



Fair Value Election for Servicing Rights and Loans



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Regulatory Perspective

- Regulatory view on expanded use of fair value
 - Views expressed in comment letters
 - Basel Committee's supervisory guidance
- Regulatory activities relevant to use of fair value
 - Capital guidance
 - Potential reporting modifications



Views in Comment Letters

- FAS 157 – Fair Value Measurements
 - Federal Reserve letter
 - Encourages FASB to conduct additional research and provide more specific valuation guidance for illiquid instruments like many bank loans before expanding the use of fair value in financial statements
- Fair Value Option
 - Interagency letter
 - Expresses concern for expanded use of fair value for assets and liabilities that cannot be reliably measured, such as non-traded, illiquid financial instruments
- FAS 156 – Servicing Rights
 - Interagency letter
 - Supported the fair value option for subsequent measurement since it facilitates good risk management techniques for servicing rights by institutions managing servicing rights on a fair value basis



Basel Committee's FVO Supervisory Guidance

- Designed to provide supervisors with guidance on the prudential supervision of banks' implementation of the FVO
- Guidance refers specifically to IAS 39 but expected to be generally applicable to FVO standards in other national jurisdictions
- Guidance is not intended to set forth additional accounting requirements beyond those established by the appropriate accounting standard-setter
- U.S. banking regulators are considering FVO supervisory guidance and will look to the Basel Committee's guidance during the development process.

Document is available at:

www.bis.org/press/p060614a.htm



Basel Committee's FVO Supervisory Guidance

- Provides 7 principles to guide supervision of banks' implementation of the FVO
 - The first 4 address supervisory expectations relevant to use of the FVO
 - Focuses on the existence of appropriate risk management systems, restraint from using the FVO on instruments that do not have reliably determined fair values, and the supervisor's ability to request supplemental information
 - The last 3 address supervisory responsibilities relevant to use of the FVO
 - Focuses on actions supervisors should take when a bank utilizes the FVO including evaluation of risk management and control practices and adjusting capital, including removal of own credit risk adjustments



Regulatory Views on the Fair Value Option

- Fair value option for servicing rights and loans
 - Fair value option provides benefit to correct an accounting mismatch and provides an incentive for strong risk management
 - Concerned about the use of fair value option for items not traded in a liquid market
 - **Servicing rights** are traded occasionally but do not have a liquid market so supervisors have some concerns about the modeling capabilities of those using and reviewing use of the FVO
 - Some **loans** are traded in fairly liquid markets but most are not – supervisors have concerns about model-driven valuations of illiquid loans, especially if the FVO is used for purposes other than to reflect appropriate risk management activities
 - Loss of the ALLL where the FVO is used for loans
 - Supervisors have encouraged disclosure requirements for certain credit risk information comparable to what would be available if an ALLL were reported



Regulatory Activities

- Capital guidance
 - Plan to reverse impact to capital attributable to “own credit risk” for liabilities measured at fair value
 - No change currently contemplated for servicing rights concentration limit
- Regulatory reporting modifications
 - Plan to capture certain fair value data
 - Focus on use of the FVO and “Level 2” and “Level 3” measurements
 - Target implementation date: 2007 reports



Questions

