

MINUTES



To: Board Members

From: Statement 140 Team
(Cizek, ext. 354; Yust, ext. 442)

Subject: Minutes of the April 2, 2008 FASB
Board Meeting: Accounting for Transfers of Financial Assets

Date: April 7, 2008

cc: Golden, MacDonald, Bielstein, Gabriele, Sutay, Posta, Chookaszian, Cosper, Leisenring, Lott, Statement 140 Team, Klimek, Allen, FASB Intranet

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

Topic: Accounting for Transfers of Financial Assets and Repurchase Financing Transactions

Basis for Discussion: Board Memorandum Nos. 81–88

Length of Discussion: 9:00 a.m. to 11:00 a.m.

Attendance:

Board members present: FASB: Batavick, Crooch, Herz, Linsmeier, Seidman, L. Smith, and Young

Board members absent: none

Staff in charge of topic: Donoghue, Mayer, Zecher

Other staff at Board table: FASB: Golden, Roberge, Lott, C. Smith, Yust, Cizek

Summary of Decisions Reached

The Board decided to remove the concept of a qualifying special-purpose entity from FASB Statement No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, and FASB Interpretation No. 46 (revised December 2003), Consolidation of Variable Interest Entities.

The Board also decided to amend the derecognition criteria in Statement 140 to improve financial reporting in the short term and to consider working on a joint derecognition research project with the IASB. Specifically, the Board voted to amend paragraphs 9(a) and 9(c) and to remove paragraph 9(b). Paragraph 9(a) will be clarified to require that the transferred financial assets must be beyond the reach of the transferor or any of its consolidated affiliates. Additionally, the isolation analysis must consider all arrangements made in connection with the transfer. Paragraph 9(c) will be amended to include an additional criterion that states that if the transferor constrains the transferee, the transferor maintains effective control over the transferred assets. This change incorporates similar requirements from current paragraph 9(b).

Lastly, the Board decided that only an entire financial asset or a participating interest of an individual financial asset will be eligible for derecognition. The participating interest may not be an interest in an equity instrument, a derivative financial instrument, or a hybrid financial instrument with an embedded derivative not clearly and closely related to the original financial asset. Additionally, the definition of a participating interest requires that (1) the cash flows received from the assets are divided among the interests in proportion to the share of ownership represented by each, (2) the participating interest holders have no recourse, other than standard representations and warranties, to the transferor or each other, (3) no interest holder is subordinated to another, and (4) neither the transferor nor any participating interest holder has the right to pledge or exchange the entire financial asset in which it owns a participating interest.

Objectives of Meeting:

The objectives of the meeting were to discuss (1) the removal of the concept of a QSPE in Statement 140, (2) possible alternatives for amending the derecognition model for financial assets in Statement 140, and (3) whether the Board wants to provide guidance about the unit of account for purposes of the derecognition model. The objectives of the meeting were met.

Matters Discussed and Decisions Reached:

Issue 1: QSPE Concept

1. Ms. Donoghue stated that since the issuance of Statement 140, the securitization markets have rapidly developed and expanded beyond what was originally contemplated by the Board. In the long term, the staff believes a new derecognition model that is convergent with the IASB will need to be developed to better account for these complex instruments. However, in the short term, the staff believes the Board can and should resolve the most significant practice issues surrounding derecognition and the concept of a QSPE. The two main objectives for developing the staff's short-term alternatives are to address significant practice issues resulting from the inability of constituents to consistently apply the guidance in Statement 140 and to improve financial reporting.
2. **Staff Recommendation:** In consideration of significant constituent input and staff research, the staff recommended that the concept of the QSPE be removed from Statement 140 and the scope exception for QSPEs to be removed from Interpretation 46(R).
3. **Board Vote:** Messrs. Batavick, Crooch, Herz, Linsmeier, Smith, and Ms. Seidman voted for the staff recommendation. Mr. Young stated he could not vote on the staff recommendation until he better understood the implications of the new derecognition model as a whole.

