

Ernst & Young's On-Call Advisory Alert

May 30, 2008

Accounting Alert

May 28, 2008 FASB Education Sessions on FIN 46(R)¹ and SFAS 140² Amendments

Notes: Decisions are not made at Education Sessions. Staff recommendations can change before they are voted on at FASB Meetings.

Bob Herz, FASB Chairman, did not attend the Education Sessions.

FIN 46(R) Changes:

The following alternatives for determining a VIE's Primary Beneficiary ("PB") (the party who consolidates the VIE) were discussed:

View A: The PB is the party (if any) qualitatively determined to control the VIE and have rights to VIE benefits.

If the PB can not be qualitatively determined, or it can not be qualitatively determined that there is no PB, the PB is the party (if any) quantitatively determined to absorb > 50% of VIE expected loss or residual return (current FIN 46(R) analysis).

View B: The PB is the party (if any) with the right to use VIE assets as if they were their own (the "Pure Control Model").

View C: The PB is the party (if any) quantitatively determined to absorb > 50% of VIE expected loss or residual return (current FIN 46(R) analysis).

There did not appear to be support for changing the Board's prior decision (View A).

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The Staff described the following alternatives under consideration for determining the risks and rewards that should be considered in applying Views A and C:

Approach 1: (applies only to VIEs with one class (i.e., no tranching) of variable interests (“VIs”)) Consider only risks created by the VIE and passed on to VI holders; do not consider VIE asset risk

Approach 2: (applies to all VIEs) Consider only risks from VIE net assets that are, by design, passed on to VI holders (consistent with FSP FIN 46(R)-6)

Some Board members appeared to support using both Approaches 1 and 2. The alternative would be to apply Approach 2 to all VIEs.

Application of FIN 46(R) Changes:

The Staff described the application of the Views and Alternatives described above to the following transactions, based on the assumed, described “facts”:

Transaction 1: Single Class GSE Guaranteed RMBS:

- Loan originator transfers loans to GSE,
- GSE transfers the loans to VIE, and
- VIE issues one class of GSE Guaranteed VIs (i.e., the RMBS).

View A: There is no PB as no one controls the VIE since it is assumed neither RMBS holders nor GSE can unilaterally change VIE activities. Quantitative analysis is not required.

The Staff indicated some may require quantitative analysis in this case. One Board member indicated such analysis is not required nor permitted since it was determined the VIE is not controlled and asked that the Amendment be clear in this regard.

View B: There is no PB as no party can use VIE assets as its own.

View C, Approach 1: A holder (if any) of > 50% of the RBMS is the PB as only GSE credit risk is relevant.

View C, Approach 2: The GSE or a holder (if any) of > 50% of the RMBS is PB, depending upon the relative magnitude of loan credit (GSE) and interest/prepayment (RMBS holder) risk.

Transaction 2: Multi-Seller Asset Backed Commercial Paper Conduit:

- Conduit is a VIE,
- Conduit’s assets are trade receivables,
- Each receivable seller provides Conduit with over collateralization to absorb receivable credit and Conduit interest rate risk,
- No seller’s receivables are > 50% of Conduit assets, and
- Bank is Conduit’s administrator and provides Conduit with credit and liquidity support for fixed fees.

View A: (the only View discussed) There is no PB as Bank controls Conduit but gets no benefit from Conduit (Bank’s fees are fixed).

It appears the Staff did not

consider variability in Bank's credit support exposure relevant.

Disclosure:

The Board discussed the Staff's analysis (not provided to observers) of its proposed new SFAS 140 and FIN 46(R) disclosures. Other than commenting that the description of the disclosures was six pages long and that "linked presentation" disclosure appeared to have been omitted (the Staff indicated this was unintended), no specifics were discussed.

SFAS 140:

While the Board previously decided the Amendment will eliminate QSPEs, the Staff noted SFAS 140 currently requires that QSPEs have third party held beneficial interests with a fair value of at least 10% of the total fair value of QSPE beneficial interests. The Staff recommended the Amendment not require any minimum threshold for third party investment in VIE financial assets for the transfer to be a SFAS 140 sale; it appeared Board members agreed. One Board member noted such a VIE would have to qualify for non-consolidation under FIN 46(R).

The Staff discussed SFAS 140's "guaranteed mortgage securitization"³ provisions, by which sale treatment, non-consolidation, recharacterization (loans to securities), and servicing asset recognition can occur when a transferor retains 100% of QSPE beneficial interests. Board members indicated they saw no basis, or need, to continue any special provisions for guaranteed mortgage securitizations.

Comment Period, Effective Date, Transition:

FASB's website indicates release of the Exposure Drafts and the Final Amendments are scheduled for the second and fourth quarters of 2008, respectively.

The Staff recommended 45 day Exposure Draft comment periods. One Board Member suggested 60 days was more appropriate as the comment period will be in the "vacation season."

While not fully discussed in view of the Board comments summarized in the next paragraph, it appeared the Staff recommended that:

1. Both Amendments apply to new VIEs and new transfers at the start of the first fiscal year beginning after November 15, 2008,
2. Both Amendments apply to existing VIEs at the start of the first fiscal year beginning after November 15, 2009, and
3. When the Amendments are first applied, there may be cumulative effect income statement recognition; prior financials would not be restated.

One Board member indicated it was premature to discuss transition and effective dates as the Board has not yet decided on specific amendment provisions. One Board Member suggested the FIN 46(R) Reconsideration Event⁴, Disclosure, and SFAS 140 changes be effective as recommended by the Staff, but that all other FIN 46(R) changes be effective as of the start of the first fiscal year beginning after November 15, 2009.

Next Steps:

The Staff indicated the SFAS 140 Amendment will be discussed at the June 4 Board Meeting and that the FIN 46(R) Amendment will be discussed at the June 4 Education Session and possibly at the June 11 Board Meeting.

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- ¹ “Consolidation of Variable Interest Entities, an interpretation of ARB No. 51.”
- ² “Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, a replacement of FASB Statement 125.”
- ³ A Guaranteed mortgage securitization is “a securitization of mortgage loans that is within the scope of FASB Statement No. 65, Accounting for Certain Mortgage Banking Activities, as amended, and includes a substantive guarantee by a third party.”
- ⁴ The Board previously decided all FIN 46 evaluations must be reconsidered each time financials are prepared (i.e., quarterly).