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360 MADISON AVENUE
NEW YORK, NY 10017
TELEPHONE 646.637.9200
FAX 646.637.9132
www.bondmarkets.com
www.americansecuritization.com

Major Projects & Technical Activities Director
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, Connecticut 06856-5116

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

Ladies and Gentlemen:

The American Securitization Forum[1] and The Bond Market Association[2] thank the Financial Accounting Standards Board for this opportunity to comment on the Exposure Draft referenced above.

We understand that FASB's two main goals in the Exposure Draft were:

1. To further restrict the kinds of support that transferors and their affiliates and agents can provide to QSPEs.[3]

2. To prevent certain entities that can reissue beneficial interests from operating as QSPEs in response to the adoption of FIN 46.[4]

As a policy matter, we do not agree with FASB that any or all of these changes need to be made. Nor do we agree with the general pro-consolidation orientation reflected in the Exposure Draft. In addition, we have serious practical concerns about the manner in which FASB is seeking to achieve its two main goals.

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[1] The American Securitization Forum (the "ASF"), an adjunct forum of The Bond Market Association (the "Association"), is a broadly-based professional forum of participants in the U.S. securitization market. Among other roles, the ASF members act as issuers, underwriters, dealers, investors, servicers and professional advisors working on securitization transactions. The views expressed in this letter are based upon input received from a broad range of ASF members including members of the ASF Accounting and Tax Subcommittee. More information about the ASF, its members and activities may be found at its internet website, located at www.americansecuritization.com.

[2] The Association represents securities firms and banks that underwrite, distribute and trade debt securities domestically and internationally. The Association's member firms account for in excess of 95 percent of all primary issuance and secondary market trading activity in the U.S. debt capital markets, including the issuance, underwriting and trading of securitized instruments. The views expressed in this letter reflect input received from a broad range of Association members who are active in the debt markets, including members of the Association's Mortgage and Asset-Backed Securities Division and Accounting Policy Committee. More information about the Association and its members may be found at its internet website, located at www.bondmarkets.com.

[3] Although this aspect is not discussed at length in FASB's "Reasons for Issuing this Proposed Statement" or Appendix A (Background Information and Basis for Conclusions), it is the first point mentioned in the "Summary" and is addressed in 6 out of the 9 amending paragraphs (3-5 and 9-11).

[4] See "Reasons for Issuing this Proposed Statement" on p. ii of the Exposure Draft.

The Exposure Draft takes a detailed, and sometimes self-contradictory, rule-making approach to several issues that are already handled in a satisfactory manner by the existing terms of Statement 140 and related guidance. Partly as a result of that rule-making approach, the Exposure Draft would, we think unintentionally, change the accounting for a large number of transactions where that change is not required in order to accomplish FASB's main goals. In fact, if the Exposure Draft is given its broadest reading, we doubt whether **any** current qualifying special-purpose entity would qualify under the proposed new standards.

The Exposure Draft indicates that some of the proposed changes are responses to new information that FASB has acquired since initially formulating the concept of a qualifying special-purpose entity in 1997 or modifying it in Statement 140. This explanation is hard to reconcile with a number of the original provisions of Statements 125 and 140, which clearly contemplated varying degrees of ongoing involvement by parties to a securitization without nullification of QSPE status. Examples include provisions relating to the treatment of retained interests, the discussion of revolving structures (including credit card master trusts), guidance on accounting for recourse when financial assets are derecognized and the fact that commercial paper is specifically included in the definition of "beneficial interests."

Rather than an adjustment in response to new information or a reaction to specific abuses of existing guidance, it appears to us that FASB is reversing decisions that were consciously made in the past and changing accounting policies without due regard for the thinking that went into those prior decisions or for reporting entities' justifiable expectation of consistency. In adopting Statement 125, FASB established a control/financial components approach to evaluating financial assets for derecognition. This approach is well suited to the pooling and legal segregation within SPEs of financial assets that support payments on beneficial interests issued by those SPEs.

In these transactions, which collectively account for multiple trillions of dollars in debt securities issued and outstanding in the United States, the various rights, risks and entitlements embodied within the transferred financial assets are, as a general matter, sufficiently dispersed so that consolidation by any single transaction participant would not be appropriate. EITF 96-20 recognized the logical implications of the control/financial components approach in the context of consolidation policy, as it applies to transferors to QSPEs. Statement 140 largely carried forward the approach taken in EITF 96-20. The Exposure Draft substantially turns away from that approach by importing a number of risks and rewards concepts that do not fit coherently with the basic control standard in Statement 140.

These proposed changes come on top of a series of almost continuous changes that FASB has made since the introduction of Statement 125. The QSPE model was introduced in 1997 and clarified shortly thereafter in 1998, in response to numerous questions posed by auditors and practitioners. This guidance was considered appropriate and sufficient by many; however, FASB has since issued a series of additional guidance that has forced market participants to continuously re-evaluate structures for compliance.

On a related point, we are concerned that the Board has taken too casual an attitude towards the direct and indirect costs to reporting entities in responding to the series of changes in GAAP affecting securitizations over the past six years. We do not concur with the statements in the Exposure Draft that "the incremental costs of implementing the amendments are minimal" or that costs that reporting entities incur to avoid recognizing assets or consolidating entities are not costs of implementing the statement.[5]

The current proposals continue this trend toward additional complexity and cost, without any demonstration that users of financial statements are not being well-served by the application of current QSPE criteria to traditional securitizations (such as mortgage-backed and credit card transactions), or that the proposed changes would yield marginal benefits in excess of their costs.[6] We continue to support the existing control-based financial components approach and do not believe that the proposed changes would facilitate fair representation.

I. Executive Summary.

Besides our broad policy concerns stated above, we have a number of specific comments on the Exposure Draft and suggested revisions, which are covered in the remainder of this letter in the following order:

A. Unintended Consequences, Hidden Costs and Innocent Bystanders.

In the course of our comments, we will mention many substantial components of the capital markets that would be harmed by the changes proposed in the Exposure Draft but have little or nothing to do with what we understand to be FASB's main goals. We have listed a number of these "innocent bystanders" here in one place to emphasize the cumulative impact:

1. In almost every sale of financial assets, the seller makes representations about the assets to the buyer and provides some repurchase, indemnity or other remedy if those representations are determined to be false. On its face, proposed new paragraph 35(e) seems to prohibit this type of undertaking between a transferor and a QSPE. (See Part II.C.1. below.)

2. FASB's arbitrary decision to require that certain additional transactions use a QSPE in order to achieve derecognition creates substantial uncertainties

[5] Exposure Draft, Appendix A, paragraph A4.

[6] Paragraph A3 of the Exposure Draft states that the Board "endeavors to determine that a proposed standard will fill a significant need and that the costs imposed to meet that standard, as compared with other alternatives, are justified in relation to the overall benefits of the resulting information" and that "investors and creditors and other users of financial information benefit from improvements in financial reporting." As discussed in detail in this letter, we believe that the costs of the proposed amendments substantially outweigh their benefits, and that there are serious questions about whether investors and other users will benefit from these changes.

for certain segments of the agency mortgage-backed securities market. Neither Freddie Mac nor Ginnie Mae use SPEs to convert mortgage loans into securities. Instead, either Freddie Mac or the mortgage banker (in a Ginnie Mae transaction) issues undivided interests in a pool of mortgage loans, and Freddie Mac or Ginnie Mae, as applicable, guarantees the timely payment of principal and interest. Some market participants are concerned that the final amendment will require that QSPEs be used in these transactions, since undivided interests are issued. At a minimum, this would require a substantial and rapid reworking of these programs. (See Part II.D. below.) Other issues for agency mortgage-backed securities transactions are created by proposed new paragraph 35(e). (See Part II.C.7. below.)

3. The proposed requirement to use QSPEs could also be read as precluding derecognition in transactions in which (i) a transferor meets all the requirements of paragraph 9 and would not be the primary beneficiary under FIN 46, but (ii) beneficial interests are issued and use of a QSPE is not practical for some reason. (See Part II.D. below.)

