FSP140R46R

LETTER OF COMMENT NO. 14

Ernst & Young

Ernst & Young LLP
5 Times Square
New York, NY 10036
Tel: 212 773 3000
www.ey.com

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Mr. Russell G. Golden
Director of Technical Application and Implementation Activities
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

Proposed FSP FAS 140-e and FIN 46(R)-e
Disclosures about Transfers of Financial Assets and Interests in Variable Interest Entities
File Reference No. FSP140R46R

Dear Mr. Golden:

We appreciate the opportunity to comment on the aforementioned proposed Financial Accounting Standards Board (FASB or the Board) Staff Position No. FAS 140-e and FIN 46(R)-e, *Disclosures about Transfers of Financial Assets and Interests in Variable Interest Entities* (the proposed FSP). We support the Board's efforts to enhance the disclosure requirements under FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities - a replacement of FASB Statement No. 125* (Statement 140) and FASB Interpretation No. 46(R), *Consolidation of Variable Interest Entities - an interpretation of ARB No. 51* (FIN 46(R)), pending their amendments. We agree that enhanced disclosures regarding transfers of financial assets and interests in variable interest entities are needed to understand the extent of a transferor's continuing involvement with transferred financial assets and an enterprise's involvement with a variable interest entity (VIE).

While we agree with the objective to improve transparency surrounding these highly complex transactions and/or structured entities, we have concerns with the Board's assumptions about the practicability of an effective date at the end of the reporting period in which the proposed FSP is issued. We observe that the proposed FSP will significantly increase the information regarding financial asset transfers and involvement with variable interest entities that most entities will be required to accumulate when preparing financial statements disclosures.

While some financial statement preparers (Preparers) may already have the raw information necessary to comply with most of the enhanced disclosure requirements in the proposed FSP, the data may not be available in the format in which the enhanced disclosures are required to be presented. For entities that frequently participate in financial asset transfers or numerous variable interest entities, even the compilation of the existing data to comply with enhanced disclosure requirements may prove challenging. Moreover, some of the additional disclosures may require information that is not currently centralized or maintained in the Preparers' financial reporting

systems. Therefore, we strongly encourage the Board to carefully consider the comments received from Preparers regarding the time and effort needed to compile the proposed enhanced disclosures.

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Scope

In paragraph 10 of the proposed FSP, the Board uses the phrase "significant variable interest in a qualifying SPE." We believe the Board should clarify that significance in this regard includes an assessment of whether the variable interest is significant to the QSPE in addition to whether the variable interest is significant to the enterprise.

Aggregation of disclosures

We believe the aggregation provisions in the proposed FSP could prove helpful in presenting the necessary information in a concise and meaningful manner. However, we believe it lacks clarity in how the aggregation provisions may be applied and could result in inconsistent application. Moreover, the volume of additional disclosures required by the proposed FSP could potentially confuse users unless properly aggregated in a meaningful manner. We recommend the Board provide further guidance through examples or other means to promote consistency in application of the aggregation provisions among all Preparers. We note that in the Proposed Statement of Financial Accounting Standards, *Accounting for Transfers of Financial Assets, an amendment of FASB Statement No. 140* (Exposure Draft to the amended Statement 140), that the Board believes FSP SOP 94-6-1, *Terms of Loan Products That May Give Rise to a Concentration of Credit Risk* (FSP SOP 94-6-1), already provides additional aggregation guidance that should be considered by Preparers. However, we believe some of the guidance within FSP SOP 94-6-1, as well as other considerations to be developed, should be specifically incorporated into the proposed FSP (directly or by reference).

Guaranteed mortgage securitizations

Under the current guidance of Statement 140, guaranteed mortgage securitizations may receive the same accounting treatment as transfers that are sales, including income recognition. However, such transactions may not be sales and could be viewed as being excluded from the disclosure requirements under paragraph 17h in the proposed FSP. We recommend the Board consider whether to specifically include guaranteed mortgage securitizations under paragraph 17h until the amendment to Statement 140 is finalized and the distinction is eliminated.

