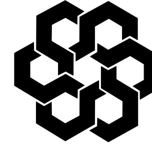

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International Accounting Standards Board

This document is provided as a convenience to observers at IASB meetings, to assist them in following the Board's discussion. It does not represent an official position of the IASB. Board positions are set out in Standards.
These notes are based on the staff papers prepared for the IASB. Paragraph numbers correspond to paragraph numbers used in the IASB papers. However, because these notes are less detailed, some paragraph numbers are not used.

INFORMATION FOR OBSERVERS

Board Meeting: **January 2009, London**

Project: **PROPOSED AMENDMENTS TO FAS 140**

Subject: **Derecognition of Financial Assets**
Selected Views of Respondents (Agenda Paper 2F)

BACKGROUND

1. In August 2005, The FASB issued an Exposure Draft (ED) to amend the derecognition guidance for financial assets in FAS 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. In September 2008, the FASB issued a proposed statement, which is a revision of the August 2005 FASB ED.

2. The ED is intended to

   - remove the concept of a qualifying special-purpose entity (SPE) from FAS 140 and the exceptions from applying FASB Interpretation No. 46 (revised December 2003), Consolidation of Variable Interest Entities, to qualifying SPEs.

- revise and clarify the derecognition requirements for transfers of financial assets and the initial measurement of beneficial interests that are received as proceeds by a transferor in connection with transfers of financial assets.
- enhance the disclosure requirements to provide users of financial statements with greater transparency about transfers of financial assets and a transferor's continuing involvement with such transferred financial assets.

3. The ED was exposed concurrently with the proposed amendments to FIN 46R, which would amend the consolidation and related disclosure requirements for enterprises that hold an interest in a variable interest entity.
4. Comments were requested from interested parties by 14th November, 2008.
5. The FASB staff presented a comment letter analysis and recommendations thereto to the FASB in December 2008 and the FASB made some preliminary decisions.

THIS PAPER

6. This paper provides
    - a summary of the views of respondents on the key aspects of the FASB proposal. It focuses on major issues, rather than documenting each and every view that was expressed on aspects of the proposals.
    - identifies and discusses the key messages and areas for consideration that arise from the responses
    - provides an update on FASB's deliberation of respondents' comments
    - considers what future work should be undertaken to build on the proposals and what has been learned from respondents' comments.
7. The paper also asks the Board one question on a particular issue. It also contains some IASB staff observations.

ISSUES DISCUSSED

8. Not all comments provided by respondents are relevant for the IASB project as the FASB and IASB models differ somewhat. Moreover, almost all of the relevant

comments relate to Approach 2 (Flowchart 2) to implementing the proposed derecognition principle for financial assets.

9. The reason could be that Approach 2 (Flowchart 2) is closer to the FASB ED and also because respondents were not asked to comment on an approach similar to or the same as the approach taken in Flowchart 1.

10. The staff notes that issues (a) and (b) are relevant for the IASB derecognition project. The staff believes issues (c) – (e) and the related concerns are only relevant for Approach 2 (Flowchart 2) of the proposed derecognition criteria for financial assets.

   a. International Convergence
   b. Interaction of Consolidation and Derecognition guidance
   c. Continuing Involvement
   d. Definition (or criteria) of part of a financial asset
   e. Practical Ability to Transfer

INTERNATIONAL CONVERGENCE

11. The FASB proposes that the revision to FAS 140 is designed to provide a short-term solution to address inconsistencies in practice in the context of the existing concepts in FAS 140 until such time as convergent standards on derecognition and consolidation are developed with the IASB and that ultimately, the two Boards will seek to issue a converged derecognition standard (see ED section titled - What Is the Effect of This Proposed Statement on Convergence with International Financial Reporting Standards?).

12. There was a unanimous focus by respondents on this proposal. A large majority of respondents accepted the need to improve the guidance on derecognition of financial asset. Preparers and auditors unanimously suggested that the FASB abandon the repair work on FAS 140 and join IASB to issue a single standard on derecognition of financial assets.