4. The Exposure Draft creates substantial uncertainties as to the future treatment of traditional issuances in revolving master trust structures. We do not believe that FASB meant the new restrictions on reissuance of beneficial interests to apply to these transactions, but the Exposure Draft is very unclear on this point. (See Part III.A.1. below.)

5. The two out of three factor test described in paragraph A12 of the Exposure Draft looks only at types of relationships of various parties with QSPEs, without assessing the true materiality of any particular relationship. As a result, trivial involvements by an incidental party to a set of transactions could change the consolidation and derecognition analysis for a transferor, by nullifying the Q-status of an SPE. (See Part III.B. below.)

B. Summary of Recommendations.

Assuming that FASB will ultimately adopt a substantial portion of the new rules in the Exposure Draft, a number of exceptions to those rules will be needed to avoid serious unintended results. Most of the balance of this letter is devoted to enumerating the necessary exceptions and identifying a few provisions of the Exposure Draft that we believe should be deleted in their entirety.

If FASB does not accept our key suggestions (or make other appropriate changes), the resulting guidance will not be operational, and we urge FASB to consider a new start. In Part VI of this letter we discuss the matched presentation, which we view as an attractive alternative in those circumstances.

We have attached as Appendix A to this letter a reprint of paragraphs 3-13 of the Exposure Draft, marked to show our suggested changes. Our main suggestions can be summarized as follows:

1. As to the proposed new limits on support commitments from transferors and their affiliates and agents, we request exceptions for:

a. derivatives provided by a transferor or its affiliates or agents that do not cancel out other parties in the aggregate from bearing a material portion of the economics associated with the underlying assets;

b. standard representations and warranties and a number of other common commercial undertakings; and

c. other support commitments that do not, alone or in the aggregate, cancel out other parties in the aggregate from bearing a material portion of the economics associated with the underlying assets.

We also request additional lead-in language to new paragraphs 35(e) and 35(f) to clarify what we think was FASB's intent: that those paragraphs are meant to elaborate on paragraph 35(c)(3), rather than being independent requirements.

We also request that FASB delete paragraphs 9-11 of the Exposure Draft and leave paragraphs 80-84 of Statement 140 as they are.

2. As to the proposed new limits relating to QSPEs that can roll over beneficial interests:

   a. We request that FASB clarify and limit the scope of the transactions that are subject to these limitations by (i) focusing on transactions where proceeds of new issuances are used to repay outstanding beneficial interests held by third parties, (ii) distinguishing remarketing of existing beneficial interests from reissuances and (iii) limiting the scope of affected transactions to those where discretion in rolling over beneficial interests can reasonably be expected to have a material influence on residual cash flows.

   b. To avoid arbitrary consolidation, we request that an SPE should not lose its Q-status solely because an enterprise combines two out of the three factors identified in paragraph A12 (or provides a majority of a liquidity commitment) unless, through such factors (or commitment), the enterprise bears a substantial percentage of the expected losses on the underlying assets, if incurred, or is entitled to receive a substantial percentage of the expected residual returns from the underlying assets, if realized.

3. As to the prohibition on holding equity instruments, we have four technical requests.

4. We also request additional transition time and three refinements to the transitional rules, each of which has precedent.

5. Unrelated to the changes proposed in the Exposure Draft, we suggest that FASB use this opportunity to make another change in Statement 140 that would provide greater accounting certainty for some mortgage loan swap transactions. (See the last paragraph in Part II.D.)

6. Finally, we discuss in Part VI the possible terms and benefits of the matched presentation.

II. Limits on Support Commitments From Transferors and Their Affiliates and Agents.

A large proportion of the changes proposed in the Exposure Draft relate to support commitments from transferors and their affiliates and agents. The Exposure Draft provides surprisingly little information as to FASB's reasons for these changes, but we infer what appear to be two essential underlying goals:

1. FASB wants the basic isolation requirement in paragraph 9(a) to apply to a transferor and its consolidated group, rather than just to the transferor as a separate legal entity.

2. FASB is concerned about liquidity, guarantees, other support commitments and certain derivatives provided by a transferor or its affiliates or agents as an indication of some form of control.

We do not object in principle to the first of these goals, though we have comments about some of the changes FASB has proposed to implement it. The second goal overlaps with the first to a great extent. Under Statement 140, most of the forms of support mentioned in goal 2 above would be relevant to the isolation analysis referenced in goal 1. To the extent of the overlap, we also do not object to the second goal.

We do, however, object to goal 2 insofar as it diverges from goal 1. The main point of divergence relates to certain derivatives and to "pure" liquidity, which is not available to fund or purchase defaulted assets. Some derivatives and some forms of pure liquidity provided by a transferor (or its affiliate or agent) might not be viewed as a problem for isolation. For instance, in municipal bond securitizations, transferors often provide a liquidity facility, but the facility is not available if the credit quality of the underlying bond portfolio deteriorates. In those circumstances, we do not see why there should be a per se prohibition on derivatives or liquidity provided by a transferor or its affiliates or agents.

At worst, liquidity provided by a transferor or its affiliate or agent is (a) a call, if the decision to draw on the liquidity is made by the transferor, affiliate or agent or (b) a put, if someone else makes the decision. If it is a call (other than a conditional or cleanup call[7]), it would already violate paragraph 9(c). At most, all FASB would need to do is fortify that point in 9(c) – but we think it is already abundantly clear. If it is a put, but does not interfere with legal isolation, then how is it a problem, since Statement 140 does not prohibit puts? To say that derivatives implicit in liquidity commitments, or otherwise provided by a transferor or its affiliate or agent, are to be treated differently from other puts and calls is confusing and has no conceptual justification.

We have commented below on each portion of the Exposure Draft that relates to support commitments from and derivatives with transferors and their affiliates and agents. Our comments include many exceptions that will be needed if FASB wishes to proceed with its initial approach without imposing substantial unintended and unnecessary costs for the capital markets.

A. Proposed Change to Paragraph 9(a).

We have no comment on the revised text of paragraph 9(a), which we believe is consistent with current GAAP. However, paragraph (d) at the bottom of page i of the Exposure Draft and paragraph A16 both use language that suggests that isolation might be required even

[7] See FASB Guide to Implementation of Statement 140, Question 49.

from affiliates whose assets and liabilities are not included in the financial statements under consideration. The main example of this would be a sister subsidiary that is not included in the stand alone financial statements of a transferor. We assume this suggestion was unintentional and request that FASB revise the applicable language to remove this uncertainty and continue current GAAP.[8]

B. Proposed Change to Paragraph 35(c)(2).

FASB's proposed change to paragraph 35(c)(2) (relating to derivatives) is overbroad and introduces substantial conceptual inconsistencies and practice issues. Based upon discussions at various Board meetings, it appears that the proposed prohibition on derivatives provided by a transferor and its affiliates and agents evolved from an initial focus on total return swaps or the equivalent. If FASB decides to retain a special rule limiting derivatives between transferors (and their affiliates and agents) and QSPEs, then we request that the new restriction be limited to derivatives that raise the initial concern.

In particular, transferors and their affiliates and agents should be able to enter into derivatives with QSPEs, excluding any derivative or combination of derivatives through which the transferor (or its affiliates or agents) would cancel out other parties in the aggregate from bearing a material portion of the economics associated with the underlying assets. This should be measured only at the trade date for the derivative(s), taking into account all future events that are reasonably foreseeable at that time.

Our suggested threshold would address FASB's concern 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."[9] It also serves to partially reconcile the risks and rewards elements that are being introduced with the basic control approach in Statement 140. If FASB believes our suggested threshold is too high, something lower might be operable. We believe it is essential, however, that there be some reasonable threshold, rather than the proposed outright prohibition.

We also note that permitted cleanup calls and removal of account provisions are sometimes derivatives (if the underlying assets are readily convertible into cash). FASB should also exclude permitted cleanup calls and removal of account provisions from the new prohibition on derivatives.

