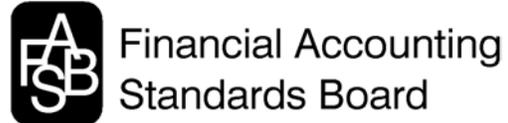


## MINUTES



**To:** Board Members

**From:** Statement 140 Interpretation Team

**Subject:** Minutes of the May 27, 2003  
Board Meeting

**Date:** May 30, 2003

**cc:** Bielstein, Leisenring, Smith, Swift, Polley, Cassel, Bullen, Lott,  
Derivatives Implementation Team, Financial Instruments Team,  
Gabriele, Sutay, Thompson, Vincent (2), Intranet

Topic: Additional Issues in the QSPE Project

Basis for Discussion: Board memorandum dated  
May 12, 2003

Length of Discussion: 3:30 p.m. to 4:15 p.m.

Attendance:

Board members present: Herz, Trott, Schipper, Foster, Crooch,  
Wulff, and Schieneman

Board members absent: None

Staff in charge of topic: Lott

Other staff at Board table: Bullen, Lusniak, and R. Richards

Outside participants: None

**Summary for ACTION ALERT:**

The Board discussed issues raised by the SEC staff and others relating to the website project summary and made the following decisions about those matters. First, the Board decided to prohibit any party that holds beneficial interests other than the most senior interest in a qualifying special-purpose entity (SPE) from making decisions about beneficial interests. Second, the Board decided to prohibit qualifying SPEs from holding equity instruments of any type. The term *equity instruments* will be defined from the holder's perspective by reference to FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. Third, the Board decided to require that the two-step transfer described in paragraph 83 of FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, include a qualifying SPE as the second step if the transfer results in undivided interests in the assets or the issuance of beneficial interests or securities. A qualifying SPE would not be required for the second step if assets or *all* of the interests in assets are transferred. [All Board members agreed.]

In related decisions, the Board decided that the proposed amendment to paragraph 35(a) of Statement 140 was not necessary since legal isolation is adequately addressed in paragraph 9(a) and that paragraph 35(c)(2) should explicitly state that a qualifying SPE may not hold any derivative instruments that transfer risk between the transferor and the entity rather than specifically prohibiting certain arrangements such as total return swaps. [All Board members agreed.]

The Board directed the staff to prepare a draft of a proposed Statement for vote by written ballot.

**Matters Discussed and Decisions Reached:**

The Board discussed issues related to the following matters:

- Decision-maker holdings
- Equity instruments
- Two-step transfers
- Guarantees from affiliates of the transferor

- Legal isolation
- Derivative instruments

The Board decided to prohibit the decision maker from holding beneficial interests other than the most senior interest in a qualifying SPE. The Board reasoned that the ability to make decisions coupled with a desire to protect one's own interests was akin to control and therefore should be restricted. The decision maker should act as an agent for the parties involved with the entity rather than protecting its own interests.

The Board decided to prohibit a qualifying SPE from holding equity securities because a transfer to a qualifying SPE permits entities to effectively convert equity instruments such as limited partnership interests, for which gains and losses would be reported in earnings under the equity method, to securities that can be designated as available-for-sale under Statement 115, which requires gains and losses on those securities to be reported in other comprehensive income. The Board decided to refer to Statement 115 rather than defining *equity instruments* because defining that term would be challenging, and constituents generally understand the term in the context of Statement 115.

The Board also decided to require that the two-step transfer described in paragraph 83 of Statement 140 include a qualifying SPE as the second step if the transfer results in undivided interests in the transferred assets or the issuance of beneficial interests or securities. The Board agreed that its proposed amendment to paragraph 9(a), which required transferred assets to be legally isolated from the transferor's consolidated affiliates (except certain bankruptcy-remote subsidiaries) to obtain sale accounting, would not accomplish its intended purpose since a true sale opinion could be obtained for transactions where an affiliate of the transferor provides a guarantee of assets derecognized in a two-step transfer.

As a result, the Board focused on the provisions in paragraph 9(b), which require that each transferee have the right to pledge or exchange the transferred assets (or beneficial interests if the transferee is a qualifying SPE) it receives. Accordingly, a transfer could meet the isolation requirement in paragraph 9(a) but

fail to obtain sales accounting if the transferee could not pledge or exchange the transferred assets or beneficial interests. For example, transferees that hold only undivided interests in assets cannot sell or pledge the transferred assets and therefore must be afforded the special accounting treatment for qualified SPEs described in paragraph 35 of Statement 140. Paragraph 35, as amended, prohibits any affiliate of the transferor from providing a guarantee of the entity's beneficial interests. Thus, by requiring two-step transfers to include a qualifying SPE as the second step if the transfer results in undivided interests in the transferred assets or the issuance of beneficial interests or securities, the Board attained its objective of prohibiting derecognition for transactions that include guarantees from affiliates of the transferor.

One Board member stated that the proposed amendments improve the accounting for qualifying SPEs, but he would have preferred to eliminate qualifying SPEs altogether.

One staff member suggested that the Board broaden the prohibition against guarantees from affiliates of the transferor by stating that a transferor cannot derecognize assets if the transferor or any of its affiliates provide any recourse to the entity other than subordinated interests. The Board responded that it did not want to prohibit recourse in all instances.

**Follow-up Items:**

None.

**General Announcements:**

None.