4. **Board Comments:** Mr. Young stated his concern that the objectives of the short-term project focused on practice issues for preparers and auditors and did not sufficiently consider the needs of financial statement users. Therefore, he could not vote on the staff recommendation until he understands whether this would be an improvement in financial reporting from an investor point of view. Ms. Donoghue responded that the financial statement user needs were considered in developing the staff recommendation. Mr. Golden added that the comprehensive project to reconsider the derecognition model would require a significant amount of time that cannot be completed in the time frame established by the Board.
5. Mr. Smith stated that he did not believe the staff recommendation focused on preparer and auditor relief as suggested by Mr. Young. Rather, the staff was attempting to develop short-term alternatives for a derecognition model that is currently not working. For the past five years, the staff and the Board have been working to deal with the fundamental issue regarding what servicer discretion is permitted in a QSPE. Mr. Smith believes it is apparent that it is almost impossible to structure a vehicle in the current market in a way that is consistent with what the Board had intended when developing Statement 140. Therefore he believes the concept of the QSPE should be eliminated.
6. Ms. Seidman stated that when developing the concept of a QSPE, the Board was trying to address isolation and surrender of control issues when deliberating Statement 140. Therefore, there was economic validity to the concept of the QSPE that enhanced and protected investor interests in the transferred financial assets. However, it has become clear to her that the question of derecognition should be approached from the perspective of the transferor to determine if derecognition is appropriate. Ms. Seidman stated that current practice issues, such as permitted servicing and rollovers of beneficial interests, are critical short-terms issues that must be addressed by the Board. Massive markets have developed around these transactions and, therefore, it is unacceptable to have uncertainty in practice.

7. Mr. Young responded to Ms. Seidman and Mr. Smith; he wanted to be clear that the alternative also would better serve investors, not only preparers and auditors. Mr. Young stated that the concept of derecognition is flawed in that too many assets and liabilities are currently derecognized. Further, Mr. Young stated his concern for using Interpretation 46(R) as an alternative to the QSPE concept. Ms. Seidman responded that the staff is bringing Interpretation 46(R) to the Board for improvement and that removing a scope exception would seem to be an improvement for investors in itself. Mr. Batavick agreed that the staff recommendation to remove the QSPE concept would improve financial reporting in the short term.
8. Mr. Linsmeier stated that, even in the short term, his objective is primarily to improve the derecognition model's ability as a whole to reflect the economics of transactions. A very important step in the project should be a final check that the outcome is a good reflection of the economics of the transactions. Mr. Linsmeier felt that the QSPE concept was a preparer-relief notion and a failed concept as suggested by the staff and other Board members.
9. Mr. Crooch stated he never felt that the QSPE concept would work in practice and agreed with the staff recommendation to remove the concept from Statement 140 and Interpretation 46(R). Mr. Herz agreed that the concept was flawed and that removing it is a necessary first step to begin contemplating improvements for investors.

Issue 2: Other Amendments

10. Ms. Donoghue stated that the staff considered the impact of removing the QSPE concept and previous Board decisions reached while deliberating and redeliberating the 2005 FASB Exposure Draft, *Accounting for Transfers of Financial Assets*, to develop alternatives for (a) amending paragraph 9 in Statement 140 and (b) for the unit of account for the purposes of derecognition.

11. **Staff Recommendation:** To best improve financial reporting, the staff recommended that the derecognition model in Statement 140 should be amended beyond the removal of the QSPE concept.
12. **Board Vote:** Messrs. Batavick, Crooch, Herz, Linsmeier, Smith, Young, and Ms. Seidman voted for the staff recommendation.

Issue 3: Derecognition Criteria

13. **Staff Recommendation:** Ms. Zecher stated that the staff felt that three of the alternatives to amend the derecognition model developed internally merited consideration by the Board. The first, which is recommended by the staff, is Alternative A3. This alternative would remove current paragraph 9(b) in its entirety and amend paragraphs 9(a) and 9(c). Paragraph 9(a) would be clarified to require that the transferred financial assets must be beyond the reach of the transferor and any of its consolidated affiliates. Additionally, the isolation analysis must consider all arrangements made in connections with the transfer. Paragraph 9(c) would be amended to include an additional criterion that states that if the transferor constrains the transferee, the transferor maintains effective control over the transferred assets. This change incorporates similar requirements from current paragraph 9(b).
14. Ms. Zecher continued that the second alternative of ‘no continuing involvement’ or Alternative B, would replace the derecognition criteria in paragraph 9 of Statement 140 in its entirety with a principle of no continuing involvement. The final alternative model is similar to Alternative A3, but would amend paragraph 9(a) to change the legal isolation criterion to an accounting isolation concept, thereby removing the reliance on true sale legal opinions.
15. **Staff Recommendation:** The staff recommended Alternative A3 because it is based on a platform already used and understood in practice. As this is an interim project to better financial information, the staff does not believe developing an entirely new derecognition model could be completed in the time frame permitted. Alternative A3 would address a significant amount of practice issues without

