MINUTES

To:	Board Members		
From:	Gibbons (ext. 446)		
Subject:	Minutes of October 5, 2005 Board Meeting: Proposed FSP FAS 140-c	**Date:**	October 11, 2005
cc:	Leisenring, L. Smith, Bielstein, Golden, Donoghue, Barker, Lusniak, Jacobs, Mahoney, Swift, Polley, Petrone, Gabriele, Bergstrom, Vernuccio, FASB Intranet		

The Board meeting minutes are provided for the information and convenience of constituents who want to follow the Board's deliberations. All of the conclusions reported are tentative and may be changed at future Board meetings. Decisions become final only after a formal written ballot to issue a final Statement or Interpretation.

Topic: Analysis of comments from constituents and the staff recommendations for proposed FSP FAS 140-c

Basis for Discussion: Memorandum 6 dated September 22, 2005

Length of Discussion: 10:15 a.m. to 10:40 a.m.

Attendance:

Board members present: Herz, Batavick, Crooch, Seidman, Schipper, Young

Board members absent: Trott

Staff in charge of topic: Barker

Other staff at Board table: Donoghue, L. Smith, Lusniak, Gibbons

Outside participants: Leisenring

<u>Summary of Decisions Reached</u>:

The Board discussed the three key issues raised in comment letters from constituents on the proposed FSP FAS 140-c: Clarification of the Application of paragraphs 40(b) and 40(c) of FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. The Board considered the staff recommendations to address those issues and reached the following decisions:

1. The term *analysis* rather than *comprehensive analysis* should be used with regard to the requirement that an analysis be performed of expected limits on the notional amount of derivative financial instruments that a qualifying special-purpose entity (SPE) may hold over the life of the qualifying SPE.
2. The limits on the notional amount of derivative financial instruments that may be held by a qualifying SPE will not be impacted by purchases of beneficial interests by a transferor that were previously issued to outside parties as long as the transferor holds those beneficial interests temporarily and reports those beneficial interests as trading securities in accordance with FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities.*
3. The effective date of the guidance in the FSP is the date that the FSP is posted to the FASB website. The guidance regarding unexpected prepayments should be applied to new SPEs and existing SPEs that receive additional assets or issue additional beneficial interests (other than those previously committed to be received or issued as a result of commitments to parties other than the transferor) after the FSP's effective date.
4. The guidance regarding a transferor's purchases of beneficial interests from outside parties as described in paragraph 10 of the FSP is effective as of the date that the FSP is posted to the FASB website for such purchases and for transferors' previous purchases of beneficial

interests from outside parties that were consistent with the guidance in the FSP.

The Board approved the proposed FSP with the changes listed above.

Objective of Meeting:

The objective of the meeting was to discuss the key issues raised by constituents in the comment letters on the proposed FSP and the staff recommendations to address those issues. The objective of the meeting was met.

Matters Discussed and Decisions Reached:

1. Ms. Barker began the discussion by stating that the staff received comment letters from 12 constituents, including 4 from the Big 4 public accounting firms, 6 from financial institutions, and 2 from trade associations. The staff analyzed the comments, which focused on three issues, and developed staff recommendations to address those issues.
2. The first issue was the request by constituents to clarify the term *comprehensive analysis* by using the simpler term *analysis.* The staff agreed with that suggestion and recommended using *analysis* instead*.* The Board agreed with the staff recommendation.
3. Ms. Barker described constituent concerns about the proposed FSP's requirement to include beneficial interests that a transferor obtains as a result of secondary market-making and trading activities in determining the limit on the amount of passive derivatives that may be held by a qualifying SPE under paragraph 40(b). Constituents raised the following concerns with the requirement in the proposed FSP:
    a. The proposed guidance is inconsistent with current practice which ignores market-making and trading activities in calculating the limits on the notional amount of derivatives that may be held by a qualifying SPE.
    b. The proposed guidance is inconsistent with the proposed amendments to Statement 140.

c. The costs to implement the proposed guidance would be costly and unreasonable.

d. Most transferors currently report beneficial interests acquired by the transferor for market-making and trading activities as trading securities in accordance with Statement 115, with changes in value reported in earnings.

e. The governing documents of the qualifying SPE may not allow the adjustment of derivative balances to comply with this FSP. If permitted, adjustment of the notional derivative amounts may result in credit downgrades by credit agencies, since the derivatives in the qualifying SPE would not offset the hedged risks in their entirety.

