

MINUTES



To: Board Members
From: Gibbons (Ext. 446)
Subject: Minutes of the December 7, 2005
Board Meeting (Transfers of Financial Assets) **Date:** December 13, 2005
cc: Bielstein, Smith, Petrone, Leisenring, Project Team, Mahoney, Carney (e-mail), Vincent, Sutay, Gabriele, Swift, Polley, Getz, FASB Intranet (e-mail)

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 or Interpretation.

Topic: Transfers of Financial Assets—Issues for Redeliberations

Basis for Discussion: Memorandum 60, dated November 22, 2005
Memorandum 61, dated December 2, 2005

Length of Discussion: 9:00 a.m. to 9:40 a.m.

Attendance:

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

Board members absent: None

Staff in charge of topic: Donoghue

Other staff at Board table: L. Smith, Lusniak, Barker, and Gibbons

Outside participants: Leisenring

Summary of Decisions Reached:

The Board discussed issues related to redeliberations of the Exposure Draft, *Accounting for Transfers of Financial Assets*, a proposed amendment to FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. The Board:

- a. Decided to issue the final document on transfers of financial assets as a stand-alone document. The final documents on hybrid financial instruments and servicing rights will be issued concurrently. The Board expects to issue the final Statements on servicing and hybrid financial instruments in the first quarter of 2006, and the final Statement on transfers of financial assets in the second quarter of 2006.
- b. Decided to address the issue of initial measurement of a transferor's beneficial interest in the final Statement on transfers of financial assets, as originally planned.
- c. Agreed with the redeliberation issues identified by the staff related to the transfers document.

Objective of Meeting:

The objective of the meeting was to make planning decisions about the issues and timing of the redeliberations of the Exposure Draft. The objective was met at the meeting

Matters Discussed and Decisions Reached:

1. Ms. Donoghue began the discussion by stating that the staff is seeking direction from the Board on the issues related to the Statement 140 transfers project. In particular, the staff asks the Board whether to proceed with the issuance of the final Statements on servicing and hybrid financial instruments as stand-alone documents followed by the issuance of a final Statement on transfers of financial assets. While the Board originally planned to issue all

three documents concurrently, there are substantive issues in the transfers document that were identified in comment letters from constituents that require redeliberations that make it unfeasible to issue a single Statement in the first quarter of 2006. The staff recommends issuing the final Statements on servicing rights and hybrid financial instruments in the first quarter of 2006, and the final Statement on transfers in the second quarter of 2006. Other questions that the staff asked the Board include:

- a. Whether the Board agrees with the staff's recommendations as to the issues to be discussed in redeliberations on transfers (see attachment)
 - b. Provided that the Board agrees with the first recommendation to separate the final Statement on transfers from the final Statements on servicing rights and hybrid financial instruments, whether to include the initial measurement of a transferor's beneficial interests in the final Statement on servicing rights. The staff recommended including initial measurement of beneficial interests in the transfers final Statement.
2. Mr. Herz asked the Board members whether anyone has concerns with the staff's approach to decoupling the transfers document from the other documents. Mr. Trott stated that the first amendment to Statement 140 should be as complete as possible and this would involve including initial measurement of beneficial interests with servicing rights. If initial measurement of beneficial interests is not included in the first amendment, the topic of initial measurement would be subjected to two evolutions (one with the servicing amendment and one with the transfers amendment). The Board can redeliberate initial measurement of beneficial interests so that initial fair value measurement for both servicing rights and beneficial interests are included in the first amendment and continue to issue the first amendment in the first quarter of 2006.
3. Ms. Donoghue stated that measurement guidance in the transfers document includes participating interests as well as beneficial interests and therefore

requires resolution of the issues related to qualifying special-purpose entities (SPEs). The staff is concerned about changing measurement guidance for beneficial interests when it is unclear where the line will ultimately be drawn between arrangements that are accounted for as participations and those that require a qualifying SPE for sale treatment.

4. Mr. Smith stated that there are many issues to redeliberate on the transfers project that may affect how Board members view the beneficial interests held by a transferor, including initial measurement of those beneficial interests. It would be premature to consider initial measurement of beneficial interests before considering the other related issues for redeliberations. The servicing project was undertaken as a separate project for a relatively narrow issue, separate from the transfers project. Although the Board may reach the same conclusions regardless of when the issue of initial measurement of beneficial interests is redeliberated, the staff asserts that it is a better course of action to consider initial measurement of beneficial interests with the transfers project, as originally planned.
5. Ms. Seidman stated that she agrees with the staff recommendation for the timing of redeliberations with respect to initial measurement of beneficial interests. In Statement 140 as currently written, purchased servicing assets and liabilities are measured at fair value so that the initial measurement of retained servicing rights at fair value is a relatively small change. In addition, a servicing right is a nonfinancial asset, which distinguishes it from other types of retained interests in a transfer situation. It is unclear whether it would be operational to accelerate discussion of initial measurement of beneficial interests given that an issue for redeliberation in the transfers project is the definition of beneficial interests. Ms. Seidman asked what scope would be used if the Board accelerated discussion of initial measurement of beneficial interests—the existing definition of a beneficial interest (which is not limited to qualifying SPEs) or all retained interests? If the latter definition is used, this is a fundamental change that is linked to the issue of partial transfers.