13. The most cited reasons for disagreeing with this proposal is the belief that the proposed convergence approach is unnecessary, inefficient and would raise the compliance cost for preparers (i.e. having to comply with 2 or 3 different derecognition regimes in a short period). For example the following respondents noted –

> The FASB and IASB have each undertaken separate derecognition and consolidation projects in response to the global credit crisis. FASB's project started first and the SEC understandably is pressing for rapid completion. As a result, both Boards are expected to issue separate standards, and then eventually converge, potentially requiring constituents to change their accounting twice – an inefficient use of time and resources. Ideally, both Boards should combine their separate projects, take the best of both, and issue a single set of identical standards as quickly as possible. We urge the FASB to reconsider the timing of its projects and engage the SEC in a similar dialogue. FASB's expected FSP, Disclosures about Transfers of Financial Assets and Interests in Variable Interest Entities, provides an appropriate bridge until then. – **Goldman Sachs**

> We believe the Board should refrain from making changes to the derecognition rules (and associated variable interest entity consolidation model) pending completion of a joint FASB-IASB project encompassing all derecognition and consolidation guidance. This would ensure any guidance would be convergent with IFRS and eliminate the potential need for entities to change accounting for derecognition twice within a relatively short time period. Such changes would be pervasive and require significant amounts of time and resources to identify data gaps, establish new policies and SOX processes, train personnel, adjust business practices and make strategic decisions (i.e., regarding capital needs) in an effective and efficient manner. Transfers of financial assets are common in financial markets and frequent changes to the accounting principles would be costly to financial statement preparers and potentially confusing for financial statement users. We believe an all-encompassing collaborative effort with the IASB provides a better opportunity for a reliable and relevant accounting standard. We recommend the Board remove the proposed amendment and work with the IASB on performing on a joint project. – **BB&T CORP**

> While we agree that changes to Statement 140 are necessary, we believe the Board should consider making those changes through its project with the International Accounting Standards Board ("IASB") on derecognition instead of this project. While we understand that the credit crisis has created a sense of urgency that is motivating the Board to act now, we do

> not believe it is in anyone's interests - users, preparers, auditors, or regulators - to require significant changes in accounting for transfers of financial assets twice within what would seems to be a relatively short period. That would be the result if the project team's assessment that the Boards could issue an exposure draft of a proposed standard by March 2009 proves correct, particularly with the delayed effective date proposed in the Exposure Draft. - **HURON CONSULTING GROUP**

> One of the objectives of the project is to improve the relevance, representational faithfulness and comparability of the information that a reporting entity provides in its financial statements. We believe that the proposal makes improvements in that regard, but in view of the fact that the International Accounting Standards Board (IASB) also has a project on its agenda to develop a new standard on' derecognition, AcSEC recommends that the Board instead focus its efforts on developing a converged derecognition standard with the IASB. We understand that the IASB project is also on a "fast track" and the IASB will bypass the Discussion Paper step and proceed directly to issue an exposure draft in the near term. AcSEC believes that it would be better to require companies to make a single change to a converged accounting standard, rather than implementing this proposal and then undertaking a second implementation effort when a converged derecognition standard is issued shortly thereafter. Substantial costs will be incurred to implement these standards. Preparers will incur costs to learn the new standard, train employees, collect significant amounts of data not collected today, change reporting and consolidation systems and make changes to systems and control structures to reflect the new requirements. Auditors will need to update practice aids, policies, tools and train employees on the new standard. Users will experience a similar learning curve. Therefore, we think it is unreasonable to ask entities to apply two sets of accounting changes within what we expect to be a short time frame. - **AICPA**

14. At the December meeting of the FASB, the staff proposed and the Board decided to proceed with the short term fix of FAS 140 and to monitor the progress on the IASB derecognition project as indicated at the October joint board meeting.

INTERACTION OF CONSOLIDATION AND DERECOGNITION GUIDANCE

15. The FASB proposes a transferor should evaluate whether it, its consolidated affiliates included in the financial statements being presented, or its agents effectively control the transferred financial asset.

16. Some respondents raised concerns about order of the application of the derecognition and consolidation requirements (i.e. which of the guidance should be applied first).

