Letter of Comment No. 47 File Reference: 1200-001

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July 31, 2003

Ms. Suzanne Bielstein Director of Major Projects and Technical Activities Financial Accounting Standards Board 401 Merritt 7, P.O. Box 5116 Norwalk, CT 06856-5116

Re: File Reference No. 1200-001; Exposure Draft, Qualifying Special-Purpose Entities and Isolation of Transferred Assets, an amendment of FASB Statement No. 140

#### Dear Ms. Bielstein:

Goldman Sachs appreciates the opportunity to comment on the above-captioned exposure draft (the "Proposal"). We understand the Proposal started as an effort by the Board to provide specific guidance about the powers of a qualifying special-purpose entity (QSPE) to issue and reissue shorter-term beneficial interests that finance longer-term assets. As the Proposal progressed, the Board decided that other aspects of Statement 140 required clarification.

Overall, we do not support the Proposal, for the reasons discussed in the Attachment to our letter. In our view, the Proposal will result in a mixed-attribute model for derecognition - part control and part risks and rewards - which lacks a unifying conceptual basis.

We also believe the substance of the proposed prohibition on transferors providing derivatives, guarantees or other forms of support to QSPEs was debated during the deliberations leading to the issuances of Statements 125 and 140, when the Board settled on a control/financial components model for derecognition. That model (which we support) clearly recognizes the potential for an enterprise to derecognize transferred assets by surrendering effective control, while also holding financial components that could entail significant risks and rewards, provided the components held by the transferor do not prevent legal isolation or result in the transferor maintaining effective control over the

transferred assets (for example, the various types of call options discussed in question 49 of the Statement 140 implementation guide; put options in paragraph 32 of Statement 140; and total return swaps in paragraph 53 of Statement 140).

If the Proposal is a step by the Board towards a fundamentally different model for derecognition (e.g., because of international convergence), it should clearly say so and allow for vigorous and extended public debate and due process.

We are aware of the comment letter jointly issued by the American Securitization Forum and the Bond Market Association. We support the contents of that letter.

Finally, we observe the scope of the Proposal expanded significantly in just a few short months, beyond its original purpose, and ending with provisions that have significant consequences for the multi-trillion dollar securitization markets. Such a situation – where significant provisions are quickly exposed for comment – is not healthy for standard setting in the longer-term. We encourage the Board to seek out affected constituents early in the process, as it recently did in forming the Valuation Resource Group.

Thank you for the opportunity to provide our comments about the Proposal. We look forward to participating in the roundtable discussion on the Proposal. Should you have any questions about our letter, please do not hesitate to contact me.

Sincerely,

/s/ Matt Schroeder

### Attachment to Goldman Sachs' Comment Letter

File Reference No. 1200-001; Exposure Draft, Qualifying Special-Purpose Entities and Isolation of Transferred Assets, an amendment of FASB Statement No. 140

## SPEs that Finance Longer-Term Financial Assets with Shorter-Term Beneficial Interests

Conceptually, we believe QSPEs should not have broad discretion in their ability to issue and reissue shorter-term beneficial interests that fund longer-term assets. We believe broad discretion is inconsistent with the QSPE model. However, we believe a QSPE in principle should be permitted to have limited discretion in this area, similar to the limited discretion a servicer of financial assets has, so long as that discretion is significantly limited, the parameters of that discretion are fully described in the legal documents that established the QSPE or that created the beneficial interests in the transferred assets and, that discretion does not materially impact residual cash flows. In our view, the FASB staff could articulate these principles (as it did approximately two years ago when it addressed servicer discretion) and leave their implementation (and related judgments) to financial statement preparers and their auditors.

# <u>Prohibition on Transferors Providing Derivatives, Guarantees and Other Support to OSPEs</u>

Paragraph A12 indicates the above prohibition results from concerns about the potential for enterprises to execute transfers that do not change their economic position in any essential way but that significantly change their financial statements. That potential already exists in a control/financial components model, although it is checked by the ability to achieve legal isolation and surrender effective control over transferred assets. Those issues were debated during the deliberations leading to the issuances of Statements 125 and 140. If the Proposal is adopted, derecognition would become another mixed-attribute model, this one requiring surrender of control and some risks and rewards. We see no conceptual basis for the prohibition, as it is inconsistent with the control/financial components model.

If the Board decides to proceed with a mixed-attribute model, we believe the Board should allow transferors of financial assets to a QSPE to function as interest rate and currency swap counterparties to the QSPE, so long as the swaps are executed at market levels at the time the assets are transferred and the QSPE is formed. In general, we believe these types of swaps are passive in nature and do not present the types of problems the Board appears concerned with, so long as they do not incorporate significant leverage features. The challenge for the Board will be to articulate a set of principles that will allow preparers and their auditors to differentiate between passive and non-passive derivatives. One approach would be to prohibit total return swaps, written puts and other types of derivatives or guarantees between the transferor and the QSPE that materially insulate residual interest holders from changes in the fair values of the QSPE's assets.

## Prohibition on Equity Instruments in a OSPE

Paragraph A14 states the Board decided to prohibit a QSPE from holding equity instruments because a transfer to a QSPE may permit an entity to effectively convert equity instruments accounted for under the equity method, to securities that can be designated as available-for-sale, in effect by-passing the income statement. Such a prohibition strikes us as extremely broad and penalizes firms such as Goldman Sachs that account for equity instruments at fair value, with changes in fair value recorded in income

One way to address the Board's concern would be for the FASB staff to announce that any instrument accounted for under the equity method will be deemed to entail significant influence and, therefore, will not be viewed as passive in nature, precluding QSPE status (in effect, reversing the exception in question 30 of the Statement 140 implementation guide for limited partnership interests). Another approach would be to retain the prohibition on equity instruments contained in the Proposal, but provide an exception for transferors that accounted for the transferred equity instruments at fair value, with changes in fair value recorded in income. Such an exception would advance the Board's goal of accounting for all financial instruments at fair value.

# Moving Paragraph 27 Legal Isolation Requirements to Paragraph 9(a)

Paragraph A16 states the Board decided to amend paragraph 9(a) to clarify that the transferred assets must be isolated from all entities in the consolidated group that includes the transferor, except for certain-bankruptcy remote entities. Paragraph 27 in the implementation guidance section of Statement 140 already includes such a requirement, but questions arising in practice suggested to the Board that emphasis and additional clarity are required.

We think the existing guidance is clear and do not support this change, primarily out of concern that moving implementation guidance to the body of the standard suggests both sections do not have equal authority. This is a matter that should be addressed by the FASB staff if additional clarity is required.

### Requirement that Second-Step Transfer be to a OSPE

We find this requirement arbitrary and lacking any conceptual basis. It is far-reaching, precluding sale accounting for securitization transactions that do not qualify as QSPEs for a variety of reasons.

For example, SPEs that issue collateralized debt obligations (CDOs) and commercial mortgage-backed securities (CMBS) might not be QSPEs because of active management by the collateral manager and broad discretion by the special servicer, respectively. Both SPEs often receive transferred assets through a two-step transfer that also gives the SPE the ability to pledge or exchange the transferred assets. Because the second step transfer is not to a QSPE, sale accounting would be precluded under the Proposal. Oddly, the reason cited by the Board for not allowing sale accounting under the Proposal is the SPE

is deemed not to have the ability to pledge or exchange the transferred assets. Yet the SPE clearly has this right and, in the case of the SPE that issues CDOs, the collateral manager's active management is prima facie evidence of that right. We suggest the Board delete this requirement.