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Heads Up

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Register now for the June 25 Deloitte *Dbriefs* webcast, "FASB's Amended Guidance on Transfers of Financial Assets and Consolidation of Variable Interest Entities." This 90-minute special-edition webcast, which will take place at 2:00 p.m. (EDT), will discuss how the newly issued FASB Statements 166 and 167 could affect your organization.

FASB Issues New Standard on Transfers of Financial Assets.

by Stephen McKinney, Trevor Farber, and Magnus Orrell, Deloitte & Touche LLP

On June 12, 2009, the FASB issued Statement 166,[1] which amends the derecognition guidance in Statement 140.[2] Statement 166 reflects the Board's response to issues entities have encountered when applying Statement 140. In addition, Statement 166 addresses concerns expressed by the SEC, members of Congress, and financial statement users about the accounting and disclosures required by Statement 140 in the wake of the subprime mortgage crisis and the deterioration in the global credit markets. The Board believes these amendments will immediately improve the accounting for transfers of financial assets. However, the accounting may soon change again. The FASB expects to join the IASB in developing a common derecognition standard. That standard is expected to be issued in 2010, with an effective date to be determined at that time.

Statement 166 is effective for financial asset transfers occurring after the beginning of an entity's first fiscal year that begins after November 15, 2009 (thus, calendar-year-end companies must adopt it on January 1, 2010). Early adoption of Statement 166 is prohibited. In addition, because Statement 166 eliminates the exemption from consolidation for qualifying special-purpose entities (QSPEs), a transferor will need to evaluate all existing QSPEs to determine whether they must be consolidated in accordance with Statement 167,[3] which is also effective for an entity's first fiscal year that begins after November 15, 2009.

The table below summarizes the more significant provisions of Statement 166 and compares them with those of Statement 140 before the adoption of Statement 166. The table is followed by a more detailed discussion. Responses to various implementation questions are provided in the appendix.

Subject	Statement 166	Statement 140
QSPEs	Eliminates the concept of a QSPE.	Indicates that financial assets transferred to a securitization vehicle that qualifies as a QSPE are typically derecognized by the transferor.
Consideration of arrangements made in connection with a transfer	Explicitly requires a transferor to consider all arrangements made contemporaneously with, or in contemplation of, a transfer when determining whether derecognition is appropriate.	Does not explicitly require the transferor to consider all arrangements or agreements made in connection with a transfer when determining whether derecognition is appropriate.
Legal isolation of transferred financial assets	Clarifies the requirement that a transferred financial asset be legally isolated from the transferor and any of its consolidated affiliates.	Requires that a transferred financial asset be legally isolated from consolidated affiliates of the transferor.

[1] FASB Statement No. 166, *Accounting for Transfers of Financial Assets* — an amendment of FASB Statement No. 140.
[2] FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* — a replacement of FASB Statement No. 125.
[3] FASB Statement No. 167, *Amendments to FASB Interpretation No. 46(R).*

Subject	Statement 166	Statement 140
Transferee's ability to pledge or exchange transferred assets	Stipulates that constraints on the transferee's ability to freely pledge or exchange the transferred assets cause a transfer to fail to qualify for sale accounting. However, if the transferee is a special-purpose entity (SPE) that is solely engaged in asset-backed financings or securitizations, the transferor can look through the SPE to each holder of its beneficial interests when evaluating these constraints.	Stipulates that constraints on the transferee's ability to freely pledge or exchange the transferred assets cause a transfer to fail to qualify for sale accounting unless the transferee is a QSPE. The transferor can look through such a QSPE to each holder of its beneficial interests when evaluating these constraints.
Derecognition of a portion of a financial asset	Prescribes guidance on when a portion of a financial asset is eligible for derecognition. A portion of a financial asset is eligible for derecognition only if the transferred portion meets the strict definition of a participating interest.	Permits derecognition of a portion or a component of a financial asset.
Initial measurement of beneficial interests that are received by the transferor	Requires that a beneficial interest in a transferred financial asset received by the transferor be initially recognized at fair value. Also requires that a portion of a financial asset retained by the transferor after a transfer of a participating interest be initially measured on the basis of a relative fair value allocation of the previous carrying amount of the asset transferred.	Indicates that the transferor's beneficial interest in a transferred financial asset is initially recognized on the basis of a relative fair value allocation of the previous carrying amount of the asset transferred.
Transfers of mortgage loans to a guaranteed mortgage securitization (GMS)	Eliminates the ability to reclassify mortgage loans to Statement 115[4] securities or to recognize a servicing asset or servicing liability when a transfer to a GMS does not meet the derecognition requirements.	Allows a transferor to reclassify mortgage loans to Statement 115 securities and recognize a servicing asset or servicing liability if it transfers mortgage loans to a QSPE in a GMS, even if the transfer does not meet the derecognition requirements.