6. Mr. Trott stated that the Board has similar issues with the hybrids project because the Board is changing the accounting for the interest that is retained as well as for those transferred in a securitization. Ms. Schipper asked whether Mr. Trott would apply fair value to the existing definition of a beneficial interest and he stated that he would.
7. Ms. Schipper stated that because of pragmatic considerations, it is acceptable but not desirable to issue the final transfers document as a separate amendment. She does not disagree with the staff recommendation for the issues to be discussed in redeliberations since the Board is not precommitting to the answers on the issues or the time the Board will spend on the issues. With regard to when to consider initial measurement of beneficial interests, she stated that determining when it is appropriate to consider initial measurement of beneficial interests involves consideration of whether it is possible to separate the frequency of required use of a structure with the question of how to treat something emitted by the structure. In the transfers document, there is a shift in the required use of structures and an elimination of the phrase *undivided interest*. The document also distinguishes participating interests (which are not remeasured) from beneficial interests (which are remeasured) that involve the use of a structure. The decision to require that beneficial interests be remeasured at fair value is a decision that can be made independently of the scope of that definition and the frequency of required use of structures. The Board may reverse, alter, change, and expand previous decisions related to the definition of a participating interest, how often structures are required, etc., but the issue of the initial measurement attribute for what is emitted by a structure is independent of other issues in redeliberations. She disagrees with the staff recommendation and agrees with Mr. Trott's viewpoint.
8. Mr. Batavick stated that he agrees with the staff recommendation. Because certain elements of the transfers document are moving targets, it would be difficult to include the issue of initial measurement of beneficial interests in the final Statement on servicing rights. The Board should not impede progress

on the final Statement on servicing rights by including initial measurement of beneficial interests.

9. Mr. Young stated that while it would be preferable to issue all three amendments to Statement 140 at the same time, the Board does not want to unnecessarily delay the amendments for servicing rights and hybrid financial instruments. As a result, he agrees with the staff recommendation that initial measurement of beneficial interests remain a component of the final Statement on transfers.
10. Mr. Crooch stated that he is concerned that by issuing amendments at separate times, it will be difficult to see the big picture and how the three documents fit together—all three documents should be issued at the same time. It is unclear that the Board will be able to identify any inconsistencies among the documents until and unless each document is completed and issued concurrently. Assuming the Board decides to decouple the documents and separately issue the transfers amendment, Mr. Crooch agrees with Mr. Trott's and Ms. Schipper's approach to include guidance on initial measurement of beneficial interests in the final Statement on servicing rights.
11. Mr. Herz stated that he agrees with the staff recommendation to separately issue an amendment on transfers. He expressed concern that there are moving lines as to which instruments should be initially measured at carry-over of basis versus fair value. Future decisions about participating interests, structures, etc. may affect a decision about initial measurement of beneficial interests. He agrees with the items for redeliberations but has not considered the most effective order in which to consider those issues. Depending on the order in which the issues are redeliberated, the Board may be able to make a decision on initial measurement of beneficial interests for inclusion in the first amendment.
12. Ms. Donoghue stated that the staff plans to provide the Board with the staff draft of the servicing document next week, provided no additional meetings or discussions are necessary. The staff estimates final issuance of the servicing amendment on March 1, 2006.

13. Mr. Herz asked whether initial measurement of beneficial interests would be one of the first issues in the transfers document to be redeliberated so that the decisions may still be included in the final Statement on servicing. Alternatively, he asked the staff what other issues related to the transfers document should be redeliberated before consideration of initial measurement of beneficial interests?
14. Mr. Smith stated that the staff's plans for redeliberation are not linked with a specific prioritization of the issues. The staff will bring the Board an analysis that summarizes the objectives for issuing the transfers document. The staff will then identify the specific amendments that were included in the Statement 140 document that relate to those objectives. Next, the staff will outline the specific comments that related to those changes in the transfers document so that Board members can understand the severity of the comments in relation to the objectives. At this point, the staff cannot answer the question of the order in which issues with the transfers document will be redeliberated.
15. Mr. Herz stated that he understands Mr. Trott's concern that arrangements where there is discretion over what amount is attributed to servicing versus other components such as interest-only strips, may create an interim period where there is a juggling of cash flows as a result of that discretion that may result in very different accounting for similar transactions. This issue is balanced with the point raised by Mr. Batavick, that there are issues in the transfers document that are moving targets, and it is unclear where certain dividing lines for measurement will be placed.
16. Ms. Schipper stated that there are two dividing line issues. Provided the Board approves the staff recommendation to delay consideration of initial measurement of beneficial interests, the first dividing line separates servicing rights (which are initially measured at fair value) and everything else (which are measured at carry-over basis). The second dividing line is in the transfers document and distinguishes between (a) interests issued by a structure (which are initially measured at fair value) and (b) participations (which are initially measured by allocating the carrying amount). The Board will likely

engage in a debate over where the second dividing line will be placed. There will still be a dividing line over fair value and non-fair-value, and there is no reason not to address the first dividing line now.