Disclosures required by paragraph 17i of the proposed FSP

Scope of continuing involvement

Paragraph 17i of the proposed FSP appears to require a significant volume of disclosure relating to all forms of continuing involvement, regardless of the significance of that involvement. We believe this could place a significant burden on many Preparers. We recommend that the Board clarify the scope of the continuing involvement subject to paragraph 17i disclosures and provide justification for its conclusions. To mitigate the potential burden of this proposed amendment, we recommend that

the Board consider certain scope exceptions. For example, the Board may consider not mandating such disclosures when the only form of continuing involvement between the transferor and the SPE represents a derivative financial instrument whose underlyings are market interest rates or currency exchange rates and that provide for cash settlements that are not subordinate to the general claims of the entity's creditors (e.g., plain vanilla interest swap). We question the usefulness of the proposed disclosures in these instances as the transferor's continuing involvement with the SPE is no different than a bank that writes such a derivative to an unrelated counterparty. We also observe that the Board already has recognized in paragraph B14 of FIN 46(R) that rights and obligations under these types of instruments generally are unlikely to cause the holder to be the primary beneficiary of a VIE.

Transferors that have continuing involvement in financial assets that it has transferred to an SPE

Paragraph 17i applies to a "transferor [that] has continuing involvement in financial assets that it has transferred to an SPE (including those transfers that are accounted for as sales and those that are accounted for as secured borrowings) at the date of the latest statement of financial position presented" We recommend that the disclosure requirements of this paragraph be separated into two categories: (1) transfers of financial assets that have continuing involvement that are accounted for as sales and (2) transfers accounted for as secured borrowings. All of the requirements of paragraph 17i would apply to category 1. However, if a transfer is accounted for as a secured borrowing, we question whether all of the disclosure requirements are relevant since these items remain on the balance sheet of the transferor. Examples of less relevant disclosures include the disclosure requirements regarding how the transferor's risk profile has changed as a result of the transfer to an SPE that is accounted for as a secured borrowing and the requirements for providing a sensitivity analysis.

Liquidity arrangements

The new disclosure requirement in paragraph 17(i)(2)(e) of the proposed FSP would require transferors with continuing involvement in financial assets transferred to an SPE to disclose the liquidity arrangements provided by third parties related to the transferred assets. We believe compliance with this requirement may be difficult in circumstances in which the transferor is not the administrator or the sponsor of the SPE. A transferor that is not involved in the formation or daily affairs of the SPE may not be privy to the details of the SPE's finance arrangements. We recommend transferors that are not the administrator or sponsor of the SPE be exempt from the disclosure requirements of this paragraph.

Sensitivity analysis

Paragraph 17i(5) of the proposed FSP requires companies to disclose a sensitivity analysis or stress test showing the hypothetical effect on the fair value of financial assets or liabilities that relate to continuing involvement of the transferor (including any servicing assets or servicing liabilities) of two or more unfavorable variations from the expected levels for each key assumption in the valuation, independently from any change in another key assumption. Although it is a current requirement of Statement 140, we observe that the sensitivity analysis becomes difficult to evaluate when key assumptions that are interrelated are instead separately stressed and disclosed (e.g., a

change in the assumed discount rate would often warrant a change in prepayment assumptions). This presentation may artificially magnify or mitigate the fair value effect of movements in key assumptions. However, we also recognize that the standard already requires that Preparers describe the limitations of these sensitivity or stress disclosures. Rather than require Preparers to describe the limitations of such disclosures, we believe the Board should consider allowing Preparers greater flexibility to determine the most appropriate approach to stressing and presenting the key valuation assumptions (i.e., stressing more than one assumption with a single sensitivity analysis). We believe the Securities and Exchange Commission's Market Risk Disclosures provides guidance and alternatives that may be useful for Preparers to consider when disclosing the sensitivity analysis required by Statement 140.

We recognize that greater flexibility for Preparers may not promote the Board's objective of enhancing the comparability and relevance of disclosures among effected entities. Therefore, if the Board decides not to modify this disclosure requirement, we believe the Board should consider retaining the existing examples in Statement 140 and providing further implementation guidance (i.e., new examples that better illustrate how the objectives could be reasonably addressed or expanded considerations for aggregating and presenting data). We believe Preparers generally have found the existing examples helpful.

Implicit arrangements

Paragraphs 17i(2) and 22C(d) of the proposed FSP requires disclosure of, among other things, "qualitative and quantitative information ... giving consideration to both explicit and implicit arrangements..." Paragraphs 17i(2)(c) and 22C(d)(2) of the proposed FSP requires disclosure of "the terms of any arrangements that could require the [transferor or entity] to provide financial support..." We note that "implicit arrangements" is not a defined term within the proposed FSP. While FIN 46(R) addresses the concept of "implicit variable interests," and FSP FIN 46(R)-5, *Implicit Variable Interests under FASB Interpretation No. 46*, provides interpretative guidance on that concept, it is unclear whether the Board intended to introduce the same concept within Statement 140 or within the proposed disclosures under FIN 46(R).