The issues addressed above will become more acute if transferors are ever required to bifurcate embedded derivatives from beneficial interests under DIG guidance. An example of a beneficial interest with an embedded derivative would be the residual interest in an SPE that holds fixed rate assets but issues floating rate beneficial interests. Economically, the residual interest contains an inverse floater derivative. A requirement to bifurcate would create a tremendous number of these accounting derivatives, raising a corresponding number of problems under the proposed guidance.

C. Proposed New Paragraph 35(e).

New paragraph 35(e) (on support commitments) is likewise overbroad and introduces significant conceptual inconsistencies and practice issues. If FASB moves forward with

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[8] See definition of "consolidated affiliate of the transferor" in the glossary to Statement 140 and FASB Guide to Implementation of Statement 140, Question 20.
[9] Exposure Draft, par. A12.

language similar to this proposal, then several exceptions or other clarifications will be needed to avoid serious unintended consequences.

A general point, affecting both of paragraphs 35(e) and 35(f), is that the relationship between those paragraphs and paragraph 35(c)(3) is not completely clear. Paragraph 35(c)(3) permits QSPEs to hold various supporting financial assets, with new limitations on the parties who may provide those assets. The proposed additional sentence at the end of paragraph 35(c)(3) states that "The limitations on the permissible counterparties to these financial assets are discussed in paragraphs 35(e) and 35(f)."

Some readers have construed that language in paragraph 35(c)(3) to mean that paragraphs 35(e) and 35(f) are meant solely to elaborate upon paragraph 35(c)(3). Under that reading, all of the limitations in paragraphs 35(e) and 35(f) would only apply to assets of the type described in paragraph 35(c)(3) – "Financial assets (for example, guarantees or rights to collateral) that would reimburse it if others were to fail to adequately service financial assets transferred to it or to timely pay obligations due to it". Other readers have noted that paragraphs 35(e) and 35(f) do not contain any reference to paragraph 35(c)(3) and that those paragraphs can easily be read as independent requirements, which just happen to also serve as the limitations referenced in paragraph 35(c)(3).

We propose the former, more limited reading of paragraphs 35(e) and 35(f), and we have suggested language to clarify the point. Even if FASB makes that clarification, we would still request the following additional clarifications.

1. Standard Representations, Warranties and Remedies.

This is the most extreme example of the issues that arise under paragraph 35(e). In all but the most exceptional sales of financial assets, the seller makes representations about the assets to the buyer and provides some remedy (repurchase, indemnity or otherwise) if those representations are determined to be false. This is recognized in current GAAP.[10] Based on the language in the Exposure Draft, there is substantial uncertainty in the market as to whether a contingent obligation of this type would preclude Q-status for the recipient of the assets.

A good precedent for a carve-out to address these issues can be found in the federal bank regulators' risk-based capital rules. Like Statement 140, those rules are concerned with the question of when a purported sale of financial assets should be respected as a sale. Recourse provided by the seller is a material factor in that decision, but the rules exclude from recourse any representations and warranties that are not meant to serve as credit enhancement, including warranties that permit the return of assets in instances of misrepresentation, obligor fraud or incomplete documentation.[11]

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[10] See for instance FASB Guide to Implementation of Statement 140, Question 22A.

[11] See 66 Fed. Reg. 59614, 59631 (November 29, 2001). The adopting release for these rules included the following discussion: "When a banking organization transfers assets, including servicing rights, it customarily makes representations and warranties concerning those assets. These representations and warranties give certain rights to other parties and impose obligations upon the seller or servicer of the assets. To the extent a banking organization's representations and warranties function as credit enhancements to protect asset purchasers or investors from credit risk, the final rule treats them as recourse or direct credit substitutes.

The final rule is consistent with the agencies' longstanding recourse treatment of representations and warranties that effectively guaranty performance or credit quality of transferred loans. However, the

2. Other Customary Commercial Terms.

Similar to representations and warranties that confirm the nature of the assets that the buyer has agreed to accept, sellers also customarily provide indemnities or similar remedies for impairment to the value of assets that result from specified events (other than deterioration of the obligor's creditworthiness) occurring after the date of sale. For example, if the transferred receivables arise from credit sales, the underlying obligors may have the right to return the purchased goods, resulting in a cancellation of the related receivable. A seller of receivables of this type will generally agree to reimburse the buyer in these circumstances. These types of terms generally are not inconsistent with legal isolation and do not confer control on the seller. The resulting adjustments to receivables balances are generally referred to in the market as "dilution" or "dilutive adjustments", and we have used the latter phrase to describe them in our suggested language in Appendix A.

Another example is that, when a transferor or an affiliated entity acts as servicer for transferred receivables, servicer errors or omissions (such as failing to maintain perfected interests in collateral that secures the transferred receivables) may diminish the value of the receivables. Servicers generally provide indemnities or other remedies relating to events of this type.

3. Compensating Interest.

In many mortgage-backed transactions, servicers agree to remit a full month of interest on each underlying loan, even if the loan prepaid during the month. However, the required additional remittance (in excess of collections received) is generally treated as a deduction from the servicing fee, rather than a gross payment by the servicer, and is capped at the amount of the servicing fee in non-agency mortgage securitizations. This is a long-standing practice to which investors are accustomed, and this obligation is taken into account in determining the value of any servicing asset or liability. We have requested in Appendix A that amounts deducted from servicing fees be permitted.

4. Interchange.

Interchange is the term for fees that banks receive through the Visa and MasterCard associations as partial compensation for taking credit risk, absorbing fraud losses and funding receivables for a limited period of time prior to initial billing. Visa and MasterCard have the right to net interchange payments due from the transferor to other participating banks against interchange payments due to the transferor. As a result, in securitizations of credit card receivables, transferors generally make an unsecured promise to make payments to the trust in an amount equal to the net amount of interchange attributable to the securitized receivables.

This is not generally viewed as interfering with the legal isolation of the related receivables because interchange is a distinct revenue stream that is linked to the creation of the receivables. Interchange is not generally recognized as an asset prior to transfer, so there is no isolation or derecognition issue as to the interchange itself.

5. Pre-Funding Accounts.

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agencies also recognize that banking organizations typically make a number of factual warranties unrelated to ongoing performance or credit quality. These warranties entail operational risk, as opposed to the open-ended credit risk inherent in a financial guaranty, and are excluded from the definitions of recourse and direct credit substitute." Id. at 59622-23.

Proposed new paragraph 35(e) appropriately excludes forward contracts in revolving period securitizations. However, similar arrangements often occur outside of revolving period securitizations. In "pre-funding" transactions, an SPE issues investor securities with net proceeds in excess of the purchase price for the receivables acquired on the closing date. The excess proceeds are placed in a pre-funding account and applied from time to time thereafter to pay for additional receivables transferred to the trust pursuant to pre-existing commitments. These arrangements do not call for any discretion on the part of the QSPE or transferor, and there is nothing inconsistent with the requirements for Q-status.

6. Permitted Investments.

Paragraph 35(c)(6) of Statement 140 appropriately permits a QSPE to hold money-market and other relatively risk-free investments purchased with cash collections pending distribution to beneficial interest holders. When a transferor or its affiliates has high enough credit ratings, the instruments purchased may be their obligations. For instance, collections in a securitization of Bank AA's receivables might be invested pending distribution in a Bank AA certificate of deposit. This could arguably violate proposed new paragraph 35(e) because it would require the transferor to make cash payments to the SPE when the certificate of deposit (or other cash equivalent investment) matures.

7. Limited or Non-Substantive Support Obligations.

Finally, in some transactions, transferors provide recourse that is limited in a manner so that it does not interfere with legal isolation. This can be accomplished by a contractual maximum on the amount of recourse, or by the transferor's and its legal counsel's determination that a recourse obligation, though unlimited on its face, is practically incapable of being drawn in a material amount. For instance, in agency multi-class mortgage-backed securities offerings, Fannie Mae, Freddie Mac or Ginnie Mae issues multi-class securities backed by pools of already-issued single class mortgage-backed securities. The applicable GSE also formally guarantees the timely payment of principal and interest on the newly issued multi-class securities, but the GSE takes on little added risk since the GSE has already guaranteed the underlying mortgage-backed securities.

