



VIA ELECTRONIC MAIL

October 10, 2005

Mr. Lawrence W. Smith  
Director, Technical Application and Implementation Activities  
Financial Accounting Standards Board  
401 Merritt 7, P. O. Box 5116  
Norwalk, Connecticut 06856-5116

File Reference: 1220-001

Dear Mr. Smith:

The Mortgage Bankers Association<sup>1</sup> is very pleased to have the opportunity to comment on the Exposure Draft, *Accounting for Servicing of Financial Assets* (the ED) which, if adopted, would amend FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets & Extinguishments of Liabilities* (FAS 140), to permit servicers to elect to subsequently measure their servicing rights at fair value. MBA has been looking forward to reviewing the ED since the Board decided last year to develop an elective fair value measurement approach for servicing rights. In fact, many of our members are looking forward to applying the guidance in the ED and are hopeful that it will be adopted in final form as soon as possible.

MBA follows the work of the FASB very closely, and recognizes how full the FASB agenda has been this past year, and how often the Board receives requests to undertake new projects. We also recognize that the Board decided to draft the ED largely to reduce mortgage bankers' costs of qualifying their mortgage servicing hedging activities for hedge accounting treatment under FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities* (FAS 133). For both reasons, we sincerely appreciate the FASB's efforts to develop the ED.

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<sup>1</sup> The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 500,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership and extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 2,900 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, Wall Street conduits, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web site: [www.mortgagebankers.org](http://www.mortgagebankers.org).

## I. MBA Position

MBA strongly supports an elective fair value approach for subsequently measuring servicing rights because it will reduce many of our members' FAS 133 compliance costs while ensuring that the economics of their mortgage servicing hedging activities are accurately reflected in their financial statements in the future. MBA also supports an elective approach because it will provide entities with the opportunity to align risk management strategies with the appropriate accounting and reporting treatment for their servicing rights. MBA therefore strongly supports the guidance in the ED although we believe the Board should consider adopting a measurement approach that is less encompassing than the proposed "class of servicing rights" approach.

Our specific thoughts and recommendations with respect to the proposed elective approach, and other guidance in the ED, are described below.

## II. Specific MBA Comments

### A. Election by Major Asset Type

Paragraph 3.c. of the ED would amend paragraph 13 of FAS 140 to permit an entity to elect, at the beginning of each fiscal year, to report classes of servicing rights at fair value based on major asset type, as follows:

"...The election described in this paragraph shall be made separately for each class of servicing assets and liabilities. An entity shall apply the same subsequent measurement method to each servicing asset or liability in a class. The class of servicing assets and liabilities shall be determined based on the major asset type being serviced as described in paragraph 17(h) (for example, mortgage loans, credit card receivables, and auto loans)..."

Based on the foregoing, a class of servicing assets and liabilities would be determined by "major asset type," which is a reference to the nature of the collateral backing a security, rather than to specific characteristics that distinguish the collateral. Thus, as proposed, an entity seeking to measure its 1-4 single family residential mortgage servicing rights at fair value presumably would be required also to measure its commercial mortgage servicing rights at fair value.

MBA notes, however, that the Board tentatively has accepted an "instrument-based" approach for subsequently measuring certain financial instruments<sup>2</sup> at fair value. MBA also notes that guidance in the ED, *Accounting for Certain Hybrid Financial Instruments*, would permit entities to elect to measure certain hybrid instruments by instrument, rather than by class of instrument. Consequently, MBA now believes the Board should consider allowing servicers to elect to measure their servicing rights at fair value on a more specific basis than the proposed "portfolio-based" approach.

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<sup>2</sup> As indicated by the most recent update of the Board's Fair Value Option Project.

In considering an “instrument-based” measurement approach for servicing rights, our members agreed that it would be desirable in terms of its consistency with the proposed approach for measuring certain hybrid and other financial instruments. However, they also agreed that it would be impracticable to apply to servicing rights and would unnecessarily complicate the analysis and comparability of servicers’ financial statements. As an alternative, they believe that an approach that relies on some objective breakout of assets within “classes of assets” would provide a more reasonable application and greater consistency in reporting across entities.