Since the issuance of Statement 140, a number of questions have arisen regarding what activities a QSPE can undertake.

QSPEs

Under Statement 140, a transfer of financial assets must meet several conditions to achieve sale accounting. One condition is that the transferee must have the ability to freely pledge or exchange the transferred assets. Because most securitization vehicles do not have this ability, Statement 140 exempts securitization vehicles that qualify as QSPEs from this requirement so that transfers to securitization vehicles could achieve sale accounting. This exception allows transferors to "look through" a securitization vehicle that is a QSPE and consider whether the investors in the securitization vehicle have the ability to freely pledge or exchange their beneficial interests. The exception is based on the premise that QSPEs are passive pass-through entities that receive a pool of financial assets and concurrently issue beneficial interests to their investors.

However, since the issuance of Statement 140, a number of questions have arisen regarding what activities a QSPE can undertake (e.g., whether an SPE can maintain its qualifying status when responding to unexpected events, such as when it has modified loans before actual default during the credit crisis). The FASB believes, on the basis of recent experience, that many entities that have been accounted for as QSPEs are not truly passive, a belief that challenges the premise on which the QSPE exception was based. Accordingly, Statement 166 eliminates the concept of a QSPE from the derecognition model. In addition, Statement 167 amends the consolidation and disclosure requirements related to QSPEs. For more information about the FASB's amendments to the consolidation guidance of Interpretation 46(R),[5] see Deloitte's June 16, 2009, *Heads Up* on Statement 167.

[4] FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*.

[5] FASB Interpretation No. 46(R), *Consolidation of Variable Interest Entities* — an interpretation of ARB No. 51.

Modification to the Derecognition Provisions

In conjunction with eliminating the concept of a QSPE, Statement 166 modifies the derecognition provisions in Statement 140. Specifically, Statement 166 (1) requires that all arrangements made in connection with a transfer of financial assets be considered in the derecognition analysis, (2) clarifies when a transferred asset is considered legally isolated from the transferor, (3) modifies the requirements related to a transferee's ability to freely pledge or exchange transferred financial assets, and (4) provides guidance on when a portion of a financial asset can be derecognized.

Consideration of Arrangements Made in Connection With a Transfer

Statement 140 does not explicitly require that all arrangements or agreements made in connection with a transfer of financial assets be considered in the derecognition analysis. This has resulted in diversity in whether arrangements made in connection with a transfer of financial assets are considered in (1) the legal isolation analysis and (2) the determination of whether the transferor has retained effective control over the transferred assets. To eliminate this diversity, Statement 166 requires that when determining whether a transferor has surrendered control over the transferred assets, an entity must consider all arrangements or agreements that are "made contemporaneously with, or in contemplation of, the transfer" of financial assets.

Statement 166 requires that when determining whether a transferor has surrendered control over the transferred assets, an entity must consider all arrangements or agreements that are "made contemporaneously with, or in contemplation of, the transfer" of financial assets.

Statement 166 also clarifies that in determining whether control over a transferred financial asset is surrendered, the transferor and all of the entities included in the financial statements being presented must assess whether the derecognition conditions have been met. Accordingly, arrangements or agreements with a transferee entered into by a consolidated affiliate of the transferor may result in the transferor's not achieving derecognition treatment.

Legal Isolation of Transferred Financial Assets

Statement 140 requires that to achieve derecognition, the transferor must surrender control over the transferred asset. Paragraph 9(a) of Statement 140 stipulates that one condition for surrendering control is that the transferred financial asset must be legally isolated from the transferor in the event of the transferor's bankruptcy or other receivership. However, because of questions and inconsistencies in practice regarding legal isolation, Statement 166 clarifies (1) when a transferor should consider obtaining a true sale or nonconsolidation opinion from its attorneys and (2) that a transferred financial asset must be isolated from the transferor and any of its consolidated affiliates that are included in the financial statements being presented (other than BRSPEs).