Paragraph 11(b) of Statement 140 and numerous related examples clearly contemplate that a transfer with some recourse can qualify for sale treatment, since recourse obligations are identified liabilities that may be incurred and, if incurred, must be recognized. An example would be a transfer of whole loans from one financial institution to another with limited recourse. Another example is that in the Ginnie Mae program, a servicer is required to remit 100% of the payments due on the mortgage loans in a pool each month, whether or not those payments have been collected. This example is not viewed as substantive because all of the mortgage loans have FHA/VA guarantees, which cover most (but not all) risks of loss.

It is hard to understand why recourse is permitted in transactions that do not involve a QSPE but flatly prohibited in transactions that do involve a QSPE. Consistent with our suggestion on derivatives, and with FASB's concern expressed in paragraph A12 of the Exposure Draft, we have suggested language in Appendix A that would permit recourse and other support commitments from transferors and their affiliates and agents so long as those commitments do not cancel out other parties in the aggregate from bearing a material portion of the economics associated with the underlying assets.

Proposed Changes to Paragraphs 80-84.

These proposed changes introduce significant new concepts that will lead to frequent and unnecessary confusion in practice, with no apparent offsetting benefits. For the reasons discussed below, we urge FASB to delete paragraphs 9-11 of the Exposure Draft and leave paragraphs 80-84 of Statement 140 as they are.

Paragraph A15 indicates that these changes were intended to make sure that the new restrictions on dealings between QSPEs and transferors (and their affiliates and agents) would apply to similar transactions that might not currently use a QSPE. However, the Exposure Draft provides no reason why the Board thought it was necessary or beneficial to apply those restrictions whenever beneficial interests are issued, nor do we see any obvious explanation.

In fact, the requirement seems somewhat paradoxical. To a large extent, the Exposure Draft seems to be intended to bring some of the risks and rewards orientation from FIN 46 to bear in transactions involving QSPEs. The paradox is that transactions that do not involve QSPEs are subject to FIN 46 already. What is the purpose of requiring these transactions to use a QSPE, when that results in only a partial application of FIN 46 concepts?

In paragraph 11 of the text of the proposed amendments, FASB provides a different rationale for these changes. Paragraph 11 proposes adding a new sentence in paragraph 83 of Statement 140 to the effect that a transfer resulting in the issuance of an undivided interest (or other beneficial interests) will be deemed not to meet the requirement in paragraph 9(b) unless a QSPE is involved. The actual text of this change (which focuses on paragraph 9(b)) bears little apparent relation to the explanation for the changes provided in paragraph A15 (FASB's desire to apply some of the other new provisions of the Exposure Draft to additional transactions).

In addition, the change to paragraph 83 is arbitrary and inconsistent with paragraph 9 of Statement 140. The lead-in language in that paragraph indicates clearly and appropriately that a transfer may relate to "all or a portion of a financial asset". Where only a portion of a financial asset is transferred, it would appear logically that the question under paragraph 9(b) is whether or not the transferee has the requisite rights to pledge or exchange the transferred portion.

The "all or a portion" language in paragraph 9 recognizes the fundamental fact that many financial assets are divisible assets. For example, consider a syndicated commercial loan, in which Bank A has advanced $10,000,000 to a borrower. Frequently, Bank A will have the right to transfer a portion of that loan to another bank. If Bank A assigns one half of its loan to an unaffiliated Bank B, then following the assignment Bank A and Bank B each have $5 million loans to the borrower. It would be strange to suggest that Bank A's assignment to Bank B could not be recognized unless Bank B obtained the right to exchange or pledge the whole initial $10 million loan, including the portion retained by Bank A.

The proposed change to paragraph 83 is also inconsistent with the portions of Statement 140 that relate to loan participations. Paragraph 104 of Statement 140 refers to a loan participation as an undivided interest in the underlying loan. Paragraph 106 says, in effect, that paragraph 9(b) can be satisfied for a loan participation if the participant has the right to pledge or exchange the participation.

Alternatively, FASB may have believed that if the second step in a two-step transfer is a transfer of beneficial interests (including undivided interests), then the issuer of the beneficial interests could never have the right to pledge or exchange the assets that it acquired in the first-step transfer. This is not true. There are transactions (such as the second example below) where an entity that issues beneficial interests retains the right to pledge or exchange the underlying assets.

The Exposure Draft creates substantial uncertainties for the multi-trillion dollar market for agency mortgage-backed securities, a market which represents one of the largest components of the overall U.S. fixed income market and is a principal factor reducing the cost of home ownership in the U.S. As noted above, Freddie Mac and Ginnie Mae generally do not use QSPEs to convert mortgage loans into mortgage-backed securities. For example, in one type of agency MBS transaction, which accounts for a significant portion of the primary issuances by the GSEs, Freddie Mac purchases a pool of conforming mortgage loans and issues participation certificates (undivided ownership interests) in the purchased loans. No common law trust or other legal entity is used. The issued securities, which carry Freddie Mac's guarantee of timely payment of interest and principal, are either issued back to the mortgage banker that provided the mortgage loans or sold in the capital markets. In Ginnie Mae's primary issuance program, a mortgage banker directly issues undivided ownership interests in a pool of mortgage loans, and Ginnie Mae guarantees timely payment of interest and principal.

Since undivided ownership interests are issued, some market participants are concerned that the final amendment will require that Ginnie Mae and Freddie Mac revise their issuance programs to use QSPEs. This would be an enormous (and otherwise pointless) undertaking, given the short transition period and massive size of these programs.

Also, the proposed changes seem almost certain to preclude derecognition in many two-step transactions in which (a) a transferor meets all the requirements of paragraph 9 and would not be the primary beneficiary under FIN 46, but (b) beneficial interests are issued and use of a QSPE is not practical for some reason. Consider two examples:

- One or more transferors sell commercial mortgage loans to an SPE that issues securities backed solely by the cash flows from the loans. The transferors have no continuing involvement with the transaction, but a two-step transaction is used out of an abundance of caution or for some independent reason. A servicer (which is not affiliated with any transferor) has discretion between selling a troubled loan or working it out, which discretion precludes Q-status. The SPE cannot otherwise pledge or exchange the loans.

- One or more transferors sell various debt securities in a two-step transaction to an SPE that issues securities backed solely by cash flows from the transferred debt securities. The transferors have some form of minority continuing involvement with the transaction. A collateral manager (which is not affiliated with any transferor) has trading authority with respect to the debt securities, which precludes Q-status.

Under current GAAP, these types of transactions can appropriately achieve derecognition. The first example can achieve derecognition in reliance on Question 22A of FASB's Guide to Implementation of Statement 140, since the transferors have little or no continuing involvement. The second example can achieve derecognition by giving the entity that holds the financial assets sufficient freedom to pledge or exchange the assets so as to satisfy paragraph 9(b). The proposed changes to paragraphs 80-84 apparently remove these possibilities, notwithstanding that the assets have been thoroughly isolated from the transferor and removed from the transferor's control.

These are some of the (we think) unintended consequences of the proposed changes to paragraphs 80-84. Those changes are so broad and novel that there are undoubtedly many other categories of innocent bystander transactions that have not yet been identified. We submit that the problems created by these proposed changes greatly outweigh any likely benefit. Consequently, we strongly recommend that FASB avoid these issues by leaving paragraphs 80-84 as they are and relying on the application of FIN 46 to transactions that do not involve a QSPE.

If FASB does not accept our suggestion above, to avoid issues with respect to agency mortgage-backed securities we request that FASB make it very clear that the new text in paragraph 83 does not apply to single-step transfers.

Also, there is an issue in existing GAAP for mortgage bankers that swap mortgage loans for mortgage-backed securities in a transaction that does not use an SPE. These swaps are generally viewed as guaranteed mortgage securitizations that are effective to convert the loans to securities for accounting purposes; however, the absence of an SPE creates some uncertainty on that treatment, and we ask FASB to clarify this point.