4. The staff notes that the prohibition on derivatives that pertains to beneficial interests held by a transferor was intended to prevent abusive practices whereby a transferor could transfer derivatives into a qualifying SPE and circumvent FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities,* requirements. If the transferor's beneficial interests are reported as trading securities, any changes in fair value are included in earnings.
5. Ms. Barker stated that the staff recommends modifying the proposed FSP to permit a qualifying SPE to hold passive derivative financial instruments that pertain to beneficial interests that were previously issued to outside parties and are subsequently purchased by the transferor as long as the transferor holds those beneficial interests temporarily and reports those beneficial interests as trading securities in accordance with Statement 115.
6. Ms. Schipper stated she understands the staff recommendation is being proposed as a pragmatic solution based on the assumption that the related changes in the Exposure Drafts for the amendments to Statement 140 will come to fruition. A person who is skeptical about the timing and content of the final standards might object to this proposed FSP since this solution is contingent upon reaching final amendments that look like the provisions in the Statement 140 Exposure Drafts. Mr. Smith stated that if we did not have the provisions in the Exposure Drafts, the staff may have a different

recommendation for this proposed FSP. Ms. Schipper stated that is another way to express the dependency of the proposed FSP on the Exposure Drafts.

7. Ms. Schipper stated that adopting the staff's recommendation creates a completely different criterion. The proposed FSP requires an analysis (to be performed at the time the beneficial interests are originally issued) of what was expected to happen in the future. The staff's recommendation requires no analysis—a transferor may do anything as long as changes in value are reported in earnings and the beneficial interests are held only temporarily, with "temporarily" undefined in the proposed FSP. Mr. Smith stated that this is still subject to the existing provisions in Statement 140, that is, a transferor could not repurchase 95 percent of the beneficial interests of the qualifying SPE. Ms. Schipper stated that there is no longer the notion that market-making and trading activity should be consistent with the design of the structure at inception. The staff's recommendation would allow for any amount of market-making activities, provided changes in value are marked-to-market and recorded in earnings. A person who is concerned that trading activities may become so extensive that they contradict the notion of a qualifying SPE may find the staff's recommendation troublesome. Ms. Schipper stated that she will neither vote for nor object to the staff's recommendation.
8. Mr. Crooch stated that he would object to the staff's recommendation without the pending amendment to Statement 140. Mr. Crooch stated he is troubled by the fact that there are no limits on market-making and trading activities by the transferor. Ms. Schipper stated that there are limits, but those limits are not very binding—the binding limits in paragraph 10 are gone, and the other limits are found elsewhere in Statement 140. Mr. Crooch stated that he will feel strongly about reconsidering this issue if the other Statement 140 documents are not approved. Despite his concerns, Mr. Crooch stated that he would not object to the staff recommendation.
9. Ms. Seidman stated that this is an interim solution. Ms. Seidman emphasized the topic at issue is purchases of interests that were accounted for as sold originally and that are subsequently repurchased—this does not change the

assessment of what is considered sold originally. To address Ms. Schipper's concern that a transferor could repurchase any amount provided it does not interfere with the requirement in Statement 140 that 10 percent of the beneficial interests are held by outsiders, Ms. Seidman stated that that can occur currently. The issue is the matching of derivatives and beneficial interests, and whether to limit the amount of derivatives a qualifying SPE can hold based on the holders of beneficial interests. The basis for conclusions in Statement 140 indicates that the reason for limiting the amount of derivatives held by a qualifying SPE is concern about avoiding the guidance in Statement 133. The staff's proposal to mark-to-market beneficial interests held by the transferor is a good solution to this issue.

