

Ernst & Young's On Call Advisory Services

Accounting Alert

Tuesday, October 24, 2006

FASB's October 18 Meeting on Legal Isolation



Transfers Project– Legal Isolation Criteria

At the October 18, 2006 FASB Meeting, a tentative decision was made to require the legal analysis in paragraph 9(a) of FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, to treat the involvements of all entities included in the consolidated financial statements being presented as if those involvements were made by the transferor. The Board was concerned that a transferor could receive a true sale opinion in situations in which the transferor's consolidated affiliates have involvements with the transferred assets and a true sale opinion would not be provided if all such involvements were made by one legal entity and considered in the legal isolation analysis.

The Board was asked to evaluate the following three proposed alternatives (Alternatives A, B and C below) regarding the legal isolation criterion and alternative C received the majority of the votes.

Alternative A: clarifies that a transferor of financial assets must perform a legal analysis to determine that the isolation criteria have been met and that such a legal analysis must consider the involvements of all entities that are included in the consolidated financial statements of the transferor.

Alternative B: clarifies that an isolation analysis must consider the legal effect of the involvements of all of the entities with the transferred financial assets that are consolidated in the financial statements being presented, such as for a parent entity that consolidates a transferor of financial assets. The isolation analysis must conclude that the transferred financial assets are, in the event of bankruptcy, beyond the reach of the creditors all of the entities included in the financial statements

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being presented in order for those assets to meet the isolation requirement. Some Board members indicated this alternative is consistent with the current requirements of FASB Statement 140.

Alternative C: requires that an isolation analysis consider the legal effect of the involvements of all of the entities with the transferred financial assets that are consolidated in the financial statements being presented, but requires that the legal analysis treat the involvements of all of the consolidated entities as if those involvements were made by the transferor. The isolation analysis must conclude that the transferred financial assets would be beyond the reach of all of the entities (and their creditors) included in the financial statements being presented, assuming that all of the involvements were made by the transferor, in order for the transferred financial assets to meet the isolation requirement for a parent entity of a transferor.

In addition, the Board considered that the parties considered in the legal analysis under Alternative C also include related parties (as defined in FASB Statement No. 57). However, based on the perceived difficulty in practice to identify all possible related parties and potential impediments to issuing guidance in a timely fashion, the Board tentatively agreed to exclude this concept in any guidance that will be issued in the near term.

If you have any questions please call your On-Call team or

Lisa Filomia-Aktas
On-Call Practice Leader
tel: (212) 773-2833
e: lisa.filomia@ey.com

On-Call Advisory Services Group:

Kobi Assaraf (212) 773-7064, Michael Brosnan (212) 773-1797, Betty Davis, (202) 327-5631, Peter Hornecker (212) 773-0227, Karla Johnsen (212) 773-5510, Tim Kane (212) 773-3648, Hee Lee (212) 773-8605, Jung Lee (212) 773-2196, James Medeiros, (212) 773-1884, Osei Prempeh (212) 773-6195, Kirk Robinson (212) 773-2713, Deha Rozanes (212) 773-0731, Mandy Sagar (212) 773-6425, Paul Sheahan (212) 773-5578, Erik Swanson (212) 773-0532, David Thrope (212) 773-0930, Jonathan Tkach (212) 773-8756 Ken Wilchfort (212) 773-3414

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In addition to our On-Call Advisory, we provide related services such as operational reviews, due diligence, and training sessions.

This alert is correct to the best of our knowledge and belief as at the date of this alert. It is, however, written in general terms and professional advice must always be obtained before any action is taken.