

MINUTES



To: Board Members

From: Donoghue (ext. 374), Lusniak (ext. 214), Detling (ext. 354)

Subject: Minutes of the May 8, 2007 Board Meeting—Transfers of Financial Assets: Transfers with Repurchase Financing Agreements **Date:** May 21, 2007

cc: L. Smith, MacDonald, R. Golden, Bielstein, Leisenring, Lott, 140 Project Team, Chookaszian, Polley, Gabriele, Allen, Sutay, Jacobs, 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: Transfers of Financial Assets—Transfers with Repurchase Financing Agreements

Basis for Discussion: Memorandum 73, dated April 23, 2007

Length of Discussion: 9:55 a.m. to 10:55 a.m

Attendance:

Board members present: Herz, Batavick, Crooch, Linsmeier, Seidman, Trott, and Young

Board members absent: none

Staff in charge of topic: Donoghue, Lusniak, and Detling

Other staff at Board table: R. Golden, Hoyt, Jacobs, and L. Smith

Outside participants: none

Summary of Decisions Reached:

The Board discussed how to apply FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, to transactions involving a transfer of a financial asset and a repurchase financing of that asset that involve the same parties to the initial transfer. The Board decided to address the issue by providing guidance in the form of a FASB Staff Position (FSP) that would permit a transferee and transferor to evaluate the accounting for the transactions separately under Statement 140 in certain circumstances.

Objectives of the Meeting:

The objectives of the meeting were for the Board to decide (1) whether to provide guidance on transfers of financial assets when a transferor enters into a repurchase financing involving the transferred financial assets, (2) how to determine whether the transactions should be evaluated as a single linked transaction or as separate transactions under Statement 140, and (3) whether the guidance should be issued as an FASB Staff Position or as part of the amendment to Statement 140. The objectives of the meeting were met.

Matters Discussed and Decisions Reached:

INTRODUCTION

1. Ms. Donoghue began the discussion by stating that the staff was asking the Board to decide among a number of alternative approaches that would provide a scope exception in Statement 140 to permit a transferor to account for a transfer and repurchase financing as two separate transactions even though Statement 140 would otherwise require that the repurchase financing be considered “linked” to the transfer. The objective of the guidance would be a short-term solution to a practice issue that is rapidly growing. Given the significant size of the market for these transactions and the operational issues involved in accounting for both transactions as one transaction, the Board agreed at the March 14, 2007 meeting to consider an exception in certain circumstances.

2. Ms. Donoghue explained that another goal is to establish guidance in a manner that is as consistent as possible with the concepts in Statement 140. Constituents have told the staff that, in many cases, separate operating units of one entity execute transfers and repurchase financings involving the same assets without the knowledge of one another's transactions, that the two transactions are not done in contemplation of each other, and that they are executed at arm's length in an active market. However, the staff also suggests that it is important to avoid permitting an exception in situations where, in substance, the transactions are designed in contemplation of one another as part of a structured transaction, or when the primary purpose of the structure is designed to achieve a preferred accounting treatment rather than to achieve an economic objective.

3. Ms. Donoghue also stated that the derecognition guidance in Statement 140 requires the relationship of a transferor to the transferred financial assets be considered and automatically "links" all involvements of a transferor with the transferred assets, even if those involvements are entered into after a transfer has been completed. To the extent that there is a need to depart from the concepts and implementation guidance in Statement 140, the factors and approaches have been developed to be as consistent as possible with other Board conclusions on whether two or more separate contracts involving financial instruments should be evaluated together as a "linked" transaction. Other guidance on linkage has been written to assess financial instruments that would otherwise be evaluated on an instrument by instrument basis whereas Statement 140 starts with the premise that all transactions involving a transferor of transferred financial assets with those assets be linked. Guidance that would permit a repurchase financing to be accounted for as a separate transaction would be a scope exception to that requirement of Statement 140.

FACTORS

4. Ms. Lusniak explained that the staff had developed six factors that it believes are key to distinguish between those transactions which should be considered together (linked) and those which should not be (delinked).

Contractual Relationships

5. The staff believes that a written contract which indicates that the two transactions are dependent on one another would be evidence that the transactions should be linked. However, the absence of such a contract does not automatically delink the transactions if the terms or actions of the counterparties indicate otherwise. Implied commitments also need to be considered because they demonstrate that the counterparties intend to engage in a series of related transactions.

A Nonrecourse Repurchase Agreement or an Agreement to Repurchase the Financial Asset Transferred at Fair Value

6. If a contract does not provide for recourse upon default of the initial transferee or it involves a repurchase agreement that allows the initial transferee to repurchase the financed asset at fair value at settlement of the financing, the staff believes that it indicates that the asset risk remains with the initial transferor who likely still controls the asset because it has obtained more than a trivial benefit from the second transaction.

