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CITY BAR

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VIA FEDERAL EXPRESS  
Financial Accounting Standards Board  
401 Merritt 7  
Norwalk, CT 06856-5116

**Re: Revised Exposure Draft of Proposed Amendments to FASB Statement No. 140 Relating to Transfers of Financial Assets (File Reference No. 1225-001) (the "transfers exposure draft")**

Ladies and Gentlemen:

The Committee on Structured Finance (the "Committee") of The Association of the Bar of the City of New York (the "Association") is pleased to submit the following comments on the transfers exposure draft, which was issued by the Financial Accounting Standards Board (the "FASB") on August 11, 2005.

The Association is an organization of over 23,000 lawyers. Most of its members practice in the New York City area; however, Association membership spans nearly every state and over 50 countries.

The Committee exists to address the unique set of legal, accounting, and regulatory issues critical to structured finance, one of the fastest growing areas in the law. The Committee appreciates the opportunity to comment on the transfers exposure draft and stands ready to assist the FASB and its staff if further clarification is required on any of the points raised in this letter.

The Committee appreciates the FASB's considerable efforts to revise and clarify the derecognition requirements for financial assets under FASB Statement No. 140 and believes that the transfers exposure draft remedies many of the objections to the June 2003 exposure draft. The American Securitization Forum (the "ASF") addressed many of the remaining unresolved issues in its October 10, 2005 letter (the "ASF Letter") to the FASB. The Committee agrees with and endorses the ASF's comments and recommendations regarding the transfers exposure draft generally, and specifically in Part III of the ASF

Letter – “Additional Isolation Guidance.” The Committee submits this letter to convey its particular concerns regarding two unresolved issues in the transfers exposure draft: (1) the lack of consistency between (a) the proposed new requirements for “legal isolation” specified in paragraphs 9(a) and 9(e) (as interpreted and expanded by paragraph A17<sup>1</sup>) and (b) the analytical underpinnings of legal isolation dictated by current bankruptcy law, and (2) the practical difficulties in applying the proposed additional guidance regarding legal isolation to the delivery of “true sale,” nonconsolidation and other similar legal opinions in connection with asset-backed securities transactions.

**1. The Proposed New Requirements for “Legal Isolation” Specified in Paragraphs 9(a) and 9(e) (as Interpreted and Expanded by A17) are Inconsistent with Current Bankruptcy Law.**

The Committee is concerned that the proposed changes under paragraphs 9(a) and 9(e), and the guidance provided in paragraph A17, are inherently inconsistent with the legal isolation analysis under current bankruptcy law. The determination of legal isolation of transferred assets sold by a transferor (often, an operating company and/or an originator of the assets) to a special purpose entity has generally relied on a two-pronged analysis: The first prong requires a conclusion that the transfer constitutes a “true sale” of the assets from the transferor to the SPE, under applicable state and U.S. bankruptcy law. The second prong requires a determination that the transferee and transferor are not subject to the equitable doctrine of “substantive consolidation,” which in certain cases may permit a bankruptcy court to treat otherwise separate legal entities as if they were a single company with the combined assets and liabilities of the original entities.

Revised paragraph 9(a), and new paragraphs 9(e) and A17, propose a new, third requirement as a condition to the determination of legal isolation under paragraph 9(a). As explained in paragraph A17, “[t]he Board learned that attorneys rendering true sale and nonconsolidation opinions might not consider or even know of (a) arrangements between the holders of beneficial interests issued by a qualifying SPE and a consolidated affiliate or agent of the transferor of financial assets and the transferee or (b) arrangements between a transferee and the consolidated affiliates or agents of the transferor. The Board decided to amend paragraph 9 to require that all such arrangements be considered in the isolation analysis *as if those arrangements had been made directly between the transferee and the transferor.*”<sup>2</sup> This requirement suggests that, for purposes of legal isolation, arrangements between, for example, a transferee of financial assets and a consolidated affiliate of the transferor are equivalent to, and should be treated as if such arrangements were, arrangements made by the transferee with the transferor. Put otherwise, the proposed revisions to paragraph 9 and new paragraph A17 demand that legal practitioners, in their determination of the legal isolation of a transferor, disregard the separateness of that transferor from its consolidated affiliates, and effectively *presume* that the transferor and such affiliates will be substantively consolidated in the event of the bankruptcy or insolvency of the transferor.

However, as noted by the Third Circuit Court of Appeals in the recent *In re Owens Corning* decision,<sup>3</sup> “there appears nearly unanimous consensus that [substantive consolidation] is a remedy to be used ‘sparingly.’”<sup>4</sup> Moreover, the *Owens Corning* court, in analyzing the “principles” to be advanced in the assessment of whether to order substantive consolidation, opined that “the general expectation of state law and of the Bankruptcy Code, and thus of commercial markets, is that courts respect entity

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<sup>1</sup> References in this letter to paragraph A17 are to paragraph A17 of Appendix A to the transfers exposure draft. All other references to paragraphs are to paragraphs in Appendix C to the transfers exposure draft.