10. Ms. Schipper asked whether "temporarily" is important. A person may consider the mark-to-market accounting to be the important factor while considering temporarily to mean only "not forever." Ms. Seidman stated that trading is presumed to be short-term, which would correspond to "temporarily." The word "temporarily" is consistent with what is expressed as the business purpose.
11. Mr. Young stated that the Board handout uses the word "repurchases" while the proposed FSP uses "purchases." Mr. Young asked whether the intent is that the beneficial interests are purchased from an entity other than a division of the transferor. Ms. Donoghue stated that that is the intent and it would be clear in the final FSP. Mr. Young stated that he supports the staff's recommendation provided that point is clear. Mr. Batavick agreed with the staff's recommendation, and Mr. Herz stated that Mr. Trott supports the staff recommendation. Mr. Herz supported the recommendation and stated that he is not very concerned about the interaction of this proposed FSP with the proposed Statement 140 amendments—this solution is appropriate.
12. Ms. Barker stated that the final issue is the transition guidance in the proposed FSP. Constituents view this proposed FSP as a change in guidance that should be applied prospectively. The staff recommends the transition guidance be applied prospectively only to new qualifying SPEs and existing qualifying SPEs that issue new beneficial interests or receive new

financial assets, other than those previously committed to be received or issued as a result of commitments to parties other than the transferor.

13. Mr. Smith stated that we need to consider grandfathering existing qualifying SPEs that are not necessarily selling new beneficial interests but which may be undertaking temporary market-making and trading activities. Transition guidance should not cause the “qualifying” status to be questioned for a qualifying SPE that has past or future repurchase activity. Mr. Herz asked how the guidance would be applied if the repurchases have not been marked-to-market and not held temporarily. Mr. Smith stated that the transition guidance would not apply in that situation—the trading classification would have to be met.
14. Ms. Seidman asked whether the repurchases after a particular date are subject to the guidance and therefore the focus is on the repurchases. Mr. Smith stated the guidance should go beyond looking at repurchases because a potential subset of qualifying SPEs may be exposed, and people may question whether the market-making and temporary investment activities were in compliance with Statement 140, causing the need for restatement—that possibility is not intended. Mr. Smith stated that Mr. Trott agreed that existing qualifying SPEs should be grandfathered. Mr. Smith stated that this issue can be resolved in drafting. Mr. Herz asked whether the change permits pre-existing transactions that meet the criteria. Mr. Smith stated the change would permit such transactions.
15. Mr. Batavick agreed with the staff recommendation. Mr. Smith stated that this guidance is typical of EITF consensuses. Ms. Schipper stated that the proposal would be for a transaction or a commercial arrangement rather than a structure. Mr. Smith stated that if the transition is read literally, there may be unintended consequences. Ms. Schipper and Ms. Seidman agreed with Mr. Smith’s analysis.
16. Mr. Young asked for clarification on the transition provisions. Mr. Smith stated that the transition in the FSP would be applicable to repurchase activity that occurred prior to and subsequent to the FSP. Mr. Herz stated that he agreed with Mr. Smith’s recommendation provided beneficial interests held as

a result of market-making and trading activities are carried at fair value. Ms. Seidman asked what the impact would be when an entity is in compliance with the proposed guidance, except for the requirement to mark-to-market the beneficial interests with changes in value reported in earnings. Mr. Smith and Mr. Herz agreed that those transactions are not within the scope of the transition provisions. Mr. Smith stated the justification is that the Board's intent is clearly stated in the basis of Statement 140. The Board agreed with the staff's transition recommendation.

Follow-up Items:

None.

General Announcements:

None.