Specifically, MBA recommends that the Board consider permitting a fair value election based on the separate mortgage loan types listed in Schedule RC-C, Loans and Lease Financing Receivables, of the Instructions to the June 2005 Call Report.<sup>3</sup> Alternatively, MBA recommends that the Board consider permitting the fair value election to be applied to servicing rights on the loan types listed in § 210.9-03 of SEC Regulation S-X.<sup>4</sup> Under this type of approach, if the election were based on the Schedule RC-C, an entity would be permitted to elect to subsequently measure its servicing rights on first lien closed-end loans secured by 1-4 family residential properties (see 1.c (2)(a) of Schedule RC-C) at fair value, without simultaneously having to subsequently measure its loans secured by multifamily residential properties (see 1.d. of Schedule RC-C)<sup>5</sup> at fair value.

An elective approach for servicing rights that is based on a third party breakout of the collateral being serviced would have several advantages. For example, it would be:

- More consistent with the “instrument-based” approach under consideration by the Board for measuring hybrid instruments and other financial instruments which would permit entities some discretion in applying the election to instruments with different characteristics;
- Objective, and therefore subject to minimal interpretation and variability in application; and
- Accommodate major differences in the contractual terms and other factors that influence mortgage servicing values. For example, the values of commercial mortgage servicing rights are relatively insensitive to changes in interest rates because such servicing contracts generally include “yield maintenance provisions” which impose on borrowers an obligation to pay servicers a significant fee in the event they prepay a commercial mortgage loan.

A more specific elective approach that would allow servicers to distinguish between servicing rights with different valuation and risk characteristics would also ease our members’ concerns about embracing a change in accounting for one of the most significant, in many cases the second largest asset, and most volatile assets, on their balance sheets.

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<sup>3</sup> See page 18 of [http://www.ffiec.gov/PDF/FFIEC\\_forms/FFIEC031\\_20050930\\_f.pdf](http://www.ffiec.gov/PDF/FFIEC_forms/FFIEC031_20050930_f.pdf)

<sup>4</sup> See <http://www.sec.gov/divisions/corpfin/forms/regsx.htm#separate>

<sup>5</sup> MBA notes that the Board has relied on the Call Report in developing previous guidance, as indicated in footnote 1 of DIG Issue C13, *When a Loan Commitment is Included in the Scope of Statement 133*, which was largely incorporated into FAS 133 by FAS 149, refers to the instructions to the bank Call Reports for definitions of loan commitments.

B. Preference for Fair Value Reporting

MBA is concerned that the Board's stated preference for a fair value election, in combination with the guidance in Statement No. 154, *Accounting Changes and Error Corrections* (FAS 154), and the proposed disclosures in the new subparagraph 17.f.(1), could put entities that elect to subsequently measure their servicing rights at lower of cost or market value at odds with their auditors and audit committee members. This could occur if the Board's preference is interpreted as an indication that *all* servicing rights must be measured at fair value unless there is some unusual or compelling reason not to do so. Indeed, the following excerpts from the guidance in the ED and FAS 154 could lead a reasonable person to conclude that a servicer should elect the fair value option absent some unusual reason for not doing so.

The excerpts read as follows:

- Paragraph 3.c. of the ED, which would amend paragraph 13 of FAS 140, contains the following statement:

"...The fair value measurement method is preferable to the amortization method for purposes of justifying a subsequent change in accounting principle under FASB Statement No. 154, *Accounting Changes and Error Corrections*..."