Editor's Note: Many constituents believe that Statement 140 already requires a transferor to consider its consolidated affiliates in its legal isolation analysis. These constituents point to paragraph 27 of Statement 140, which states, in part, "Derecognition of transferred assets is appropriate only if the available evidence provides reasonable assurance that the transferred assets would be beyond the reach of the powers of a bankruptcy trustee or other receiver for the transferor or any consolidated affiliate of the transferor . . . ." Nevertheless, the Board decided to clarify that the legal isolation analysis takes into account all consolidated affiliates of the transferor included in the financial statements presented, other than BRSPEs. Depending on an entity's previous interpretation of Statement 140, the Board's clarification may require a transferor to update its legal opinions to take into account the effect of a consolidated affiliate's involvements with transferred financial assets if there are transfers after the effective date of Statement 166.

Transferee's Ability to Pledge or Exchange a Transferred Asset

As previously stated, Statement 140 requires that to achieve derecognition, the transferor must surrender control over the transferred asset. Under paragraph 9(b) of Statement 140, for the transferor to surrender control over the transferred assets, the transferee must obtain control over these assets. For this condition to be met, the transferee must have the ability to freely pledge or exchange the assets obtained. However, because a securitization vehicle often is limited in its ability to pledge or exchange transferred assets, Statement 140 allows a transferor to "look through" certain securitization vehicles and consider whether the investors in the securitization vehicle have the ability to freely pledge or exchange their beneficial interest. Under Statement 140, that exception to "look through" the securitization vehicle is only allowed if the securitization vehicle meets the definition of a QSPE. However, because Statement 166 eliminates the concept of a QSPE, the Board modified the derecognition provision to permit a transferor to look through any type of SPE when the transferee is solely engaged in asset-backed financings or securitizations. The transferor can achieve derecognition in asset-backed financings and securitizations even if the SPE would not have been considered a QSPE under the current Statement 140, provided that the transferor is not required to consolidate the SPE and the derecognition criteria in Statement 166 are met.

Derecognition of a Portion of a Financial Asset

Statement 140 allows a transferor to derecognize a portion or a component of a financial asset. However, because Statement 140 does not provide explicit guidance on, or a description of, what is considered a portion or a component of a financial asset, questions have arisen about how a transferor determines whether it has surrendered control over a portion of a financial asset, particularly when it still maintains custody over the entire financial asset or provides financial or other support to the transferred portion of the financial asset. Therefore, Statement 166 modifies the derecognition requirement related to the accounting for transfers of a portion of a financial asset. Under the new requirement, a transfer of a portion of a financial asset is eligible for derecognition only if that portion meets the definition of a participating interest.

A participating interest is defined as a portion of a financial asset that (1) conveys proportionate or pro rata ownership rights with equal priority to each participating interest holder; (2) does not allow for recourse to, or subordination by, any participating interest holder; (3) does not entitle any participating interest holder to receive cash before any other participating interest holder; and (4) does not give any participating interest holder the right to pledge or exchange the entire financial asset unless all participating interest holders agree to pledge or exchange the entire financial asset. The Board believes that allowing derecognition of a portion of a financial asset only when the participating interest requirements are met resolves the question of when a transferor has surrendered control over a portion of a financial asset under Statement 140.

Statement 166 requires that all beneficial interests in transferred financial assets that are received by the transferor be initially measured at fair value rather than by an allocation of previous carrying amounts.

If the portion of a financial asset meets the definition of a participating interest, the transferor would still need to assess whether the transfer of the participating interest qualifies for sale accounting. Should the transfer of a portion of a financial asset not meet the definition of a participating interest or the participating interest not qualify for derecognition, the transferor would account for the transfer as a secured borrowing.

Initial Measurement of Beneficial Interests That Are Received by the Transferor

Statement 140 currently requires a transferor that receives an interest in transferred assets to initially measure its beneficial interest by allocating, on the basis of a relative fair value allocation as of the date of the transfer, the previous carrying amount between the portion of the assets sold and the portion retained. The FASB has subsequently concluded that beneficial interests that relate to transferred assets and that are received by the transferor are new assets of the transferor and should be initially measured consistently with the initial recognition of other financial assets. Accordingly, Statement 166 requires that all beneficial interests in transferred financial assets that are received by the transferor be initially measured at fair value rather than by an allocation of previous carrying amounts.

Editor's Note: This change may significantly impact the gain or loss that a transferor recognizes on a securitization transaction. Because a retained beneficial interest will be initially recognized at fair value rather than by an allocation of the previous carrying amount of the assets transferred, the difference between the carrying amount of the assets transferred and the fair value of the proceeds received (i.e., the sum of any cash or other assets received, "including beneficial interests and separately recognized servicing assets . . . less any liabilities incurred, including separately recognized servicing liabilities") will be the transaction gain or loss. Under the current guidance in Statement 140, recognition of a portion of this difference is deferred as a component of the cost basis in the beneficial interest that is retained by the transferor.