16. **Board Vote:** Messrs. Batavick, Linsmeier, Smith, and Ms. Seidman voted for the staff recommendation. Messrs. Crooch, Herz, and Young voted for Alternative B.
17. **Board Comments:** Ms. Seidman asked whether adopting IAS 39, *Financial Instruments: Recognition and Measurement*, was considered as an alternative for the short-term project. Ms. Zecher responded that the IAS 39 model was considered as an alternative. However, the model has significant practice issues and would be operationally challenging for entities to implement and markets to interpret in the near-term. Instead, the staff recommends that convergence be achieved in a long-term project to comprehensively develop an improved derecognition model for financial assets.
18. Ms. Seidman stated that she supported the staff recommendation instead of Alternative B. At times she believes that a no continuing involvement principle for derecognition may not reflect the true economics of the transaction, such as when the transferor retains a de minimis amount of recourse. Additionally, Alternative B is not convergent. Ms. Seidman stated that Alternative A3 contains the level of short-term change while still making significant improvements. Ms. Seidman also stated that she acknowledges the problems with paragraph 9(a) as the criterion relies on judgments made by attorneys. However, she believes that the criteria in paragraph 9(a) is based on precedents in the court system that look to how parties behave in markets and, therefore, she does not believe it is a fundamentally flawed principle. She also feels that although the criteria in paragraph 9(b) will be removed, such criteria are implicit in paragraph 9(a) and ultimately caught with the amended paragraph 9(c). Ms. Seidman added that an important change to paragraph 9(c) is to consider the involvement of affiliates in determining whether the transferor maintains effective control.
19. Mr. Lott agreed with Ms. Seidman's interpretation of paragraph 9(b), but stated that the staff recommendation may not be clearly worded. Current paragraph 9(b)

requires consideration of the ultimate benefit to the transferor. The staff recommendation changes the emphasis to whether the transferor imposed the constraint, not whether the constraint provides a benefit to the transferor. Ms. Seidman stated that the added criterion to paragraph 9(c) is meant to identify if the transferor maintains control over the transferred financial asset. She recognized this concern and believes that it should be addressed during the drafting phase of the project.

20. Mr. Batavick stated that Alternative B would require exceptions to be completed in the short term and that it would not reflect the economics of the transaction. Therefore, he supports the staff recommendation.
21. Mr. Young stated that he does not support Alternative A3 and disagrees with the staff analysis that Alternative B cannot be completed in the short-term because he does not believe any exceptions to the no continuing involvement derecognition principle should be allowed. This would remove the requirement for preparers to perform a derecognition test and then consider consolidation. Particularly because of the incentive to achieve derecognition treatment, Mr. Young stated he is not surprised that preparers stretch the boundaries of the derecognition test. Instead, Mr. Young would prefer Alternative B if it included a linked presentation model to display the economics of the transaction as well as additional disclosure requirements. He is concerned that Alternative A3 will create a second consolidation model with the linked presentation concept. The measurement of linked presentation and the ability to move in and out of the presentation could cause significant complexity. Mr. Young stated his belief that investors are most concerned with the number of assets derecognized from the balance sheet. Therefore, he would not support the project if the Board chooses to pursue Alternative A3.
22. Mr. Smith stated that he would like to support an accounting isolation model, Alternative 2, because he thinks it gives the best answer and properly portrays the economics of whether the assets have been transferred. However, Mr. Smith

supports Alternative A3 because of the requirement to complete the project by the end of the year.

23. Messrs. Crooch and Herz stated they preferred a no continuing involvement principle. Mr. Herz said that fair value for all financial assets could replace the need for derecognition but acknowledges that this is not plausible in the short term. Mr. Smith asked Messrs. Crooch, Herz, and Young if their vote meant that they believe Alternative B could be completed by year-end in consideration of implementation issues. Mr. Golden clarified the staff position that Alternative B could be completed in the near-term if no exceptions were provided. However, the staff anticipates that practice would request exceptions that would slow the project. Mr. Young responded that he did not support any exceptions and believes that Alternative B could be completed in the short term.
24. Mr. Young stated that linked presentation with Alternative B would properly reflect any interest maintained by the transferor if the elements of the linked presentation are fair valued. Ms. Seidman stated that she believes it would be misleading for transferors to present assets on their books when only a de minimis level of recourse is maintained. For example, a third party in the same economic position as a transferor would not present the assets on its books because it had not originally held and transferred the assets. Mr. Young replied that history matters, in his opinion, in terms of whether a servicer is a transferor. Ms. Seidman stated that she is concerned that an entity would have the opportunity to control derecognition by simply maintaining a low level of recourse if it desired to present the transferred assets on its balance sheet.
25. Mr. Linsmeier asked whether a derivative entered into by a transferor whose underlying represents one of the risks related to previously transferred assets would be considered continuing involvement of the transferor. Messrs. Herz, Smith, Young, and Ms. Seidman responded that if the derivative was tied specifically to the transferred assets, this would be considered continuing involvement. Mr. Linsmeier said that he disagreed and therefore could not support Alternative B.

