Issue Paper

Subject: Interpretation of FASB Statement No. 140 – Treatment of CMBS Trusts as Qualifying Special Purpose Entities (QSPEs)

Issue: On December 20, 2005, the Financial Accounting Standards Board (FASB) voted to add a limited-scope project to its agenda to provide interpretive accounting guidance with respect to the passive nature of a qualifying special-purpose entity (QSPE).

The treatment of CMBS trusts as QSPEs is critical to the CMBS market because transfers of loans to trusts that are not QSPEs must be treated as secured borrowing arrangements, rather than as sales, for accounting purposes. This would disrupt the commercial real estate industry because lenders might be forced to look for alternative avenues for selling their loans, thus reducing borrowers' access to funding through the capital markets.

Background: FASB Statement No. 140 (FAS 140), *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities,* is the accounting standard for securitizations and other transfers of financial assets. The guidance in FAS 140 distinguishes transfers of financial assets that are sales from those that are secured borrowings, and stipulates that a transfer of a loan to a securitizing entity must be a QSPE in order for the transfer to be accounted for as a sale. FAS 140 contains the defining conditions for a QSPE, including a condition that the permitted activities of the QSPE must be significantly limited and entirely specified in the legal documents that established the SPE, or created the beneficial interests in the transferred assets that the SPE holds. FAS 140 went into effect for transfers of financial assets after March 31, 2001. Additional guidance on the types of activities that are permissible for QSPEs can be found also in EITF Discussion Topic D-99, *Questions and Answers Related to Servicing Activities in a Qualifying Special-Purpose Entity under FASB Statement No. 140*, which was released in July 2001, and the FASB Special Report, A Guide to Implementation of Statement 140…, dated 2001.

CMBS structures have been fundamentally the same since the inception of the market in the early 1990's. To date, typical CMBS trusts have been considered to meet the conditions of a QSPE as set forth in the accounting literature. Based largely on this understanding, thirty to forty percent of new commercial mortgages today are dependent on liquidity provided through access to capital markets through securitizations. Some auditors, however, have recently questioned whether the trusts used in commercial securitizations are, in fact, QSPEs based on the premise that certain types of commercial servicing activities are not "permissible" activities of a QSPE.

To address these questions, the FASB decided on December 20, 2005 to open a special project to clarify servicer discretion in the context of a QSPE. Three specific issues were raised as examples of activities that might be contrary to the intent of FAS 140:

1. the ability to waive a due-on-sale provision (i.e. substitute borrowers);
2. the substitution by a borrower of collateral underlying a loan; and
3. the extent of permitted servicer activities in connection with the sale of real estate temporarily held by the QSPE.

FASB plans to issue principles-based guidance and will use the above examples to demonstrate how parties to securitizations and their accountants should evaluate the activities that are permitted for a QSPE.

To assist in developing this guidance, the FASB formed a resource group earlier this year consisting of representatives from the commercial mortgage securitization industry, the residential mortgage securitization industry, the four largest accounting firms, the banking and insurance industries, and participating observers from the Public Company Accounting Oversight Board (PCAOB), the U.S. Securities and Exchange Commission (SEC) and banking regulators. Representatives from The Capital Consortium, which is a federation of five trade associations – the Commercial Mortgage Securities Association (CMSA), Mortgage Bankers Association (MBA), the National Association of Realtors (NAR), The Real Estate Roundtable (RER) and The Bond Market Association (TBMA) along with its affiliate the American Securitization Forum (ASF), also participate in this resource group. The purpose of the resource group is to assist the FASB staff in understanding the nature of activities exercised by servicers of different types of securitized assets.

MBA Position: MBA strongly believes that any decision by the FASB that would unnecessarily restrict the long-standing and beneficial activities of servicers of assets held in CMBS trusts would have dramatic, adverse implications for all participants in the CMBS market. Those implications would include new limitations on standard commercial loan servicing practices which would be viewed negatively by the ratings agencies.

On a technical level, if the entity fails to meet the conditions for QSPE status, originators and loan sellers might have to consolidate the securitized assets and hold them on their balance sheet, even though they no longer own them, as opposed to treating them as loan sales. Failure to secure accounting sale treatment would create massive uncertainty in the marketplace, require regulatory capital disproportionate to the risks and could result in a reversion back to an illiquid commercial real estate market.

Status: MBA is working with other industry participants to highlight how the CMBS market has successfully developed over the last ten years. The CMBS market has become the second largest source of capital for commercial and multifamily real estate lending. Its liquidity provides reliable debt financing to commercial real estate borrowers. Total U.S. issuance of commercial mortgage backed securities as of September 29, 2006 was $132.9 billion.[1]

[1] Commercial Mortgage Alert, September 29, 2006.

MBA, in conjunction with the other trade associations within the Capital Consortium, has been working cooperatively with the FASB to provide practical information on how the industry is operating in accordance with the established accounting standards created by the FASB as they relate to servicing. The Capital Consortium has prepared question and answer documents to demonstrate that the current CMBS structures are consistent with the requirements of FAS 140, and has shared these documents with the FASB Resource Group. MBA has used these documents to educate Congressional staff of the House Financial Services Committee and Senate Banking Committee during meetings conducted during the National Policy Conference on April 26 and 27, 2006. MBA has also taken the lead in coordinating communications with the public on the status of the FASB servicer discretion review.

At its July 26th Board Meeting, FASB decided to address issues pertaining to the permitted activities of a QSPE jointly by combining discussions and decisions related to the Servicer Discretion project with the Transfers of Financial Asset project. During an FASB Educational Session on September 20th, FASB staff received feedback from the Board on two approaches to address permitted activities of a QSPE. The approaches also would clarify the amount of servicer discretion permitted for commercial mortgage loans held by a QSPE. A final draft of the approach would be discussed at a future FASB Board Meeting, tentatively scheduled for October 11, 2006.

CREF Staff Contacts:	**Deborah McKinnon** **(202) 557-2740**
	Jennifer Williams **(202) 557-2840**
Legislative Staff Contacts:	**Erick Gustafson** **(202) 557-2913**
	Josh Denney **(202) 557-2816**
	Burton Wood **(202) 557-2806**

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