17. The order of application could have significant influence on the standalone statement of financial position of a subsidiary or a structured entity and whether a transferred financial asset would remain on the consolidated financial statement of the transferor. For example some respondents commented that -

> The proposed Statement implies that consolidation guidance should be applied before derecognition guidance. However, this is not explicitly stated. If this was the Board's intent, this should be clarified. We would observe that such a requirement would prohibit a transfer from a parent to a subsidiary from being recognized as a sale on the stand-alone financial statements of the parent. Is this what the Board intended? We believe that the more logical approach would be to first analyze the transfer under the amended FAS 140 and then analyze the consolidation of the transferee entity, since that follows the order of the business activity. - **CITIGROUP**

> It appears that paragraph 9 as revised by the proposed Statement requires that the transferor first apply the guidance in ARB 51 and Interpretation 46(R) to determine whether the transferee will be consolidated before determining whether the transfer of financial assets should be accounted for as a sale. However, a transferor may transfer assets to a transferee in which it holds no other interests, and as part of the transaction the transferor may receive a controlling financial interest in the transferee (e.g., the power to direct activities through a servicing arrangement and significant benefits through a beneficial interest) and accordingly now be required to consolidate the transferee. It is unclear whether paragraph 9 would require the original sale to be unwound as the consolidated affiliate would maintain effective control of the financial assets. The Board should clarify in which order a transferor should apply the consolidation principles and derccognition principles and the effect of this order. - **DELOITTE**

> As we noted above, this proposal is presumably being issued simultaneously with the proposal to amend FIN 46(R), Consolidation of Variable Interest Entities. It is unclear to us whether to apply this Standard first and then the proposed FIN 46(R) or vice versa. For example, if the proposed amendment to FIN 46(R) were applied first, then a former QSPE for which the transferor is deemed to be the primary beneficiary would be consolidated and, thus, become a consolidated affiliate. Then, in applying

the proposed amendment to FASB Statement No. 140 to the transfer of assets to the former QSPE, proposed paragraph 9 sales criteria would not be met, because the assets were
transferred to a "consolidated affiliate." However, if the proposed standard amending FASB Statement No. 140 were applied first, sales treatment could potentially be achieved before the FIN 46(R) consolidation analysis was performed. AcSEC believes that the amendments to FASB Statement no. 140 should be applied first, as it is usually the transfer of assets that leads to the transferor's attaining a controlling financial interest in
the variable interest entity. We request that the Board clarify whether it intends that a "consolidated affiliate," as that term is used in paragraph 9(a) of the proposed amendments to FIN 46(R), would include a variable interest entity consolidated under FIN 46(R). We also recommend that the final Standard clarify the intent of the Board with respect to the priority of application of both proposed Standards, because the order of applying the two standards could result in a significant difference in the standalone financial statements of the parent company and the special purpose entity.
- **AICPA**

18. The staff notes that this issue and related concerns are relevant for both proposed approaches (but mainly Flowchart 2).

19. The staff intends bringing a paper discussing the interaction of the proposed consolidation and derecognition requirements to the Board in February. The staff will address the concerns raised by respondents at that session.

CONTINUING INVOLVEMENT

20. The FASB proposes to continue to permit derecognition of financial assets with continuing involvement, in limited situations, with the addition of enhanced disclosure requirements about a transferor’s continuing involvement (see paragraph A28 of the ED).

21. With the exception of the CFA institute and two other respondents, all respondents agreed with the FASB proposal to permit derecognition if the transferor continues to have a continuing involvement in the asset transferred.

22. The three respondents in favour of a no-continuing involvement model commented as follows:

I believe the no-continuing-involvement alternative (there were 3 alternatives presented by the staff for the Board's consideration) merits further consideration. While the Board's vote against the proposal, on April 7, 2008,

> was in fact 4-3, the reasons advanced were neither convincing nor compelling - **Donald Gorton**
>
> We support de-recognizing assets only when control has been surrendered, and associated financial benefits and risk exposures have ceased, and to derecognize liabilities only when they have been extinguished. To that end we urge the Board to adopt a *no-continuing involvement* model for transferred assets to qualify for derecognition accompanied by robust disclosures. This model would be the least complex approach that would also eliminate financial engineering opportunities - **CFA Institute**
>
> We believe a better long-term solution would be to prohibit sales accounting if any recourse is retained by the seller. This basic concept, with minimal exceptions, was used by bank regulators until 1997, when regulatory accounting was changed to comply with GAAP - **New York State Banking Department**

