain in exactly the same pro rata position as the original date through the life of the financial asset. In standard loan participation agreements, it is not uncommon for the transferor's proportionate interest to vary over the life of the original financial asset. Consider the following examples:

- Under construction loan agreements, the lead bank may advance its own funds first to avoid the necessity of contacting the participants before each draw. A "true up" occurs shortly after the lead bank advances the funds.
- A participant may negotiate to sell its share back to the lead bank, which would change the lead bank's proportionate interest.
- If the loan originator sells a portion of the loan after the inception of the asset, collections from the borrower prior to the participation would not be pro rata with the ultimate allocation of interests among the participants.
- If the loan originator initially transfers 50% of a loan to another lender and later transfers another 20% to that lender or another party, the transferor's ownership shares do not remain pro rata over the life of the original financial asset.
- Many loan participation agreements provide for a "first-out" provision under which principal payments are applied first to the participating bank and then to the lead bank once the participating bank is paid off.

Our understanding of paragraph 8B(b) is that the transfers listed above would not qualify as a participating interest under the guidance in the proposed Standard. This conclusion would likely cause many common participation agreements to fail to qualify for sales treatment. At the very least, if the Board does not decide to eliminate the concept of a participating interest as we recommended, we suggest the guidance be modified to require any pro rata requirements relate to the life of the participation, not only at inception. If our understanding of the requirements is not correct, we suggest modifying the language to make the Board's intentions clear.

We also don't understand why participating interest holders can have no recourse to the transferor. FASB Statement No. 140 is based on a financial components approach under which every participant in the transaction records the assets they retain or acquire and the liabilities they assume. Recourse is a factor in determining whether isolation of an entire transferred asset has been achieved, but does not preclude sale accounting. Thus we believe that having some recourse should not prevent sale accounting for a participation as long as paragraph 9(a) is met.

We would be pleased to respond to any questions the Board or its staff may have about any of the preceding comments. Please direct any questions to Jay D. Hanson (952-921-7785.)

Sincerely,

McGladrey & Pullen, LLP

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