Marketability

7. The staff believes that marketability is important because it provides evidence that the repurchase financing is not based solely on the uniqueness of the asset. The staff believes that marketability is demonstrated by the asset being readily obtainable or traded in an active market. It is also demonstrated by the initial transfer and repurchase financing being at market rates.

Rights to Collateral

8. The staff believes that both the initial transferee's ability to substitute collateral for the asset provided in a repurchase agreement and/or the initial transferor's nonreliance on the collateral indicate that the initial transferee may still control the asset unless it is readily obtainable. This factor is important because it considers the ability to use the collateral as an indicator of control.

Timing and Terms

9. The staff believes that the shorter the time between when the transactions are entered into, the more likely they should be linked. In addition, transactions that are done for the same term (a repurchase to maturity) effectively provide the initial transferor with control over the assets because the initial transferor has the ability to use the assets without ever having to return them to the borrower.

Business or Economic Purpose

10. The staff believes that unless there is a valid business or economic purpose for entering into two separate transactions when the same economic result could be achieved with one transaction, the transactions should be considered linked. The staff believes this factor is important to include because permitting a scope exception for transactions that lack of a valid economic or business purpose but still meet the other factors could permit an exception solely to get an accounting result. The staff realizes this factor is subjective but added it based on Board input at the March 14, 2007 Board Meeting.

BOARD DELIBERATION: FACTORS

11. Ms. Seidman stated that it seems that the goal of the factors is to help determine the existence of a valid purpose. The spirit of the first five factors is to determine whether or not the repurchase financing is truly a financing, in which case the initial transferor is transferring market risk and assuming credit risk. She questioned whether a better approach would be to use the criteria in paragraphs 47–49 of Statement 140 to determine if the repurchase in the transaction in question is really a financing or it has the effect of sending the risk back to the transferor. Under that approach, transactions would be linked if they failed to meet those criteria or were contractually linked. She questioned whether two different sets of criteria are necessary. She stated that it might be possible for a transaction to meet the delinkage factors but fail the criteria in paragraphs 47–49.

12. Mr. Trott stated that he believes that a stronger set of criteria are needed in these cases than those in paragraph 47. Ms. Donoghue stated that those

paragraphs likely don't cover this specific issue sufficiently. Mr. Trott stated that he believes that the first five factors are adequate. He stated that the linkage guidance should apply to both the transferee and transferor. He does not believe that the business or economic purpose factor would be helpful in determining whether or not transactions should be delinked. Ms. Seidman agreed that the business purpose factor would not be useful.

13. Mr. Linsmeier stated that he believes that the business purpose factor would be very difficult to implement. He believes that an entity could come to the conclusion that almost any of the transactions in question have a valid business purpose because they provide some benefit. The first five factors are appropriate and describe when a business purpose exists. Mr. Crooch agreed that the business or economic purpose factor could be eliminated.

14. Mr. Young stated that he believes that the first two criteria already exist in Statement 140. He said that he would be uncomfortable allowing prospective application in transition for transactions that failed the first two criteria because that guidance already exists in Statement 140 and he believes that clearly those transactions should have been linked. He does not believe that that transition should provide amnesty for transactions where Statement 140 had clearly been misapplied.

15. Mr. Herz stated that if an entity is structuring a transaction to get a specific accounting treatment that should not be considered a valid business purpose. If a regulatory or tax requirement is based on the financial reporting result and the entity receives a regulatory or tax benefit it still would not be a valid business purpose because the transaction was accounting motivated. Mr. Trott stated that he believes that when the situation Mr. Herz described occurs it is due to a flaw in the regulation, not the financial reporting standard.

16. Mr. Golden suggested that the staff could reword the sixth factor and use that factor to explain the objective of the other factors. Ms. Donoghue stated that the staff could provide that as an objective in the beginning of the document. The FSP would state that the guidance is not intended to permit a scope exception for transactions entered into solely to achieve an accounting result.

Mr. Young asked if the FSP would have explicit guidance about how the transaction would be accounted for as a forward if the transactions were deemed to be linked. Mr. Trott stated that it would be better to be explicit that the transactions should be accounted for as a forward if they are linked. Ms. Seidman stated that accounting for the transactions as a forward contract is the implication of linkage.

17. The Board agreed that the first five factors should be used to determine whether the transactions should be delinked. The Board agreed that business or economic purpose should not be a factor, but rather that it should be the objective of the other five factors.

ALTERNATIVE APPROACHES

18. Mr. Detling stated that the staff developed several alternative approaches for the Board's consideration. While each approach is presented using similar factors, the application of those factors in each approach is slightly different. Those approaches are:

- a. Approach 1—Link both transactions together in all cases.
- b. Approach 2—Use a Rebuttable Presumption Approach that presumes linkage all the factors indicating delinkage are met.
- c. Approach 3—Use a Presume Separate Approach that considers the two transactions delinked unless any of the factors indicating linkage are met.
- d. Approach 4—Consider the two transactions as being delinked.
- e. Approach 5—Use an indicator approach to consider all of the factors as indicators of whether the transactions should be linked or delinked and then make a determination based on the facts and circumstances of each situation.