III. Limits on QSPEs that Can Roll Over Beneficial Interests.

The following changes proposed in the Exposure Draft relate to this point:

- Change to paragraph 35(c)(3) and new paragraph 35(f) (which collectively limit who can provide support commitments to QSPEs that roll over beneficial interests).

- Changes to paragraphs 80-84 (which effectively impose the requirements above on additional transactions by requiring the use of a QSPE in two-step transactions that result in the issuance of undivided interests).

As discussed above in Part II.C.4., we strongly oppose the proposed changes to paragraphs 80-84 and do not see any benefit from those changes to counterbalance the serious issues and confusion that they create. Our discussion below focuses on the proposed new paragraph 35(f) and the related new cross-reference in paragraph 35(c)(3).

We have two major sets of concerns relating to these proposed changes. The first set relates to their scope. The second set relates to the illogical results that may arise from application of these changes.

A. Scope Issues.

1. Defining Reissuance.

Our most important concern relating to the scope of these proposed changes is that some constituents might believe that the concept of "reissuance" as used in the Exposure Draft includes periodic issuances of securities in traditional master trust structures. Several factors indicate that FASB should not be, and we hope was not, concerned by this type of issuance:

a. FASB carved the forward commitments in these transactions out of the restriction in new paragraph 35(e). The problem is that there is no clear parallel carve out in 35(f), relating to entities that can reissue beneficial interests.

b. The descriptions of "reissuance" in the Exposure Draft are much more consistent with a commercial paper type of funding program – where proceeds of new issuances of BIs are used to repay maturing

BIs – than a traditional master trust program, where each series is paid from collections, and proceeds of new issuances are paid to the transferor as a reduction of the retained transferor interest. Since traditional master trust issuances result in a reduction of the retained transferor interest, there has been no prior sale/derecognition. The portion of the receivables represented by that interest was initially transferred solely in exchange for beneficial interests.

c. FASB has dealt extensively with revolving period securitizations and master trusts, beginning at least with the deliberations leading up to the adoption of Statement 125 in 1996. It is hard to see how these issuances could be "[c]ontrary to the Board's initial understanding and belief"[12], when both Statement 125 and Statement 140 have specifically referred to this type of issuance.

d. Market participants have devoted substantial resources to modifying these structures to comply with prior steps in the 125/140 process, including TB 01-1.

In light of these factors, we ask that FASB more clearly define reissuance to exclude this type of activity. We have proposed a definition in Appendix A, which focuses on whether the proceeds of the new issuance are applied to repay maturing beneficial interests held by parties other than the transferor (and its related parties) or instead are paid to the transferor. We have also suggested that FASB use the narrower and more descriptive phrase "roll over" instead of the term "reissuance."

We also request confirmation that the concept of "reissuance" does not include remarketing of existing beneficial interests. For instance, in municipal bond securitization programs, certificates representing a beneficial interest in a pool of municipal bonds are periodically remarketed by a designated remarketing agent. The remarketing agent resets the interest rate on the certificates at a market-clearing rate at the time of each remarketing. Because the same securities remain outstanding, this should not constitute reissuance. The remarketing activity is not treated as a new issuance for either tax or securities law purposes.

2. Materiality of Reissuance.

Our second scope concern is that FASB seems to presume that any rolling over of beneficial interests by an SPE will always create a potential for some party to materially influence its own, or some other party's, economic returns. In many cases, this is not true. In particular, we do not believe that the ability to make decisions about rolling over investment grade instruments that are limited to a tenor of 397 days or less provides a meaningful ability to influence any party's economic returns. We request that the special new provisions relating to SPEs that roll over beneficial interests should only apply where the range of permitted maturities creates a possibility to materially influence the residual cash flows in a transaction and that a restriction to maturities under 397 days be included as an example of a range that would not ordinarily create that possibility.

Our suggested 397-day tenor limit is drawn from Rule 2a-7 under the Investment Company Act, the primary regulation governing money market funds. In Rule 2a-7, the SEC has set out the requirements that a registered investment company must satisfy if it wishes to use the phrase "money market" (or similar terms) in its name. Companies that satisfy these

[12] Exposure Draft, Appendix A, par. A6.

requirements are permitted to use the Amortized Cost Method[13] or the Penny-Rounding Method[14] to calculate their current price per share, rather than the market valuation methods otherwise applicable to registered investment companies.

Rule 2a-7 imposes a number of requirements, relating to, among other things, the maximum maturity (which is generally limited to 397 days) and credit quality of individual investments, weighted average portfolio maturity and portfolio diversification. The fact that the SEC permits funds that limit their investments to under 397 day maturities (and satisfy these other requirements) to use the Amortized Cost Method or Penny-Rounding Method reflects the SECs acknowledgment of the very limited volatility of valuations within that range.

That regulatory recognition is supported by market information. For instance, one of our large bank members provided information, which we believe to be representative of the market generally, that analyzes the pricing on a particular master trust's money market securities of various tenors over the last 18 months. Separate analyses were completed for securities with maturities of 1-3 days, 4-14 days, one month, 2 months and 3 months. Spreads (interest rate differentials) were computed for each of these categories vs. the same benchmark: one-month LIBOR. On average, the spreads between one-month LIBOR and the one, two and three month maturity categories were 4.6 basis points, 4.5 basis points and 4.5 basis points, respectively. Even the very short (1-3 day and 4-14 day) categories varied only slightly (about 0.7 basis points) from the one, two and three month categories in average spread below one-month LIBOR.

Rather than comparative pricing, decisions between different maturities within the permitted money market range tend to be driven by administrative/operational factors, such as a desire to stagger maturities and avoid having too much paper mature on any given day, investor demand and limiting the average maturity difference between assets and liabilities.

B. Arbitrary Consolidation.

One of the main problems with the new changes is that the criteria that nullify Q-status under proposed paragraph 35(f) do not require any assessment of the actual amount of control, or expected losses/residual return, held by the entities whose activities can nullify Q-status. These changes introduce an arbitrary consolidation regime, where immaterial actions of a third party can nullify Q-status and result in consolidation with a transferor (or preclude derecognition), when those actions (i) are not within the transferor's control, (ii) have no effect on the transferor's economic position and (iii) do not provide the third party with substantial control or substantial variability in return.

The two out of three approach described in paragraph A12 presumes that a party with two of the named factors will have a combined set of risks/upside/decision making abilities that will usually or often make that party a primary beneficiary under FIN 46.[15] There are myriad situations where this is not true, particularly given the business consolidation in financial

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[13] Defined in Rule 2a-7 as "the method of calculating an investment company's net asset value whereby portfolio securities are valued at the fund's Acquisition costs as adjusted for amortization of premium or accretion of discount rather than at their value based on current market factors."

[14] Defined in Rule 2a-7 as "the method of computing an investment company's price per share for purposes of distribution, redemption and repurchases whereby the current net asset value per share is rounded to the nearest one percent."

[15] If par. A12 is retained, it should be revised to conform to the body of the Exposure Draft on an important point: the two out of three test only comes into play if the SPE can reissue beneficial interests. That limitation does not appear in the discussion in par. A12.

services, resulting in large, diversified organizations that may incidentally "touch" a single SPE in multiple ways without even knowing it. For instance:

- A third party liquidity provider to the commercial paper program of a large master trust may have an affiliate that incidentally buys a Class B security issued by the same trust in its ordinary course of secondary trading.

- An insurance company may issue a surety bond that guarantees one series of securities issued by a master trust, and another affiliated insurance company may buy a mezzanine security from a different series in the same trust.

When something like this happens, the results are hard to justify on a principled basis:

- A relative bit player combines two out of the three listed factors.

- Because of the combination of these factors the SPE is no longer a QSPE, so a FIN 46 analysis is necessary, and if paragraph 9(b) is not satisfied derecognition is no longer permitted.

- Under FIN 46, the transferor or some other party that does not combine two out of three factors may be required to consolidate as the primary beneficiary.

