

Ernst & Young's On-Call Advisory Alert

May 22, 2008

Accounting Alert

May 21, 2008 FASB Board Meeting on SFAS 140¹ Amendment

At the May 21, 2008 FASB Board Meeting, the Board discussed three questions presented by the FASB Staff. The questions relate to the accounting under SFAS 140 for retained beneficial interests. The questions addressed at the May 21st Board Meeting relate to previously unresolved issues raised in the Exposure Draft *Accounting for Transfers of Financial Assets*².

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). Two questions³ raised at the FASB Education Session held on May 14, 2008 are a consequence of eliminating the QSPE exception. Those two questions were not discussed at the May 21st Board Meeting but are expected to be raised at a subsequent meeting once the amendments on FIN 46(R) are more developed.

Question 1: Should a beneficial interest received by a transferor, in connection with a sale of an entire financial asset to an entity that is not consolidated by the transferor, be considered proceeds of the sale if the transfer meets the requirements for sale accounting?

Question 2: Should a beneficial interest received by a transferor as proceeds of a sale be initially measured at fair value?

Under the current provisions of SFAS 140, retained beneficial interests are not considered proceeds of a sale and are initially measured based on allocated carrying value. Proceeds are measured at fair value. Effectively, gain or loss on sale is not recognized on retained beneficial interests.

The Staff recommended that retained beneficial interests be treated as proceeds and be measured at fair

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values noting that retained beneficial interests often have risk and reward profiles that differ substantially from the asset transferred. Based on the comments made at the Education Session on May 14th, the Staff does not believe there is a substantial difference between retained beneficial interests and other assets received in a transfer such as servicing assets, which are initially measured at fair value based on the guidance in SFAS 156⁴. 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 115⁵.

A majority of the Board appeared to agree that a retained beneficial interest should be treated as proceeds of a sale and initially be recorded at fair value.

Question 3 – Should a participating interest in a financial asset that continues to be held by a transferor be initially measured at its allocated carrying amount in accordance with the existing measurement guidance in paragraph 10 of Statement 140, as amended by FASB Statement 156, *Accounting for Servicing of Financial Assets*?

The Staff does not believe participating interests meet the definition of a new asset. Consequently, the Staff believes they should be measured at allocated carrying value, which is the current methodology. Some Board Members expressed a belief that a retained participating asset may not have the same characteristics of the asset transferred regardless of the narrowly defined nature of a participating interest.

The Board voted 4 to 3 in favor of the Staff recommendation.

Next Steps: The Board is expected to hold an Education Session on May 28th to discuss disclosure, transition and effective date provisions for amendments to both SFAS 140 and FIN46(R)⁶. A Board Meeting is expected to be held on June 4th to vote on outstanding matters related to the proposed amendments to both SFAS 140 and FIN 46(R).

Matters discussed at FASB board meetings are subject to issuance of proposed guidance (e.g., an Exposure Draft) for comment prior to issuance of a final standard.

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

² The Exposure Draft was released in June 2003 and was not finalized.

³ Those two questions are (i) 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? and (ii) Should there continue to be an exception for guaranteed mortgage securitizations?

⁴ *Accounting for Servicing of Financial Assets.*

⁵ *Accounting for Certain Investments in Debt and Equity Securities*

⁶ *Consolidation of Variable Interest Entities an interpretation of ARB No. 51*