

May 16, 2008

Accounting Alert

May 14, 2008 FASB Education Session on SFAS 140¹ Amendment

At the May 14, 2008 FASB Education Session, the Board discussed five questions the FASB Staff will present at the next Board Meeting scheduled for May 21st. The questions relate to the accounting under SFAS 140 for retained beneficial interests. At the April 2nd Board Meeting, the Board decided to eliminate the concept of a QSPE from SFAS 140 and define the criteria for when the derecognition criteria may be applied to a portion of a financial asset (i.e., participating interest). Some of the questions addressed at the Education Session relate to previously unresolved issues while others are a consequence of eliminating the QSPE exception.

Question 1: Should retained beneficial interests in a transferred financial asset be considered proceeds of a sale?

Question 2: If the retained beneficial interests should be considered proceeds, should they always be measured at fair value?

Under the current provisions of SFAS 140, retained beneficial interests are not considered proceeds of a sale and are carried on the transferor's balance sheet based on allocated cost. Proceeds are measured at fair value. Effectively, gain or loss on sale is not

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¹ Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, a replacement of FASB Statement 125

recognized on retained beneficial interests.

The Staff recommended that retained beneficial interests be treated as proceeds and be measured at fair value. The Staff does not believe there is a substantial difference between retained beneficial interests and other assets received such as servicing assets which are measured at fair value. The Staff is also concerned with comparability of assets in enhanced disclosures under anticipated amendments to SFAS 140. It was also noted that currently a transferor can essentially elect to measure at fair value a retained beneficial interest that is a security by classifying that interest as a trading security under SFAS 115.

One Board member expressed concerns that such changes are not convergent with International Financial Reporting Standards, which do not permit retained beneficial interests to be measured at fair value.

Some Board members expressed concern that transactions could be structured to recognize gains when there was not a substantive transfer of the asset – such as by creating a retained beneficial interest that is nearly like a participating interest (e.g., 99% of the retained beneficial interest shares proportionally in the asset cash flows) or by establishing non-substantive entities that are not consolidated.

Question 3 – Should Participating Interests be initially measured at allocated carrying amount?

The Staff does not believe participating interests meet the definition of a new asset. Consequently, the Staff does not believe they should be measured at allocated carrying value, which is the current methodology.

It appeared Board members agreed with the Staff's recommendation.

Question 4: Should a requirement be added to the sale criteria of SFAS 140 that at least 10% of the beneficial interests in the transferred financial assets be held by parties other than the transferor, its affiliates or its agent?

Currently, the QSPE criteria require at least 10% of the beneficial interests of a QSPE are held by parties other than the transferor, its affiliates or its agents. The Staff is concerned that the elimination of the QSPE requirement could result in derecognition of financial assets when there is no substantive third party involvement.

Some Board members commented that a transferor holding 90% of the beneficial interests in an entity would likely consolidate the entity under FIN 46(R), resulting in the asset continuing to be recognized in the consolidated financial statements of the transferor.

Concerns were raised by some Board members as to whether the consolidation model under a revised FIN 46(R) would require consolidation in such circumstances as when a transferor is holding 90% or more of the beneficial interests. Concerns were also raised as to how silos in a multi-seller entity would be treated under a revised FIN 46(R) model and whether derecognition could be achieved in such a structure while also not consolidating.

The Board indicated that it would be unlikely to reach a conclusion on this question prior to receiving the Staffs' recommendations as to further clarification to the overall objective of the primary beneficiary qualitative analysis under revised FIN 46(R).

Question 5: Should there continue to be an exception for guaranteed mortgage securitizations?

Currently, the requirement that at least 10% of the fair value of a QSPE's beneficial interests be held by parties other than any transferor, its affiliates or its agents does not apply when the transfer is a

“guaranteed mortgage securitization.”² An effect of that provision, in conjunction with paragraph 46 of SFAS 140³, is that retained mortgage-backed securities in a guaranteed mortgage securitization in which the SPE meets all conditions for being a QSPE are classified in the financial statements of the transferor as securities that are subsequently measured under Statement 115, even if the transferor retains 100% of the mortgage backed securities. The Staff asked the Board whether this exception should continue such that the securities obtained are classified as SFAS 115 securities in the absence of the QSPE exception and the transferor is required to consolidate the securitization entity under an amended FIN 46(R). The Staff noted that this exception was discussed in connection with the issuance of SFAS 156.

It was not clear whether or not the Board members agreed with the proposed exception.

Changes to matters discussed at FASB Education Sessions can be made before being voted on and/or approved at a FASB Board meeting.

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² A guaranteed mortgage securitization is a securitization of mortgage loans that is within the scope of SFAS 65, *Accounting for Certain Mortgage Banking Activities*, as amended, and includes a substantive guarantee by a third party.

³ Paragraph 46 of SFAS 140 provides that a QSPE shall not be consolidated in the financial statements of a transferor or its affiliates.