The proposed changes also arbitrarily require syndication of guarantees, liquidity facilities and derivatives in circumstances where there is no concentration of variability to justify consolidation. For instance:

- Under proposed paragraph 35(f)(1), no QSPE could have a single provider of a surety bond that guarantees the senior beneficial interests. Yet, most transactions that feature a surety bond currently have a single provider, and those providers typically have very limited variability in their expected returns.

- Syndication is more common in the liquidity market, but it is far from universal, and it is highly arbitrary to require that no single party provide more than 50% of the liquidity commitments. Liquidity providers often have a variability of expected return that is comparable to the variability on the most senior beneficial interests (*de minimis*).

- Perhaps the most extreme example of the unnecessary complication and expense created by this aspect of the rule is an interest rate swap provided to an SPE by a party not otherwise involved in the transaction. An interest rate swap seems to be "a commitment . . . to deliver additional cash . . . to fulfill the SPE's obligations to BIHs." In many transactions that involve an interest rate swap, the swap would be the only such commitment. Apparently under proposed paragraph 35(f)(1), such a swap would have to be syndicated, and no party could provide more than 50%.

The proposed changes would also apparently require any fee received by a surety bond provider in a transaction involving reissuance to be paid at the highest order of priority in the cash waterfall. This is simply not realistic, and we fail to see any element of effective control in this scenario. The surety provides a commitment to supply additional cash and has a beneficial interest (the right to receive the fee), but that fee would not otherwise always be at the most senior priority. For example, it could come second in line, after a trustee fee.

As currently drafted, the result of a party having two out of the three named factors or providing more than 50% of a liquidity facility is that the entity in question is no longer a QSPE. That could have double consequences: some enterprise might have to consolidate the SPE; and, if paragraph 9(b) was not otherwise satisfied, the requirements for derecognition by the transferor might not be met. We submit that the second consequence – failure of derecognition – may not be appropriate even in some circumstances when the consolidation consequence was arguably appropriate. Specifically, if some party unrelated to the transferor had a controlling financial interest through holding two of the three factors or providing more than 50% of a liquidity facility, why should the transferor's derecognition analysis be affected? At present, however, we are not sure how to split these two consequences apart.

We do, however, request that FASB limit the arbitrary nature of this consolidation regime by only nullifying Q-status if (x) a party has relationships that satisfy any of paragraph 35(f)(1), (2) or (3) **and** (y) as a result of those relationships, the party bears a substantial percentage of the expected losses on the underlying assets, if incurred, or is entitled to receive a substantial percentage of the expected residual returns from the underlying assets, if realized.

We have suggested appropriate language changes to proposed paragraph 35(f) in Appendix A. Besides the points addressed above, our suggested changes also provide clarity as to what sort of decision making power (unilateral) is required for the decision making factor to come into play.

IV. Prohibition on Equity Instruments.

We have four technical requests with respect to this facet of the Exposure Draft.

1. Consistent with discussions at the May 27, 2003 FASB meeting, the prohibition on QSPEs holding equity securities should make use of the definition of "equity security" from Statement 115 and should use that term, rather than "equity instrument." In other words, QSPEs should not be permitted to hold transferred equity securities, as defined in Statement 115. We have made this change in our suggested language on Appendix A.

2. However, many QSPEs hold beneficial interests issued by other SPEs that take the form of equity, and we request that those beneficial interests be excluded from the new prohibition.

3. Similarly, many QSPEs hold shares of money market funds as temporary investments permitted by paragraph 35(c)(6) of Statement 140. Money market shares are equity securities within the meaning of Statement 115 but are not the type of investment that FASB was concerned about in prohibiting QSPEs from holding equity securities. We request that FASB exclude money market shares from that prohibition.

4. Just as QSPEs can hold non-financial assets temporarily as a result of collecting transferred financial assets, FASB should permit QSPEs to hold equity securities acquired through collection. This could happen in several ways, including (a) stock of an operating company may be held as collateral for a loan and foreclosed upon, (b) equity securities of an obligor may be automatically received in exchange for defaulted debt securities in a Chapter 11 reorganization and (c) stock of a single property company may be held as collateral for a commercial real estate loan in lieu of a mortgage on the real estate and may be foreclosed upon. We have

suggested appropriate additions to paragraph 41 of Statement 140 in Appendix A.

V. Transitional Rules.

We generally concur with the approach to transition rules taken in the Exposure Draft. However, we request that FASB grant an additional interim period of transition time to public entities and also consider three other accommodations. We believe that at least one more interim period of transition time is justified by the number of new concepts that FASB is introducing and the complex issues they create.

The additional accommodations that we request are as follows:

1. Like Statement 140, this amendment could require changes in currently qualifying SPEs that can only be made with investor consent. In those circumstances, we request additional transition time consistent with what FASB provided in FTB 01-1.

2. If FASB imposes new restrictions on derivatives and other transactions between a QSPE and the transferor or its affiliates or agents, there could be situations in which a master trust has non-complying derivatives or other commitments related to pre-existing beneficial interests and little flexibility to alter the non-conforming arrangement. In that circumstance, an SPE should not lose its qualifying status upon issuing new beneficial interests or acquiring additional assets, so long as any such new beneficial interests do not benefit from the non-complying arrangement.

3. The parenthetical phrase in paragraph 13 –"(through commitments to beneficial interest holders unrelated to the transferor)" – should be deleted or reworded to clearly communicate its meaning. We believe that in Statement 140 this phrase was meant to refer to forward commitments between a transferor and a QSPE that were required to remain in place because of commitments to unrelated beneficial interest holders. However, the phrase can be read to suggest that the additional assets must actually be obtained from BIHs not related to the transferor.

VI. The Matched Presentation.

Board members have from time to time expressed frustration with the number of issues that have arisen under Statements 125 and 140. We continue to prefer the control-based financial components approach embodied in Statement 140, so long as FASB accepts enough of our comments in this letter to maintain an operational control-based approach. However, if FASB does not accept enough of our comments on the Exposure Draft to maintain an operational control-based approach, then we would support an alternative, which we refer to as the matched presentation. Our proposal is similar – but not identical – to the linked presentation in the UK. Among other things, we have suggested modifications that would accommodate liquidity and limited amounts of recourse, which would preclude linked presentation in the UK.

The proposed matched presentation is also similar to leveraged lease accounting for lessors under Statement 13. As in leveraged lease accounting, we think this special presentation would appropriately reflect the economic effects of securitizations.[16]

Under the matched presentation, a separate section of the asset side of the balance sheet would be devoted to display of SPEs. The SPEs' gross assets would be shown on a separate line, immediately followed by a deduction for the non-recourse debt and third party equity interests issued by the SPE, arriving at the reporting entity's interest in the SPE. This does not violate netting concepts under FINs 39 and 41. Those Statements do not apply because there are no offsetting obligations. Rather than netting, this is a gross-up of the investment in the SPEs.

Example:

Investment in [and advances to] Special-Purpose Entities (see Note X):

Gross assets managed………………………………	$100,000,000
Non-recourse debt and third party equity interests...	90,000,000
Investment in special-purpose entities………..	$10,000,000

Similarly, a separate section of the income statement would be devoted to the interest and other income of the SPE. The income earned by the reporting entity from its investment in the SPE would be shown net in the income statement, with disclosure of the SPE's gross amounts of interest income, interest expense, servicing fees, bad debt losses, etc. in the notes to the financial statements. The investment in the SPE would have to be marked-to-market through income.

In the Background and Basis for Conclusions section of Statement 125 (paragraph 103), the Board indicated that the use of a linked presentation approach had some appeal because it highlights significant information about transactions that have characteristics of both sales and secured borrowings. The Board indicated, "however, that the linked presentation would not have dealt with many of the problems created by the risks-and-rewards approach." We would be anxious for the Board to identify those problems. We are confident that the number of problems that would simply go away by adopting a well-designed and disciplined matched presentation approach far exceed the number of problems that would not be fixed.