23. For the great majority that are not in favour of a no-continuing involvement model, the commonly cited reason is that the no-continuing involvement approach would not reflect the economics of many transactions and it is inconsistent with the financial components approach. For example the following respondents noted –

> We agree with the Board's decision to not support a no-continuing-involvement model. Such a model would be inconsistent with the overall economics of many financial asset transfers. Additionally, a no-continuing-involvement model is inconsistent with the fundamental financial components approach that was the basis for FAS 140 and its predecessor, FASB Statement No. 125, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities. In the case of financial assets, we believe a financial components approach will result in accounting for transactions that more consistently reflects the underlying economics. - **PWC**
>
> We agree with the Board's decision to continue to permit derecognition of financial assets when transferors have continuing involvement with the assets. We believe that an accounting model that would preclude sale accounting if a transferor had any form of continuing involvement would not provide information that would faithfully represent the underlying economic event in all cases. We believe such information would be of limited usefulness to financial statement users. – **GRANT THORNTON**

24. At the December meeting, the FASB staff proposed and the Board decided that a no-continuing involvement approach would not be appropriate.

25. The staff would like to remind the Board of the above reasons and would recommend that the Board discourage attempts at tightening the derecognition rules for the sake of it.

COMPONENTS (Part of an Asset)

26. The FASB proposes specific conditions for reporting a transfer of a portion of a financial asset as a sale. A transfer of a portion of a financial asset as a sale is eligible for derecognition only for a pro rata portion that meets the definition of a participating interest.

27. The proposal defines a participating interest as a portion of a financial asset (other than an equity instrument, a derivative financial instrument, or a hybrid financial instrument with an embedded derivative that is not clearly and closely related as described in Statement 133) that:

- Conveys proportionate ownership rights with equal priority to each participating interest holder
- Involves no recourse (other than standard representations and warranties) to, or subordination by, any participating interest holder
- Does not entitle any participating interest holder to receive cash before any other participating interest holder.

28. Respondents from many constituent groups commented that the FASB definition (or criteria) for eligible components (participating interests) is too restrictive and it is without conceptual merit. Some respondents highlighted that the proposal would create inconsistency in practice and would reduce comparability of financial statements. For example the following respondents noted –

> The Clearing House does not agree with the Board's proposal of creating the concept of a "participating interest." We are not aware of any abuses in practice related to transfers of a portion of an asset and this new concept makes the standard much more difficult to apply. We believe the criteria specified to meet the definition of a participating interest are too restrictive and would cause many participations that are widely used in practice to fail sales treatment under the proposal. We note that some participations may not receive sale treatment, whereas if the financial assets were

transferred in their entirety with similar economic terms and economic outcome to an SPE with an equivalent interest retained, the transfer would be able to meet the criteria for sale accounting. We believe that it is not an improvement in financial reporting if the form of the transaction dictates the accounting, rather than the economic substance. - **THE CLEARING HOUSE ASSOCIATION**

We suggest that the Board reconsider this requirement and better articulate the principle on which criterion (a) is based. The participating interest definition may not always result in accounting that reflects the economics of a transaction. Consider a factoring arrangement whereby a portion of a $100 financial asset (a trade receivable) is legally transferred to a transferee and such portion represents a right to the first $90 of cash flows from the trade receivable (i.e., the portion not sold is subordinate). Under paragraph 8B(c), such a transfer of a portion of a trade receivable would not qualify as a participating interest because of the subordination feature. However, the same economics could be achieved by transferring the entire $100 financial asset, with the transferor accepting a receivable from the transferee, where the obligation for the transferee to pay depends on the performance of the trade receivable (i.e., the transferee is required to pay amounts collected from the trade receivable in excess of $90). In essence, the transferor accepts a non-recourse collateral-dependent receivable from the transferee. The economic substance of the two transactions is the same, but they may result in different accounting. - **PRICEWATERHOUSE COOPERS**