While a beneficial interest in transferred assets that is received by the transferor is considered a new asset of the transferor, Statement 166 clarifies that a portion of a financial asset that is retained by the transferor in a transfer of a participating interest is not a new asset and should not be measured at fair value. (This is consistent with the Board's view that a participating interest has risk characteristics that are identical to the portion of the financial asset that was not transferred.) Therefore, under the amended guidance, a participating interest that is retained by the transferor should be initially measured by allocating, on a pro rata basis as of the date of the transfer, the previous carrying amount between the participating interest sold and the participating interest that continues to be held.

Transfers of Mortgage Loans to a Guaranteed Mortgage Securitization

Transferring mortgage loans to a QSPE in a GMS is a common transaction in the mortgage banking industry. Statement 140 allows an entity that transfers mortgage loans to a QSPE in a GMS to reclassify the transferred mortgage loans to Statement 115 securities even if the transfer does not achieve sale accounting. In addition, pursuant to Statement 156,[6] an entity that transfers mortgage loans to a GMS can recognize a servicing asset or liability for the right or obligation to service the mortgage loans even if the transfer did not qualify as a sale.

The FASB decided to eliminate this exemption in Statement 166. Accordingly, an entity will only be able to reclassify mortgage loans to Statement 115 securities and recognize a servicing asset or servicing liability if the transfer meets the conditions for derecognition.

The disclosures in Statement 166 will be required for both public entities and nonpublic entities.

Additional Disclosure Requirements

The amendments to Statement 140 include additional disclosure requirements to address financial statement users' concerns regarding the transparency of transfers of financial assets. The disclosure requirements are generally consistent with, and supersede, those included in FSP FAS 140-4 and FIN 46(R)-8,[7] issued in December 2008. However, the disclosures in Statement 166 will be required for both public entities and nonpublic entities.

The additional disclosure requirements primarily focus on the transferor's continuing involvement with transferred financial assets and the related risks retained. Accordingly, transferors must disclose (1) whether they provided financial or other support to the transferee (or its beneficial interest holders) that they were not previously contractually required to provide, including the primary reasons for providing the support, and (2) details of any arrangements that could require any future financial support. Statement 166 states that this includes, but is not limited to, any future financial support that could result from "explicit written arrangements, communications between the transferor and the transferee or its beneficial interest holders, and unwritten arrangements customary to similar transfers." Financial statement preparers must also provide details about any SPEs involved in the transfer, including the nature, purpose, size, and activities of the SPE, and how it is financed.

6 FASB Statement No. 156, *Accounting for Servicing of Financial Assets* — an amendment of FASB Statement No. 140.

7 FASB Staff Position No. FAS 140-4 and FIN 46(R)-8, "Disclosures by Public Entities (Enterprises) About Transfers of Financial Assets and Interests in Variable Interest Entities."

Appendix — Implementation Questions and Answers

Transition

Should the transfer of a financial asset that was accounted for under Statement 140 be reassessed upon the adoption of Statement 166?

Statement 166 must be applied prospectively to transfers of financial assets occurring on or after its effective date. Accordingly, transferors should not reevaluate historical transfers of financial assets under the derecognition criteria in Statement 166. For example, the transferor would not be required to assess whether the transfer of a portion of an asset that occurred before Statement 166's effective date and was derecognized meets the definition of a participating interest.

In addition, the transferor of an asset that was precluded from derecognition under Statement 140 may not reassess derecognition of the financial assets solely as a result of the adoption of Statement 166. For example, if a financial asset was transferred to an SPE that is not qualifying and the SPE is constrained from pledging or exchanging the transferred assets, the transfer is generally precluded from sale treatment under Statement 140.[8] The transferor cannot reassess its accounting conclusion as a result of adopting Statement 166, even though the Statement may allow for derecognition of the transfer on the basis of its revised "look through" provisions. However, an entity must consider the guidance in Statement 167 to determine whether consolidation of the SPE is required.

If an entity has established a revolving structure under which it periodically transfers financial assets into a trust that was established before the effective date of Statement 166, how would it assess the transfer of financial assets into that trust after adopting Statement 166?

