

MINUTES



To: Board Members

From: Statement 140 Interpretation Team
(N. Stell, ext. 211)

Subject: Minutes of the April 30, 2003 Board Meeting **Date:** May 1, 2003

cc: Bielstein, Leisenring, Smith, Swift, Polley, Cassel, Bullen, Lott, Derivatives Implementation Team, Financial Instruments Team, Gabriele, Sutay, Thompson, Vincent (2), Intranet

Topic: Permitted Activities of Qualifying Special-Purpose Entities

Basis for Discussion: Board memorandums dated April 25, 2003 and April 28, 2003

Length of Discussion: 9:00 a.m. to 9:45 a.m.

Attendance:

Board members present: Herz, Trott, Schipper, Foster, Crooch, Wulff, and Schieneman

Board members absent: None

Staff in charge of topic: Lott

Other staff at Board table: Bullen and Stell

Outside participants: None

Summary for ACTION ALERT:

The Board reaffirmed its decision to issue an Exposure Draft that would amend FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, but changed its decisions about certain of the provisions of that Exposure Draft. The Board decided that the comment period for the Exposure Draft would end on July 31, 2003, based on an expectation that the Exposure Draft will be issued by early June and decided to hold a public roundtable meeting or meetings shortly thereafter.

The Board reversed its earlier decisions about commitments to provide assets to make payments to beneficial interest holders and parties that made decisions about reissuing beneficial interests and decided to replace them with the following:

- A qualifying special-purpose entity (SPE) would be prohibited from being a party to a swap with the transferor (or its affiliates or agents) if such a swap transfers substantially all of the types of risks inherent in the assets back to the transferor.
- A qualifying SPE would be prohibited from holding commitments from the transferor and its related parties to provide cash or other assets to make payments due to beneficial interest holders. If a qualifying SPE issues beneficial interests with terms shorter than the terms of the qualifying SPE's assets, other limits would apply.

Matters Discussed and Decisions Reached:

The Board made the following decisions related to the issuance of an Exposure Draft that would amend Statement 140.

- The Exposure Draft is expected to be issued by early June.
- The comment period (approximately 60 days) will expire on July 31, 2003.

- A public roundtable will be held to discuss the Exposure Draft and related comments received with interested constituents shortly after the comment period ends.

The Board discussed total return swaps and unanimously decided to prohibit a qualifying SPE from being a party to such a swap with the transferor (or its affiliates or agents). The Board used the term *total return swaps* to refer to an agreement that transfers substantially all of the types of risks inherent in the assets back to the transferor regardless of the name of the instrument even if the arrangement covers only a specified percentage of the value of the assets. The Board urged the staff to avoid using the term *total return swap* in drafting the Exposure Draft.

The Board decided to reverse the following decisions made at the April 22, 2003 Board meeting:

1. A qualifying SPE may not hold a commitment from the transferor, its affiliates, or agents to provide additional cash or assets to make the contracted payments to beneficial interest holders (for example, liquidity commitments and financial guarantees of the beneficial interests). That requirement is not intended to prohibit servicing advances that do not require the servicer to make the advance if it believes it will not recover its advance.
2. A party that is committed to provide additional cash or assets to make the contracted payments to beneficial interest holders may not hold interests that will absorb more than 50 percent of the expected losses of the entity if they occur.
3. A party that makes decisions about issuing beneficial interests of the entity may not hold interests that will absorb more than 50 percent of the expected losses of the entity if they occur.

The Board decided to replace those decisions with the following:

A qualifying SPE may hold financial assets (for example, liquidity commitments) that provide additional cash or other assets to make the contracted payments to the beneficial interest holders if the party obligated

to provide those assets is not the transferor, its affiliates, or agents. If the beneficial interests a qualifying SPE issues at the time it receives transferred assets will not absorb all of the cash flows from those assets, that is, if it is able to reissue beneficial interests, the following limits apply:

- No single party (including affiliates or agents) is obligated to provide more than half of the additional cash or assets.
- No party (including affiliates or agents) obligated to provide the additional cash or assets makes decisions about reissuing beneficial interests. (The term *decisions* implies discretion. Choices that are entirely specified and significantly limited at inception and cannot be changed except by a majority vote of beneficial interest holders other than the transferor and the party or their respective affiliates or agents that make decisions about issuing beneficial interests are not decisions as the term is used here.)
- No party (including affiliates or agents) obligated to provide the additional cash or assets holds beneficial interests that are not the most senior in priority.

Board members agreed that the revised requirements are more consistent with the framework in Statement 140. They are intended to prevent transferors from arranging financing for the assets because that is tantamount to control in this circumstance. They also are intended to prevent a single single party from providing key financial support for the entity and either making key decisions or owning interests that would give it an incentive to exercise control over the entity or its assets. As a group, they are intended to create checks and balances that should prevent a party other than the transferor from exercising control.

Follow-up Items:

The staff indicated that it would post a summary of the tentative conclusions reached by the Board to date on the FASB website.

General Announcements:

None.