<sup>2</sup> Paragraph A17 (emphasis added).

<sup>3</sup> *In re Owens Corning*, 419 F.3d 195 (3d Cir. Aug. 15, 2005).

<sup>4</sup> *Id.*, 419 F.3d at 209. In *In re Owens Corning*, the Third Circuit Court of Appeals went on to hold that a bankruptcy court should order the substantive consolidation of two entities only when “(i) prepetition [the entities for whom substantive consolidation is sought] disregarded separateness so significantly their creditors relied on the breakdown of entity borders and treated them as one legal entity, or (ii) postpetition their assets and liabilities are so scrambled that separating them is prohibitive and hurts all creditors.” *Id.*, 419 F.3d at 211.

separateness absent compelling circumstances calling equity (and even then only possibly substantive consolidation) into play”.<sup>5</sup> In sharp contrast to this approach, new paragraph 9(e) and paragraph A17 appear to dismiss the existence and integrity of the boundaries between affiliated entities, by requiring a “hypothetical consolidation” of the transferor and its consolidated affiliates.

This hypothetical consolidation, or presumed disregard of the separateness of the transferor from its consolidated affiliates, is at odds with the respect for entity boundaries mandated by governing “substantive consolidation” case law. The Committee respectfully requests that, to the extent that *legal isolation* is indeed the touchstone for determining surrender of control under paragraph 9(a) of the transfers exposure draft, paragraph 9(a) (as well as paragraphs 9(e) and A17) be revised as suggested in the ASF Letter, in order to reflect, and to be consistent with, the present state of case law upon which the determination of legal isolation is necessarily based.

## **2. Practical Difficulties in Applying the Additional Isolation Guidance to Asset-Backed Securities Transactions**

In addition to the objections to paragraph A17 of the transfers exposure draft raised by the ASF Letter, the Committee is also concerned by the practical implications of the proposal “to explicitly require that the isolation analysis include consideration of whether the transferred financial assets are also isolated from the consolidated affiliates of the transferor, other than a consolidated bankruptcy-remote entity,”<sup>6</sup> to the extent this proposal is intended to establish a due diligence requirement for attorneys in delivering “true sale,” non-consolidation or other similar opinions. The consideration of known affiliate arrangements is properly part of the bankruptcy isolation analysis for attorneys rendering such opinions. However, the Committee is concerned that, to the extent this provision requires attorneys to consider the activities of *all* consolidated affiliates of a transferor, the practical difficulties of timely compliance for transactional attorneys involved in the structured finance market, combined with the cost of such compliance (which could well be prohibitive), may effectively prevent, in common ABS transactions, the delivery of the basic opinions required to establish legal isolation for purposes of the paragraph 9 analysis under FASB Statement No. 140.

The problem is one of both scale and scope. Many frequent issuers of asset-backed securities are affiliates of, or are themselves, large, widespread organizations subject to the laws of multiple jurisdictions. Any requirement to review the activities of such an entity and all of its consolidated affiliates and to identify any activities that may have implications for the isolation analysis, particularly within the time and cost framework of tightly structured, market-sensitive securitization transactions, will in many circumstances represent a nearly insurmountable hurdle to the rendering of standard bankruptcy/insolvency-related opinions.

Accordingly, the Committee proposes that the requirement in paragraph A17 that “the isolation analysis include consideration of whether the transferred financial assets are also isolated from the consolidated affiliates of the transferor, other than a consolidated bankruptcy-remote entity,”<sup>7</sup> be clarified as it applies to attorneys rendering “true sale” and nonconsolidation opinions. To this end, paragraph A17 should be amended to specify that attorneys, in rendering such opinions, (i) should consider any such affiliate arrangements actually known to them (after asking their clients to disclose all such arrangements to them), (ii) may rely on representations or certifications of the transferor in determining whether any additional arrangements exist and (iii) should cover solely entities that are not bankruptcy-remote special purpose entities and that are in the chain-of-title of the transferred assets or have rendered support of some kind to the transactions at hand.

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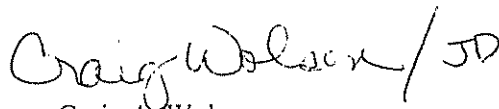
<sup>5</sup> *Id.*, 2005 419 F.3d at 211.

<sup>6</sup> Paragraph A17.

<sup>7</sup> *Id.*

The Committee appreciates the opportunity to comment and stands ready to assist the FASB with further information or other assistance regarding this important matter.

Very truly yours,

  
Craig A. Wolson

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