We disagree with the proposed change to the accounting for transfers of participating interests. We do not understand why the Board believes the transferor should account for a transfer of a participating interest that provides recourse as a borrowing. That decision suggests that risks and rewards are important to determining whether a transfer qualifies for derecognition, which conflicts with the notion underlying Statement 140 that control over the financial asset is the determining factor. While we understand the concerns expressed by Board members about relying solely on an attorney's legal assessment that a financial asset has been isolated from the transferor, we do not understand why those concerns are greater for transfers of participating interests than they apparently are for transfers of financial assets in their entirety. We do not see why a legal opinion is sufficient to conclude that a financial asset has been isolated from the transferor when transferred in its entirety, but is not sufficient when the transfer involves a participating interest that does not meet all of the conditions in paragraph 8B. For better or worse, the Board has a derecognition standard that is based on control and it should apply that

standard consistently to all transfers, regardless of the form they take. - **HURON CONSULTING GROUP**

AcSEC questions the necessity of creating the guidance included in the proposed Standard for a "participating interest." We are not aware of any abuses in practice related to transfers of a portion of an asset and this new guidance makes the standard much more difficult to apply, would significantly change practice and would result in accounting that doesn't make sense. We believe the criteria specified to meet the definition of a participating interest are too restrictive and would cause many participations that are widely used in practice to fail to qualify for sales treatment under the proposal. We note that some participations may not receive sale treatment, whereas if the financial assets were transferred in their entirety to an SPE with similar economic terms and economic outcome with an equivalent interest retained, the transfer would be able to meet the criteria for sale accounting. We believe that it is not an improvement in financial reporting if the form of the transaction dictates the accounting, rather than the economic substance. - **AICPA**

The concept of a participating interest adds unnecessary complexity to the proposed Statement, which we believe is unwarranted. We recommend that this concept be eliminated from the proposed Statement and, instead, require transfers of both entire financial assets and portions of a financial assets to meet the same criteria for sale accounting. It would be helpful to understand why the Board considers it necessary to evaluate transfers of a portion of a financial instalment differently than the transfer of an entire financial asset. We are not clear as to what it is about the transfer of a portion of a financial asset that requires additional restrictive criteria that must be met in order to achieve sale accounting. We believe that the application of the requirements in paragraph 9 to all transfers of financial assets, including transfers of a portion of a financial asset, should be conceptually consistent and should not result in two economically identical transactions being accounted for differently **- CITIGROUP**

29. At the December meeting, the FASB staff suggested the Board should not redeliberate the component issue except for the implication for the two-class participation. The Board agreed with the staff recommendation.

30. The staff notes that the issue of treating identical transactions differently due to the definition of part of an asset is relevant for Flowchart 2 only. For example, under that approach, transfer of a senior interest in an asset would not qualify as

part of an asset eligible for derecognition and hence the derecognition criteria will be applied to the asset in its entirety. However, as the staff explained at previous meetings, the same economic effect can be achieved by transferring the financial assets in its entirety to a vehicle and purchasing a subordinated interest in the vehicle.

31. As noted by respondents, there appear to be no practice of abuse using the derecognition guidance for part of an asset. If the Board decides not to revisit this issue, the staff would like the Board to clearly state its intention and basis for not allowing for derecognition of some parts of an asset.

Two-class Participations

32. One respondent stated that a two-class participation, in which all interests in the underlying asset have been transferred, should be accounted for as a sale -

> If the concept of participating interests is retained in the final Statement, it is not clear why two-class participations should not meet sale requirements if all cash flows are passed through to participants and participants in each class are pari passu with the participants in their respective classes. For example, if an entity originates a loan and transfers a senior 80% undivided interest in the loan to a third party (Party A) and shortly thereafter transfers the junior 20% undivided interest in the loan to another third party (Party B), the proposed Statement reads to require that the parties (the originator, Party A, and Party B) each account for the transactions as a secured borrowing or secured lending, notwithstanding the fact that the originator has no continuing economic interest in the asset and notwithstanding the fact that Party A and Party B may have no knowledge of the involvement or form of the other participation. Is it the Board's intention that each transfer be considered a secured borrowing or secured lending or should the transfers be collectively evaluated and considered a sale once the originator no longer has a continuing economic interest in the asset? - **CITIGROUP**