A. Benefits of the Matched Presentation.

One of the difficulties with SPE consolidation issues is that current rules provide an all or nothing solution. One could argue that it is just as misleading to consolidate the whole as it is to consolidate nothing when the transferor retains rights only to certain portions of the cash flows of a financial asset. The matched presentation provides a more logical and practical

[16] See Statement 13, par. 108: "The first issue concerning leveraged leases in the Discussion Memorandum asked whether leveraged leases are unique in the sense that special standards are required to recognize their economic nature. The affirmative responses to this issue generally gave as reasons the arguments stated in the Discussion Memorandum. The essence of those arguments is that the combination of nonrecourse financing and a cash flow pattern that typically enables the lessor to recover his investment in the early years of the lease and thereafter affords him the temporary use of funds from which additional income can be derived produces a unique economic effect."

approach which we believe would take some pressure off of these issues. In addition, we believe that the matched presentation would have the following benefits:

1. It would add transparency to financial statements, since the information would be on display on the face of the balance sheet, supplemented by additional disclosure in the notes to the financial statements.

2. Traditional balance sheet ratios and debt covenants would not be disturbed as they would by adding liabilities that are not obligations of the consolidating entity.

3. Similarly, regulatory risk-based capital requirements would not be disturbed as they would by adding assets that are not owned by the consolidating entity.

4. The matched presentation results in the derecognition of the transferred financial assets in the balance sheet to the extent of proceeds and it avoids considerable difficulties. In many instances, particularly when the transferor has provided some form of credit enhancement, the transferee acquires an interest in the cash flows of an asset and the transferor transfers its rights to those cash flows. However, the asset itself sometimes cannot be physically separated into the portion sold and the portion retained to enable each party to control its portion of the underlying asset. As a result, control over the underlying asset is shared and relegated to provisions in trust documents or other agreements that are acceptable to both the transferor and transferee.

B. **Eligibility for the Matched Presentation.**

If FASB were to give serious consideration to the matched presentation, criteria would have to be developed to qualify for its use, and there would need to be discipline over its use. A number of factors that could be considered for eligibility include:

1. There is a transfer of financial assets. A transfer for this purpose includes selling the assets or portions thereof, or contributing them directly or indirectly through special-purpose vehicles to an SPE. Unlike the definition in paragraph 364 of Statement 140, the posting of collateral as security for debt, even if non-recourse, should not constitute a transfer.

2. The matched presentation would be available (subject to the following requirements) to the transferor and possibly to other entities to be determined upon further deliberation.

3. The assets are used to support payment on securities, at least one class of which are rated investment grade by a nationally recognized rating agency upon issuance. The investors look primarily to the cash flows of the financial instruments to repay their investments.

4. Any SPE involved would have to be a bankruptcy-remote entity such that the assets would be beyond the reach of the reporting entity and its creditors (irrespective of whether the reporting entity was the transferor).

5. If the SPE's beneficial interest holders have any recourse to the transferor or any of its consolidated affiliates, then:

    a. the maximum amount of recourse (other than for normal representations and warranties) must be classified as debt in the balance sheet – that is, it is not eligible to be displayed as a contra to the assets;

    b. if the reporting entity is the transferor, the quantity and quality of recourse must be such as not to preclude legal true sale; and

    c. if the reporting entity is not the transferor, then the reporting entity's exposures to the assets must benefit from substantial first loss protection.

    Liquidity facilities that do not fund defaulted assets would be excluded from this provision.

6. Even if the transfer is to an SPE and the SPE is not able to sell or pledge the transferred assets, control is relinquished by the transferor if the transferor is unable to reclaim the transferred assets.

7. The securitization SPE can issue debt securities collateralized by financial assets and/or participation securities representing undivided interests in the assets and/or equity instruments representing residual interests in the assets.

8. The transferor or an affiliate can service the assets and can enter into derivative transactions with the SPE, which will be accounted for under Statement 133, as amended.

9. Revolving structures qualify and random removal of accounts that are no longer needed to support the debt or participation interests, according to the governing documents, can be removed from the securitization SPE and reclassified on the balance sheet to an unmatched category of assets.

10. The reporting entity could not have an option to purchase the SPEs assets other than a cleanup call when the level of the financial assets outstanding falls to 10% of the level at the date transferred.

VII. Conclusion.

We have tried to identify as many of the unintended consequences of the changes proposed in paragraphs 4, 5 and 9-11 of the Exposure Draft as we could. However, it is virtually inevitable that some issues have gone undetected, given the scope of those changes, the number of new concepts they introduce into Statement 140 and the inconsistency of some of the new rules with existing provisions of Statement 140. We have suggested changes to address the problems that we have identified under paragraphs 4 and 5, but we also urge FASB to consider again whether the benefits to be gained from these changes (as well as the changes in paragraphs 9-11[17]) outweigh their costs, including currently foreseeable costs of compliance and the costs of dealing with the as-yet unidentified new problems.

We believe that the control-based financial components approach in Statement 140 yields fair representation and useful financial statements. We also believe that Statement 140 and other existing GAAP already handle several of the specific points addressed by the Exposure Draft in a satisfactory manner.

* * *

The ASF and the Association appreciate the opportunity to provide the foregoing comments in response to the Exposure Draft. We look forward to participating in the roundtable discussion on the Exposure Draft. Should you have any questions or desire any clarification concerning the matters addressed in this letter, please do not hesitate to contact either Dwight Jenkins, Executive Director of the ASF, at 646.637.9232, or George Miller, Senior Vice President and Deputy Counsel of the Association, at 646.637.9216.

Sincerely,

/s/ Vernon H.C. Wright	/s/ Esther Mills
Vernon H.C. Wright Chairman American Securitization Forum	Esther Mills Chair, Accounting Policy Committee The Bond Market Association

[17] See request in Part II.D.

Appendix A

Suggested Language

We have reprinted paragraphs 3 through 11 of the Exposure Draft below, and marked the text of those paragraphs to show the changes we recommend.

STANDARDS OF FINANCIAL ACCOUNTING AND REPORTING
Amendments to Statement 140

3. Paragraph 9(a) is replaced by the following:

> The transferred assets have been isolated from the transferor—put presumptively beyond the reach of the powers of a bankruptcy trustee or other receiver for the transferor or any **consolidated affiliate of the transferor** that is not a special purpose corporation or other entity designed to make remote the possibility that it would enter bankruptcy or other receivership (paragraphs 27, 28, and 83(c)).

4. Paragraphs 35(c)(1)–35(c)(3)[18] are replaced by the following:

c. It may hold only:

(1) Financial assets transferred to it that are not equity securities (as defined in Statement 115*) ~~instruments~~ and that are passive in nature (paragraph 39)

(2) Passive derivative financial instruments ~~entered into with counterparties other than the transferor, its affiliates, and agents~~ that pertain to beneficial interests (other than another derivative financial instrument) issued or sold to parties other than the transferor, its affiliates, or its agents (paragraphs 39 and 40); if entered into with the transferor or any of its affiliates or agents, such a derivative financial instrument must not, as of the trade date (taking into account all future events that are reasonably foreseeable at that time), by itself or in combination with other derivatives provided by the transferor or its affiliates or agents, be expected to cancel out other parties in the aggregate from bearing a material portion of the economics associated with the underlying assets.[19]

(3) Financial assets (for example, guarantees or rights to collateral) that would reimburse it if others were to fail to adequately service financial assets transferred to it or to timely pay obligations due to it, that it entered into when it was established, when assets were transferred to it, or when beneficial interests (other than derivative financial instruments) were issued by the SPE, and that are entered into with certain parties. The limitations on the permissible counterparties to these financial assets are discussed in paragraphs 35(e) and 35(f).

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[18] To provide greater accounting certainty for some transactions in which mortgage bankers swap mortgage loans for guaranteed mortgage-backed securities without using a legal SPE, we also suggest that FASB clarify that such transactions qualify as guaranteed mortgage securitizations.

[19] We request that FASB also include an exception for otherwise permitted cleanup calls and removal of account provisions.

*For purposes of this paragraph and paragraph 41, neither beneficial interests in other SPEs that hold only financial assets (other than equity securities, as defined in Statement 115) nor any investments of a type permitted by paragraph 35(c)(6) shall be deemed to be “equity securities”, even if those beneficial interests are in the form of equity.