17. Mr. Herz summarized his thoughts by stating that four Board members support the staff recommendation to separately issue the final Statement on transfers and to consider initial measurement of beneficial interests with that amendment. He asked whether the Board had other comments on the staff's recommendations as to the issues to be discussed in redeliberations on the transfers document. Ms. Donoghue stated that the staff is interested in whether the Board has identified issues in addition to those the staff has identified.

18. Mr. Herz stated that there are concerns with the remeasurement of a transferor's beneficial interest at fair value when the transferor retains nearly 90 percent of the beneficial interests and outside parties hold just over 10 percent. There are concerns about remeasurement to fair value in that instance because the economics of the assets have not been significantly changed. Ms. Donoghue stated that this issue has been added as item number 5 on the revised list of issues as a result of discussions at last week's education session.

19. Mr. Trott asked why we are working on a fair value option if there are concerns with the issue raised by Mr. Herz. Ms. Seidman stated that the fair value option project would only address measurement for new transactions and would require subsequent measurement at fair value. The fair value option is a very different issue and does not create a problem related to the discretionary timing of gains and losses. Mr. Trott stated that he will consider whether to dissent to the servicing document if the measurement of beneficial interests is not included.

20. Ms. Donoghue stated that the staff's plan is to begin redeliberations of the issues in the transfers document in the first quarter of 2006, which will be conducted concurrently with the processing of the draft of the final Statements on servicing and hybrid financial instruments, which will be subjected to

external and Board reviews. Ms. Donoghue stated that the staff considers it possible to issue the transfers document in the second quarter of 2006, but this may change depending on the length of redeliberations.

Follow-up Items:

None.

General Announcements:

None.

Issues to Be Discussed during Redeliberations for Transfers of Financial Assets

1. Reconsideration of the concept of requiring that an entire financial asset first be transferred to a qualifying SPE (or other entity that is not consolidated with the transferor) to meet the requirements for sale accounting for transactions that involve transfers of portions of financial assets unless the resulting portions meet the definition of a participating interest.
2. Consideration of issues related to the definition of a participating interest, including:
 - a. Definition of recourse
 - b. Whether to permit a transferor to allocate third-party guarantees, such as government guarantees, unequally among participating interest holders
 - c. Whether to permit any other exceptions to the allocation of cash flows with unequal priority, recourse, or subordination
 - d. How to define an *individual financial asset* for purposes of applying the requirements of paragraph 8A.
3. Consideration of issues related to isolation, including:
 - a. Whether to require that a hypothetical legal analysis be performed that considers the impact of direct and indirect support arrangements by an affiliate of the transferor—including entities that are included in the consolidated group of the parent entity of the transferor—as if the support were provided by the transferor in evaluating whether the transferred assets are isolated
 - b. Whether isolation for transactions involving a qualifying SPE requires a hypothetical true sale analysis of arrangements between a beneficial interest holder and the transferor, its consolidated affiliates, or its parent, as if those arrangements were made by the transferor directly (paragraph 9(e))
 - c. Whether to clarify what is meant by “any arrangement or agreement *made in connection with a transfer*”
 - d. Whether the implementation guidance provided by paragraphs 27A and 27B should be expanded to include jurisdictions that do not require a “true sale” of financial assets to place transferred financial assets beyond the reach of a transferor, its affiliates and agents, including in bankruptcy or receivership

- e. Whether the specific implementation guidance provided for jurisdictions under U.S. bankruptcy law should be included in the implementation guidance provided in paragraphs 27A and 27B
 - f. Whether Board members would object to paragraphs 9(d) and 9(e) being merged under paragraph 9(a).
4. Consideration of issues related to the application of paragraph 9(b), including:
- a. The application of paragraph 9(b) to transferors' beneficial interests
 - b. The application of paragraph 9(b) to multi-step transfers, including those involving bankruptcy-remote entities
 - c. The application of paragraph 9(b) to transfers from one qualifying SPE to another qualifying SPE.
5. Consideration of whether a qualifying SPE must issue more than 10 percent of the fair value of its beneficial interests to outside parties in order to meet the requirements of a qualifying SPE.
6. Reconsideration of provisions for initial measurement of a transferor's beneficial interest.
7. Consideration of whether to provide additional measurement guidance on the subsequent measurement of a transferor's beneficial interest.
8. Consideration of the removal of paragraph 40 in its entirety and the modification of paragraph 35(c)2 of Statement 140 to remove the restriction on a qualifying SPE from holding derivative financial instruments that do not pertain to the beneficial interests of the qualifying SPE.
9. Reconsideration of the restrictions on rollovers of beneficial interests.
10. Consideration of whether to provide additional guidance on the permitted activities of a qualifying SPE.
11. Consideration of permitting a qualifying SPE to hold certain equity instruments such as titling trust certificates and money-market investments.
12. Reconsideration of the effective date and transition provisions.