33. The staff notes that the two-class participation issue identifies a weakness in Flowchart 2 which needs addressing.

Derivatives, Hybrid and Equity Instruments

34. A number of respondents note the lack of explanation and/or basis for the FASB's exclusion of part of a derivative, hybrid and equity instruments from qualifying as participating interests (component/part of an asset). For example, the following respondents commented that -

> We suggest that the Board provide additional explanation on why the transfer of a portion of an equity, derivative, or hybrid financial instrument would not meet the definition of a participating interest. In addition, the Board should clarify whether the term "equity instrument" as used in paragraph 8B(a) of Statement 140, as added by the proposed Statement, is intended to include interests that are equity in legal form, interests that would be classified as equity for accounting purposes, or both. As many securitized instruments have characteristics of both debt and equity, the Board should clarify whether it intends for interests in securitizations to be excluded from the scope of instruments that may meet the definition of a participating interest. For example, would a "seller's interest" in a credit card securitization trust (which is in the form of a debt security) meet the definition of a participating interest, whereas a residual interest in a trust that has certain characteristics of an equity instrument would not meet the definition of a participating interest? - **KPMG**

> Further, if the concept of participating interests is retained in the final Statement, we do not see the conceptual merit in excluding a transfer of equity instruments, derivative instruments, and hybrid financial instruments from classification as a participating interest when they would otherwise meet the requirements to be classified as a participating interest. Those limitations had some merit when the Board originally considered this concept in connection with QSPEs, which could only hold passive financial assets, but with the elimination of QSPEs, it seems to be a restriction without a justifiable purpose. Moreover, we see no reason to treat the transfer of a pari passu interest in a hybrid debt instrument any different from the transfer of a debt instrument that docs not contain a bifurcatable embedded derivative. However, if the Board proceeds with including special accounting for transfers of a portion of a financial asset, we ask that the Board expand the scope of the definition of participating interests to include such instruments or clarify why it makes conceptual sense to exclude those instruments. - **CITIGROUP**

> Although defining a portion of a financial asset that would be eligible for sale accounting could be beneficial, we do not agree with the Board's proposed definition because it may not result in accounting that reflects the economics of transactions. …… It is unclear to us why certain assets are not eligible for sale accounting under this definition. For example, the proposal does not articulate the principles behind why certain hybrid

instruments with embedded derivatives that are not clearly and closely related are not eligible to be treated as participating interests. In certain cases, the cash flows from these instruments could be separated in a manner to comply with the participating interest definitions (other than the requirement in paragraph 8B(a)). Consider a debt security for which the interest rate is adjusted because of changes in response to movements in the S&P index. Such a financial asset would be deemed to have an embedded derivative that is not clearly and closely related (i.e., the S&P indexation), but would appear eligible to be participated in by another holder (and meet all the other requirements of the definition of a derivative). Another example is a contingent call option held by the borrower that may not be considered clearly and closely related to a loan or a security issued. However, we also believe that there may be some cases where the embedded derivative that is not clearly and closely related would require "exercise" by the financial asset holder — this may not meet the definition of a participating interest because the decision to exercise would not allow for each participating interest holder to have the same rights associated with its exercise (e.g., convertible debt). It is unclear how decision-making rights attached to the transferred participating interests and retained interests could be separated to comply with criteria (b) and (c) of paragraph 8B. - **PRICEWATERHOUSECOOPERS**

35. At the December meeting of the FASB, the FASB staff recommended and the Board agreed not to redeliberate this issue.

36. The IASB staff, however, agrees with those respondents. The staff has addressed this issue in Agenda Paper 2B, which will be discussed at this meeting.

TRANSFEREE'S RIGHT TO SELL OR PLEDGE THE ASSET

37. The FASB proposes that a transferor should evaluate whether it controls the transferred financial asset. If the transferee is constrained from pledging or exchanging the transferred financial asset and such constraint is not designed primarily to provide a benefit to the transferee, the transferor maintains effective control over the transferred financial asset (see paragraph 9(c)(3) and 54A of the ED).

38. A significant majority of respondents questioned whether restrictions on an SPE from selling the assets supporting a securitisation, benefits either the transferor or the SPE or both.