An entity that uses a revolving structure to securitize financial assets should assess whether transfers after the adoption of Statement 166, and that are part of a master arrangement entered into before the date of adoption, achieve derecognition under Statement 166. Entities should not rely solely on their previous conclusion for prior transfers to the trust, but may need to update their legal isolation analysis for the amendments in Statement 166 or update their analysis for the transfer of a portion of an asset to ensure that they comply with the participating interest requirements. In addition, an entity must also consider the guidance in Statement 167 to determine whether the revolving structure must now be consolidated by the entity.

Gain/Loss on Transfer

How do the initial measurement provisions of Statement 166 impact the transferor's recognition of a gain or loss on a securitization transaction?

Statement 166 amends the initial measurement requirements for beneficial interests received by the transferor in exchange for the transferred assets. Therefore, the transferor's measurement of a gain or loss on the transfer may be significantly impacted. Because the beneficial interest received will now be initially recognized at fair value rather than by an allocation of the previous carrying amount of the assets transferred, the difference between the carrying amount of the assets transferred and the fair value of the proceeds received (i.e., the sum of any cash or other assets received, "including beneficial interests and separately recognized servicing assets . . . less any liabilities incurred, including separately recognized servicing liabilities") will be the transaction gain or loss. Under Statement 140, recognition of a portion of this difference is deferred as a component of the cost basis in the beneficial interest that is received by the transferor.

Participating Interests

How does a gain or loss that is paid up front or through an interest-only strip impact the assessment of the participating interest and, ultimately, whether derecognition is appropriate?

A transfer of a portion of a financial asset represents a participating interest if, among other things, the cash flows from the transferred financial assets are divided proportionately among the participating interest holders. Statement 166 indicates that "any cash flows received by the transferor as proceeds of the transfer of the participating interest shall be excluded from the determination of proportionate cash flows." When a transferor sells a participating interest in a loan and market interest rates have fluctuated after the loan's origination, the difference between the market interest rates and contractual rate of the loan represents the transferor's gain or loss on the sale. Although such amounts may be paid up front as a premium, the transferor will often retain an interest-only strip representing the gain or loss. Whether the gain or loss is paid up front or through an interest-only strip will impact the assessment of the participating interest and, ultimately, whether derecognition is appropriate.

Specifically, if the transferee pays the transferor up front for the amount representing the gain or loss, this amount should be excluded from the evaluation of the participating interest requirements since it would not result in a disproportionate sharing of risks. However, if an up-front payment is not made to the transferor but the transferor retains an interest-only strip representing

[8] As noted in Question 22A of FASB Staff Implementation Guide (Statement 140), "A Guide to Implementation of Statement 140 on Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities," in a transfer to an SPE that is not a QSPE, the transfer would meet the requirements of paragraph 9(b) if the transferor has no continuing involvement with the transferred assets.

the gain or loss, the cash flows on the interest-only strip should not be excluded from the evaluation of the participating interest requirements and derecognition would not be appropriate. The FASB concluded that derecognition is not appropriate when the transferor retains an interest-only strip, since the prepayment risk that the transferee and transferor are exposed to is disproportionate to their interests in the financial asset.

For example, assume that an entity originates a loan of $1,000 with a contractual coupon of 8 percent and subsequently sells a 50 percent interest in that loan in a declining interest rate environment where market rates for the loan are 6 percent. If the transferor retains a 2 percent interest-only strip representing the gain on the sale (i.e., transferees receive a 6 percent coupon), the participating interest requirements are not met and derecognition is not appropriate. However, if the premium representing the gain is paid up front (i.e., transferees receive an 8 percent coupon as part of their interest), derecognition may be appropriate.

How does a third-party guarantee impact the evaluation of a participating interest?

A transfer of a portion of a financial asset represents a participating interest if, among other things, the participating interest holders do not have recourse to any other participating interest holder (other than standard representations or warranties, as defined in Statement 166, and obligations to (1) service, (2) administer, and (3) share in setoff benefits). Statement 166 indicates that cash flows subject to a third-party guarantor do not fail the analysis of a participating interest because the third-party guarantee is considered a "separate unit of account." The FASB's conclusion is based on its belief that a third-party guarantee represents a separate arrangement in which the guarantor will assume ownership of the participating interest in the event of default (i.e., upon default, the third-party guarantee no longer exists, since the guarantor assumes the ownership of the participating interest and the rights and obligations of the other participating interest holders do not change).

Should an entity subsequently reassess a transfer of a portion of a financial asset that does not meet the definition of a participating interest to determine whether the participating interest definition is met?