5. The following subparagraphs are added after paragraph 35(d):

e. It may not enter into an agreement described in paragraph 35(c)(3) (other than a forward contract in a revolving period securitization as discussed in paragraphs 77–79 or a similar undertaking in a transaction with a “pre-funding period”, in which the initial cash proceeds raised exceed the purchase price of the financial assets transferred at closing and all or a portion of the excess is used to pay for additional assets over a specified period of time pursuant to a commitment set out in the related documents) with a transferor, its affiliates, or its agents ~~that commits any of those parties to deliver additional cash or other assets to the SPE or its BIHs~~.* That prohibition applies to liquidity commitments, financial guarantees, written options, and other arrangements with the SPE as well as commitments to purchase outstanding beneficial interests directly or indirectly from the beneficial interest holders or to otherwise settle beneficial interests with their holders. It also applies to total return swaps and any other derivative instruments that may require delivering additional financial assets. It applies even if the commitment is contingent or conditional, whether the contract is settled net or gross, whether the settlement is current, deferred, or prepaid, and regardless of the relationship of the notional amount of the instrument, if any, with the face amount or value of the transferred assets. However, it does not apply to (i) customary representations, warranties and other terms that are not designed to protect the transferee from credit losses, including terms that permit the return of assets or provide similar remedies in instances of misrepresentation, fraud, incomplete documentation, servicing violations or non-credit-related dilutive adjustments to transferred receivables, (ii) amounts deducted from servicing fees, (iii) transfers of interchange in credit card securitizations, (iv) investments of the type referred to in paragraph 35(c)(6) or (v) other commitments that, singly and in combination, are not expected to cancel out other parties in the aggregate from bearing a material portion of the economics associated with the underlying assets.

f. If it has the ability to ~~reissue~~ roll over** beneficial interests, by applying the proceeds of new issuances of beneficial interests to retire maturing beneficial interests held by parties other than the transferor and its related parties (and the roll overs create a possibility for some party to materially affect residual cash flows, which would ordinarily not be the case if maturities were restricted to 397 days and under), no party (including affiliates or agents) bears a substantial percentage of the expected losses on the underlying assets, if incurred, or is entitled to receive a substantial percentage of the expected residual returns from the underlying assets, if realized as a result of the following ~~additional limitations apply~~ factors:

(1) ~~No~~ Such party (including affiliates or agents) enters into a commitment (or commitments) ~~to deliver additional cash or other assets to fulfill the SPE's obligations to BIHs~~ described in paragraph 35(c)(3) of Statement 140 (other than a forward contract in a revolving period securitization or pre-funding transaction, as

described above) if that commitment has (or those commitments have) a fair value that is more than half the aggregate fair value of all such commitments to the SPE~~.~~;

(2) ~~No~~ Such party (including affiliates or agents) both makes unilateral decisions† about ~~reissuing~~ rolling over beneficial interests and either enters into a commitment (or commitments) ~~to deliver additional cash or other assets to fulfill the SPE's obligations to BIHs~~ described in paragraph 35(c)(3) of Statement 140 (other than a forward contract of the type described above) or holds beneficial interests ~~other than the most senior in priority~~ that are subordinated as to payment of principal; or

(3) ~~No~~ Such party (including affiliates or agents) both holds beneficial interests ~~other than the most senior in priority~~ that are subordinated as to payment of principal and enters into a commitment (or commitments) ~~to deliver additional cash or other assets to fulfill the SPE's obligations to BIHs~~ described in paragraph 35(c)(3) of Statement 140 (other than a forward contract of the type described above).

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*This prohibition does not include a commitment for servicing advances if the servicer will ~~can choose not to make the advance if it believes~~ recover~~y of~~ the advance from collections on the assets ~~of the SPE is in doubt~~.

** Remarketing of beneficial interests does not constitute a roll over.

†For this purpose, the term *decisions* implies discretion. The ability or responsibility to take action does not imply decision making for purposes of this Statement if the party taking the actions has no discretion.

6. The second sentence of paragraph 39 is deleted.

7. The first sentence of paragraph 41 is replaced by the following:

> A qualifying SPE may hold equity securities or nonfinancial assets other than servicing rights only temporarily and only if those equity securities or nonfinancial assets result from collecting the transferred financial assets.

~~7~~8. The first sentence of paragraph 45 is replaced by the following:

> A qualifying SPE may have the power to dispose of assets to a party other than the transferor, its affiliate, or its agent on termination of the SPE or maturity of the beneficial interests, but only automatically on fixed or determinable dates that are specified at inception in a manner specified at inception.

~~8~~9. The following sentence is added at the end of paragraph 45:

> Also, if the SPE can decide whether to sell transferred assets to third parties or distribute them to BIHs, the manner of disposition is not specified at inception.

~~9. Paragraph 80 and the heading preceding it are replaced by the following:~~

> **~~Isolation of Transferred Assets in Securitizations and Other Transactions That Result in Issuance of Beneficial Interests~~**

> ~~A transaction resulting in issuance of beneficial interests (including undivided interests) carried out in one transfer or a series of transfers may or may not isolate the transferred assets beyond the reach of the transferor and its creditors. Whether it does depends on the structure of the transaction taken as a whole, considering such factors as the type and extent of further involvement in arrangements to protect investors from credit and interest rate risks, the availability of other assets, and the powers of bankruptcy courts or other receivers.~~

~~10. In paragraphs 81–84, the word *securitization* or *securitizations* is replaced by *transaction* or *transactions* each time that word appears.~~

~~11. The following sentence is added at the end of paragraph 83:~~[20]

> ~~However, isolation is only one of the requirements in paragraph 9, and unless the transfer described in paragraph 83(b) is to a qualifying SPE, the transfer shall be deemed not to meet the requirement in paragraph 9(b) that the transferee has the right to pledge or exchange the transferred assets.~~

Effective Dates and Transition

1~~2~~0. Public entities shall apply this Statement prospectively to transfers occurring after the beginning of the ~~first~~ second interim period after the issuance of the final Statement. Private entities shall apply this Statement prospectively to transfers occurring after the beginning of the first annual period after the issuance of the final Statement.

1~~3~~1. A formerly qualifying SPE that fails to meet one or more of the conditions for being a qualifying SPE as amended by this Statement shall continue to be considered a qualifying SPE if it maintains its qualifying status under previous accounting standards, does not issue new beneficial interests after the effective date, and does not receive assets other than those it was committed to receive ~~(through commitments to beneficial interest holders unrelated to the transferor)~~ under arrangements made before the effective date of this Statement. An additional transition period shall be permitted in two circumstances for formerly qualifying SPEs that otherwise meet all of the requirements specified in the preceding sentence:

a. If a formerly qualifying SPE cannot be restructured to qualify under the revised standards without the consent of the holders of pre-existing beneficial interests, that SPE shall continue to be considered a qualifying SPE even if it issues new beneficial interests after the effective date, so long as all beneficial interests issued by the SPE after the effective date permit the necessary changes in structure. In this case, the additional transition period ends three months after the earliest date at which sufficient approvals to permit the necessary changes can be obtained from BIHs and any other persons whose approvals are required by the terms of the prior contractual arrangement, but in no event later than [the fifth anniversary of the effective date].

b. If the only reason that a formerly qualifying SPE no longer qualifies is that prior to the effective date the transferor or its affiliates or agents have

[20] If FASB does not delete this paragraph, to avoid issues with respect to agency mortgage-backed securities we request that FASB make it very clear that the new text in paragraph 83 does not apply to single-step transfers.

provided a derivative or other support commitment not permitted under the revised standards, then that SPE shall continue to be considered a qualifying SPE even if after the effective date it issues new beneficial interests or receives assets other than those it was committed to receive, so long as any such new beneficial interests are not entitled to the benefits of such non-complying derivative or commitment.

Otherwise, the formerly qualifying SPE shall be considered disqualified and shall not be eligible for the exceptions in paragraph 46 of Statement 140 and paragraphs 4(c) and 4(d) of FASB Interpretation No. 46, Consolidation of Variable Interest Entities.