39. The most prevalent concern was that restrictions on the transferee's right to sell or pledge the asset can be both for the benefit of the transferor and the transferee but will primarily be for the ongoing benefit of the transferee. Some of the respondents commented as follows:

> In paragraph 54B of the Exposure Draft, the Board concludes that a transferee's ability to receive the economic benefits of the transferred financial asset (that is, to collect cash flows from the transferred financial asset) does not result in the transferee receiving a benefit from that constraint. CSG disagrees with that conclusion because, in our view, the transferee benefits from this constraint by receiving the cash flows from the assets in the trust. The constraint mitigates the risk that the assets will be sold and, therefore, continues the ability of those assets to produce cash flows. Therefore, CSG recommends that the Board indicate that the rights to cash flows are a benefit to the transferee. If the Board believes that the continued ability of assets to provide cash flows does not result in the transferee receiving a benefit from the restriction, we request that the Board provide the reasoning behind why it does not provide the transferee a benefit. - **CREDIT SUISSE**

> Take, for example, credit-linked note issuers. These entities sell credit protection in the form of credit default swaps (CDS), issue notes that are linked to the underlying credit that is referenced by the CDS, and are collateralized by low-risk assets transferred to the entity. The transferor is typically the CDS counterparty, and the investors are unrelated third parties (often there is only one investor). In these transactions, the investors benefit from the selling restrictions because the transferred assets 1) provide a portion of the interest income that the investors receive from the credit-linked note and 2) provide the source for principal repayment (assuming no default in the CDS reference). As a result, it is important for the investors to be satisfied that the assets held by the special purpose entity (SPE) will meet certain criteria. By selecting low-risk assets at the inception of the transaction and prohibiting those assets from being changed, the investors' interests are protected. The transferor will also benefit from the selling restrictions because the transferred assets serve as collateral for the purchased CDS. Applying the proposed guidance to this situation, we are likely to conclude that the investors primarily benefit from the selling restrictions, which under a paragraph 54A analysis would correspond to the transferee benefiting. We would argue that because the transferred assets provide the return and principal repayment to the investors, the investors primarily benefit from the selling restrictions. However, there is a significant level of judgment involved in this determination because the transferor also requires the SPE to hold low-risk assets to serve as collateral for the CDS. - **MERRIL LYNCH**

40. At the December meeting, the FASB decided not to revisit this issue. The IASB staff, however, believes it is major concern and is relevant for the approach taken in Flowchart 2.

41. The staff notes that the practical ability to transfer test in Flowchart 2 is not the same as the SFAS 140 ED ability to pledge or exchange test. The reference to 'for its own benefit' in the practical ability to transfer test means precluding others from the economic benefits of the asset as opposed to the restriction benefiting the transferee. Moreover, the proposed model focuses on practical ability to transfer and not the ability to pledge or exchange. The two may be perceived as similar but they differ in emphasis and may give different outcomes in some cases.

42. One of the reasons for the difference in outcomes is that the FASB ability to pledge or sell is considered together with the legal isolation test whereas the practical ability test focuses only on the economic implications. Also, if the transferor has an obligation and entitlement to reacquire the asset transferred (whether the asset is readily obtainable or not), the transaction would fail the derecognition criteria in FAS 140.

43. That notwithstanding, the staff believes the respondents' comments raise concerns about Flowchart 2 (Flowchart 1 no longer has the practical ability test and even if it did it would not matter because of the subsequent test in that approach).

44. The rationale behind Flowchart 2 is that if the transferee lacks the practical ability to transfer the asset for its benefit, then one can conclude that the transferor has maintained control of the asset.

45. The staff thinks this is based on the premise that the restriction is to the benefit of the transferor. But as stated in the respondents' comments, this is not always the case.

46. In many securitisations (if not all) the securitisation vehicle's inability to sell the assets in the vehicle is primarily for the benefit of the beneficial interest holders.

47. The staff therefore notes that it might not be appropriate for the derecognition criteria to stop at the practical ability to transfer stage without assessing whether

the restriction prevents the transferee from obtaining and precluding others from the economic benefits underlying the asset.

48. The staff recommends that the Board redeliberate this issue or provide a basis why this issue should not be addressed further.

Question for the Board

49. Does the Board agree with the staff recommendation in paragraph 48? If not, why not?