- Paragraph 14 of FAS 154 reads:

"The issuance of an accounting pronouncement that requires use of a new accounting principle, interprets an existing principle, *expresses a preference for an accounting principle*, or rejects a specific principle *may require an entity to change an accounting principle*. The issuance of such a pronouncement constitutes sufficient support for making such a change provided that the hierarchy established for GAAP is followed. The burden of justifying other changes in accounting principle rests with the entity making the change." (Emphasis added)

- And, paragraph 3. of the ED proposes the following additional disclosure:

"17.f. For servicing assets and liabilities subsequently measured at fair value:

(1) The classes of servicing assets and liabilities amortized and management's basis for its decision not to subsequently measure those classes of servicing assets and liabilities at fair value."

To ensure that the guidance in the ED is permitted to be applied as intended (i.e. that a fair value measurement approach is not mandatory), MBA recommends that the Board:

- Clarify that the first statement above (under paragraph 3.c. of the ED) is intended to convey that an entity that elects to subsequently measure its servicing rights at fair value would not have to justify the change pursuant to FAS 154.

- Include language in the final guidance indicating that the Board's expressed preference for fair value is not intended to signal that an entity's selection of the LOCOM measurement approach is inappropriate or inconsistent with GAAP.
- Eliminate the phrase in proposed new subparagraph 17.f. (1) that would require management to explain the basis for its decision not to elect to report its servicing rights at fair value.

#### C. Reclassification of Available-for-Sale Securities at Transition

MBA believes the ED should include a transition provision to permit entities a one-time election to reclassify their available-for-sale (AFS) securities (utilized to hedge their servicing rights) as trading securities. If entities that currently use AFS securities to hedge their servicing rights are not permitted to make this election, they may continue to report their servicing rights at LOCOM to match the economics of their servicing rights and their AFS securities. A one-time reclassification opportunity would also serve the Board's objective of requiring these instruments to be reported at fair value in the future.

We believe the election should be permitted to be applied:

- By entities that use their AFS securities to hedge changes in the values of their mortgage servicing rights;
- Irrevocably, such that once the reclassification is made, the securities can never be reclassified; and
- As a cumulative effect adjustment to beginning retained earnings, consistent with the transition to an elective measurement approach for servicing rights.

MBA also recommends that no parameters be specified for reclassifying AFS securities consistent with the Board's recent decision, within the Fair Value Option Project, not to impose "eligibility criteria" on the fair value election. The Board members reasoned that making the fair value option broadly available is more consistent with their ultimate objective of requiring such securities to be reported at fair value in the future.

### III. Conclusion

Again, MBA greatly appreciates the Board's efforts to develop the ED. Many of our members are looking forward to measuring their servicing rights at fair value and are hopeful that they can do so by the proposed dates in the ED. Consequently, we urge the Board to move quickly to release the guidance in the ED in final form as soon as possible.

In undertaking to finalize the guidance in the ED, we again recommend that the Board:

- Consider adopting a less encompassing measurement approach than the proposed "class of servicing rights" approach. MBA recommends that the Board consider permitting servicers to measure their servicing rights based on a third-party breakout of assets such as the Schedule RC-C of the Instructions to the June 2005 Call Report or § 210.9-.03 of SEC Regulation S-X;

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- Clarify that the expressed preference for the fair value measurement method in the guidance is intended to convey that servicers that elect to adopt the proposed change in accounting principle for servicing rights that are reported at fair value are not required to justify the change pursuant to FAS 154, and eliminate the phrase in proposed new subparagraph 17.f.(1) of the ED that would require management to disclose the basis for its decision not to report servicing assets and liabilities at fair value; and
- Include a transition provision that would permit servicers a one-time opportunity to reclassify their AFS securities as trading securities, pursuant to the parameters described herein.

For more information about our comments on the ED, please contact Alison Utermohlen, Senior Director of Government Affairs and Staff Representative to MBA's Financial Management Committee. Alison can be reached directly at (202) 557-2864 or [autermohlen@mortgagebankers.org](mailto:autermohlen@mortgagebankers.org).

Most sincerely,

A handwritten signature in black ink, appearing to read "Jonathan L. Kempner". The signature is written in a cursive, flowing style.

Jonathan L. Kempner  
President and Chief Executive Officer