Depending on the Board's intent, we note that the guidance in FIN 46(R) and FSP FIN 46 (R)-5 may not be operational in the context of Statement 140. Also, with respect to FIN 46(R), it is important to note that not all arrangements with a variable interest entity are necessarily variable interests in that entity. Accordingly, we recommend that both the Board's intentions and the term "implicit arrangements" be clarified in the proposed FSP. Although we understand the potential usefulness of disclosures of implicit arrangements, we believe the requirement to disclose "any" arrangement is overly broad and requires a great degree of speculation on the part of the Preparers. We believe disclosures of implicit arrangements should be limited to circumstances in which (1) the entity believes it is at least reasonably possible (as defined in FASB Statement 5, *Accounting for Contingencies*) that it will provide financial or other support to the transferee or its beneficial interest holders (e.g., liquidity commitments and obligations to purchase assets) that it is not otherwise contractually required to provide or (2) that the interests meet the definition of implicit variable interests, as defined in FSP FIN46(R)-5.

Servicing exception

Paragraph E8 of *Appendix E - Background Information and Basis for Conclusions* to the proposed FSP states "Footnote 10 to paragraph 17(i) (4) of Statement 140 provides an exception from the disclosures required by that paragraph if a transferor's only continuing involvement is servicing the transferred financial assets. Based on constituent feedback about the difficulty of providing a definition of servicing that would be consistently applied, the Board concluded that the disclosure exemption in footnote 10 to paragraph 17(i) (4) should be removed for this proposed FSP." We do not believe the related disclosures would be meaningful in situations in which typical servicing is the only continuing involvement as those disclosures may imply risks to the transaction that do not represent the transferor/servicer's ongoing economic exposure. While we acknowledge the difficulty in appropriately defining servicing that should qualify for an exemption and agree consistency is important, we do not believe the Board has provided a sufficient basis to support the elimination of this exemption in its entirety. We also note the Board has acknowledged such servicing can be treated differently in some circumstances, such as in the Exposure Draft to the amended Statement 140, in which it is carved out in determining the appropriate treatment for participation interests.

We recommend that the Board develop parameters to describe when the exemption would be appropriate. That exemption would apply when the servicer is receiving fair compensation for its services and is not subject to significant risks and rewards of changes in the fair value or cash flows of the servicing assets (other than reductions in servicing fees because of reductions in the number of underlying services assets). For example, arrangements in which all or part of the fee is subordinated to the cash flows of other beneficial interest holders in the structure or in which the fee is contractually dependent on asset performance (other than simply being a set dollar amount or percentage of the overall balance of assets being serviced) would not qualify. Additionally, collateral or portfolio management arrangements in which the manager shares in a portion of the increase or decrease in the fair value of the assets or in realized gains or losses would not be considered the type of servicing that would qualify for the exemption.

Required disclosures for consolidated variable interest entities versus voting interest entities

We note that the proposed FSP's amendments to paragraph 23 of FIN 46(R) eliminate the exception from the required disclosures for entities that are the primary beneficiary and also hold a majority voting interest in the variable interest entity. The primary beneficiary of a VIE is required to consolidate the assets and liabilities of a VIE, thereby subjecting those assets and liabilities to the disclosure requirements under existing GAAP. As the proposed disclosures relate only to VIEs, it is unclear why the Board is requiring additional disclosures for consolidated subsidiaries that are VIEs, but not to those subsidiaries that are a voting interest entities. We do not believe disclosure requirements for assets and liabilities of subsidiaries should differ based on the model applied to conclude that consolidation is required. If the Board continues to believe that different disclosures are required for VIEs and voting interest entities, it should articulate the principle that justifies such a difference.

In addition, we would observe that under current practice, many Preparers do not determine whether a subsidiary is a VIE in circumstances in which the entity has concluded that they would consolidate a subsidiary under both the VIE or voting-interest-entity model. We anticipate that the proposed

disclosures will require reporting entities to perform additional analyses to determine whether a subsidiary is a VIE or not, which may require significant time and effort in certain circumstances.

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We would be pleased to discuss our comments with the Board members or the FASB staff at your convenience.

Very truly yours,

Ernst & Young LLP