Issue 4: Unit of Account

26. Mr. Mayer stated that the staff believes that the Board should provide guidance on when a portion of a financial asset is eligible for derecognition. The staff considered (a) the participating interest definition previously defined in the 2005 Exposure Draft, with editorial changes, (b) allowing portions of specified cash flows of an individual debt instrument, (c) allowing pro rata portions of specified cash flows of an individual debt instrument, or (d) utilizing the guidance on portions of financial instruments in IAS 39.
27. **Staff Recommendation:** Mr. Mayer stated that the staff recommends that only transfers of entire financial assets or participating interests should be eligible for derecognition. The staff clarified that this definition would be applied to individual assets and would result in a reduced population of transactions eligible for derecognition. The staff also believes that such a definition would reduce structuring opportunities that may circumvent the requirements in both Statement 140 and Interpretation 46(R).
28. **Board Vote:** Messrs. Batavick, Crooch, Herz, Linsmeier, Smith, and Young supported the staff's recommendation to specify that only portions of financial assets that meet the definition of a participating interest, as defined in the 2005 Exposure Draft, are eligible for derecognition. Ms. Seidman voted to specify portions of financial assets as specifically identified cash flows of an individual debt financial instrument.
29. **Board Comments:** Mr. Herz asked whether the staff considered allowing only whole financial assets to be eligible for derecognition. He noted that the participating interest definition would require the transferor to use an entity to be eligible for derecognition. Ms. Seidman responded that such an idea went against the entire financial component approach that underlines Statement 140. Ms. Donoghue added that the staff did not believe that the ability to transfer simple portions of financial assets is a pressing issue that needs to be addressed in the short term. She stated that the two pressing problems relating to transfers of portions of

financial assets are (a) divisions that result in recomponentization of pools of financial assets and (b) transfers involving disproportionate allocations of risk. She noted that the participating interest definition would help to address these issues.

30. Ms. Seidman did not believe the participating interest definition was necessary. She noted the definition was originally based on the criteria examined by attorneys for a legal isolation opinion. As such, she believed that this concept would already be considered in the legal analysis required by paragraph 9(a).
31. Mr. Smith questioned the purpose of the definition if it could be circumvented by transferring the financial assets through an entity. Ms. Seidman also was concerned about this issue. Mr. Linsmeier noted that the transferor would now have to evaluate that entity for consolidation under Interpretation 46(R) using the risk and reward criteria. Mr. Golden clarified that the question was whether the Board wanted the unit of account to be the individual dollar or the original contractual form of the financial asset.
32. Mr. Herz stated that linked presentation also would help address problems caused by only allowing transfers of entire financial instruments. However, Mr. Linsmeier noted such an approach would put more pressure on the linked presentation principle. Mr. Mayer added that such an approach would put more pressure on determining the measurement basis for linked presentation.
33. Ms. Donoghue stated that she was concerned about the substantial cost that would be borne by small banks if they were required to use an entity to derecognize a pro rata transfer of a portion of a financial asset.

Follow-up Items:

Ms. Donoghue stated that the Board decision to remove the QSPE concept would cause structured transactions using entities to be subject to a consolidation analysis. Once the Board addresses issues relating to Interpretation 46(R), the Statement 140 team will return to the Board to propose a linked presentation alternative and additional disclosure requirements. Ms. Seidman asked the staff to reconsider the need for linked presentation

with the Alternative A3 derecognition model. Additionally, Ms. Seidman stated that a linked presentation disclosure requirement may be more appropriate than linked presentation in the statement of financial position.

General Announcements:

Mr. Herz informed the public audience that the Board added a project to improve the disclosure requirements for credit derivatives including credit default swaps.