19. At the March 14, 2007 meeting, the majority of Board members did not express much support for Approaches 1 and 4. There was support for

Approaches 2 and 3. The staff developed the fifth approach (the “indicator” approach) based on the Board’s instructions at the last meeting.

20. Mr. Detling explained that the staff had applied the approaches to some example transactions (involving a U.S. Treasury Security, an MBS, a specific loan, and a subordinate tranch of a securitization). He indicated that the delinkage guidance for the transactions involving a specific loan or group of loans and the subordinated tranches is more definitive under Approaches 2 and 3 than under Approach 5. The Indicator Approach results in some difficulty for all of the examples because some factors (such as timing) are subjective. That approach requires greater analysis to implement.

21. Mr. Detling stated that the staff believes that Approaches 2 and 3 will not always have identical outcomes. In cases involving subjective factors where a reporting entity is unsure whether it meets a factor or not (such as cases that are ambiguous due to marketability, implied commitments, or timing), the entity might come to different conclusions under approaches 2 and 3. Generally, however, approaches 2 and 3 would lead to similar conclusions.

BOARD DELIBERATION: ALTERNATIVE APPROACHES

22. Ms. Seidman stated that in evaluating the approaches she believes that Approach 3 would lead to the same conclusion in Approach 2. However, the documentation requirements under Approach 3 would be less burdensome. Approach 2 would require a reporting entity to evaluate a much larger group of transactions and would be more costly than Approach 3. Approach 3 is also clearer than Approach 5. Therefore, she supports Approach 3. She stated that she did not believe that this guidance was really a scope exception but rather an interpretation of what *ongoing* means.

23. Messrs. Crooch and Trott supported Approach 2. Mr. Crooch stated that the initial transferee in the transactions ought to know that it entered into the two transactions using the same security and the same counterparty and ought to determine that all it really has is a forward contract to buy the security in the future. Mr. Batavick rejected Approach 5 because it would be too burdensome.

He prefers Approach 2 over Approach 3 because it is more consistent with the existing requirements Statement 140.

24. Mr. Young stated that he did not necessarily like any of the approaches. He believes that some of the criteria are repeating existing guidance in Statement 140. He would prefer not to give a list of factors that would have to be met because he believes that would be providing bright lines. He prefers providing guidance that would presume that the transactions are linked and then let the existing guidance in Statement 140 determine the ultimate result. Nevertheless, he would not object to Approach 2.

25. Mr. Linsmeier also preferred Approach 2. He too was concerned with whether the Board had the right set of factors. He stated that when the document is exposed, the document should specifically ask whether the factors correctly identify the right set of transactions that should be treated independent of one another. Mr. Herz supported Approach 2 and agreed that the document should request that constituents determine if the set of factors correctly identifies transactions that should be considered independent. His hope is that if constituents disagree, they will provide a fact pattern of a transaction that fails the factors even though the transactions appear independent. In addition, constituents should also provide input on the operability of the guidance.

DOCUMENT TYPE

26. Ms. Donoghue stated that the staff is concerned because the issue deals with a practice issue that has been identified and these transactions are common. Some of these transactions are not accounted for in a manner that is consistent with the way Statement 140 is currently written. If guidance is not provided soon, some entities might have to account for these transactions as linked even though they might be entered into independently. The staff is concerned that providing this guidance in the Exposure Draft of the amendment to Statement 140 would not be timely. Subsequent decisions in the project are not likely not to change this decision.

27. Mr. Golden stated that the confusion in practice over how to account for these transactions arose partly because accountants were not aware of how the two transactions might relate. In addition, in Statement 140 repurchase agreements have a different accounting model to determine whether they should be accounted for as a secured borrowing. Therefore, some may legitimately have believed that they should have followed the model for repurchase agreements in accounting for the repurchase financing transaction.

BOARD DELIBERATION: DOCUMENT TYPE

28. Mr. Trott prefers that the guidance be issued in the form of an FSP. He believes that issuing the guidance sooner would aid preparers and auditors in determining how to account for the transactions. He also believes that users would benefit as well, knowing that the transactions were accounted for consistently. Retrospective application would likely be very costly. He stated that once the guidance was finalized it could likely become effective very quickly if it was applied prospectively to transactions occurring after the effective date of the document. Messrs. Linsmeier and Young questioned whether the transition should allow entities to not apply the guidance retrospectively in cases where the transactions clearly should have been linked. The Board agreed that the guidance should be issued in the form of an FSP. The Board requested that the staff develop transition alternatives.

Follow-up Items:

29. The staff will begin to draft the proposed FSP and will present transition alternatives to the Board at a later meeting.

General Announcements:

None.