Statement 166 does not specifically address subsequent reevaluations of whether a portion of an asset is a participating interest. It states that when a participating interest holder's recourse to the transferor expires, the "transferred portion shall be reevaluated to determine if it meets the participating interest definition." When the recourse to the transferor or the rights of a participating interest holder change, as a result of either the passage of time or a modification to the transfer arrangement, the transferor is required to reassess its participating interest conclusion.

Legal Isolation

Will the amendments in Statement 166 impact an entity's evaluation of the legal isolation requirement?

Statement 166 provides more detail than Statement 140 about the items an entity should consider when performing a legal isolation assessment. For example, Statement 166 stipulates that when performing its derecognition assessment (including the legal isolation analysis), an entity must consider all of the entities in the financial statements being presented (although many believe that paragraph 27 of Statement 140 already requires a transferor to consider its consolidated affiliates in its legal isolation analysis). An entity should consider the additional guidance in Statement 166 when performing its legal isolation assessment for any future transfers. The entity may need to update prior legal opinions to take into account the additional guidance in Statement 166 when such opinions are the basis for future assessments (e.g., the opinion is used in a future similar transfer).

Transferee Constraints

Will transfers to an entity that was previously considered a QSPE still qualify for derecognition?

Statement 140 allows an enterprise that transfers financial assets to a securitization vehicle that meets the definition of a QSPE to derecognize the transferred assets when the transferee was constrained from pledging or exchanging the assets but the beneficial interest holders were not (provided that the transfer also satisfies the conditions in paragraphs 9(a) and 9(c) of Statement 140).

Because Statement 166 removes the concept of a QSPE, the FASB modified these requirements; otherwise, most transfers of financial assets to securitization vehicles would fail to qualify for sale accounting because the transferee does not have the ability to freely pledge or exchange the transferred assets. Therefore, Statement 166 allows a transferor to look through a transferee's beneficial interest holders if the transferee is an "entity whose sole purpose is to engage in securitization or asset-backed financing activities." Accordingly, the transferor should "look through" such an SPE when evaluating whether there are any restrictions on the transferee's ability to pledge or exchange transferred assets, even if the entity would not have been considered a QSPE under the previous guidance.

However, when evaluating whether it should derecognize a financial asset, an entity must consider whether it and any of the entities included in its financial statements being presented have surrendered control of the asset. As a result of the modifications to Interpretation 46(R) by Statement 167, which is also effective for an entity's first fiscal year that begins after November 15, 2009, the transferor may be required to consolidate many entities used in securitization and asset-backed financing transactions. Although Statement 166 expands on which entities the transferor is permitted to "look through" when transferability restrictions are imposed on the transferee entity, if the transferee entity is consolidated by the transferor, derecognition would be precluded.

Disclosures

How will the disclosure requirements change as a result of the issuance of Statement 166?

The FASB issued FSP FAS 140-4 and FIN 46(R)-8 in December 2008 to accelerate the requirement for **public** companies to provide additional disclosures about the transfers of financial assets. Statement 166 incorporates those disclosure requirements. In addition, the disclosure requirements will now apply to private companies as well.

Other

How does a lack of continuing involvement affect an entity's derecognition analysis?

Statement 166 indicates that if the transferor has no continuing involvement with the transferred financial assets, the lack of continuing involvement would take precedence in the evaluation of whether a transferee is constrained from pledging or exchanging the transferred financial assets (i.e., derecognition may be allowed when the transferor has no continuing involvement, even if the transferee is constrained in its ability to pledge or exchange the transferred financial assets). A transferor is still required to assess whether the transfer satisfies the other derecognition conditions of Statement 166.

Accounts Receivable Securitizations

Will the transfer of trade receivables to a BRSPE that subsequently issues interests in the BRSPE qualify for derecognition?

An accounts receivable securitization may be structured so that the transferor first transfers its trade receivables to a BRSPE, which it consolidates for financial reporting purposes. The BRSPE then issues two classes of participation certificates. Typically, the senior class of participation certificates is sold to a third party (such as a multiseller commercial paper conduit) and the junior certificates are retained by the entity. Before the adoption of Statement 166, these transactions could result in the derecognition of the senior participation certificates in the entity's consolidated financial statements. However, under Statement 166, an entity will need to evaluate the transfer of the senior certificates to determine whether they meet the definition of a participating interest. Because the participation certificates do not share the same priority, it is unlikely that they will meet the definition of a participation interest, and the transaction would be accounted for as a secured borrowing.

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