



VIA ELECTRONIC MAIL

January 11, 2006

Patricia A. Donoghue
Project Manager
Financial Accounting Standards Board
401 Merritt 7, P. O. Box 5116
Norwalk, Connecticut 06856-5116

RE: SR Amendment Cold Review Draft

Dear Ms. Donoghue:

The Mortgage Bankers Association (MBA) was very pleased to be invited to review the guidance in the referenced final draft of proposed Statement No. 156, *Accounting for Servicing of Financial Assets*, for potential operational issues, consistency in the standards and the basis for conclusions sections, and possible improvements in content and wording. Our review detected concerns relating to a few proposed disclosures, and several opportunities for simple wording clarifications. MBA believes our recommended changes will improve the guidance in the draft and render it ready for application by the mortgage banking industry.

I. MBA Position

MBA strongly supports the guidance in the draft, including changes from the Exposure Draft (ED) relating, primarily, to how a “class of assets” shall be determined for purposes of applying the fair value election, whether available-for-sale securities that are used as hedges of servicing rights can be reclassified as “trading” securities, and whether entities must disclose their reasons for deciding, or not deciding, to subsequently measure their servicing rights at fair value. MBA believes these changes will ease transition to the guidance for all servicers of financial assets, and permit an appropriate amount of flexibility in application of a change in accounting principle for an asset that represents, for many mortgage banking companies, the second most significant asset on their balance sheets. MBA believes, however, that the guidance in the draft can be improved further, as explained below.

II. MBA Recommendations

A. Eliminate Proposed Disclosure Relating to Impact of Fair Value Measurement

Paragraph 8.A. **Initial Measurement and Disclosures Related to Fair Value**, under **Effective Date and Transition**, (page 27 of draft) includes the following proposed new disclosure which did not appear in the August 11, 2005, ED:

"8. An entity shall disclose the following in the first fiscal year in which separately recognized servicing assets and servicing liabilities are subsequently measured at fair value (the change in accounting principle):

- a. The method of applying the change and an estimate of the effect of the change on income from continuing operations, net income (or other appropriate captions of changes in the applicable net assets or performance indicator), any other affected financial statement line item, and any affected per-share amounts for the current period. Presentation of the estimate of the effect on financial statement subtotals and totals other than income from continuing operations and net income (or other appropriate captions of changes in the applicable net assets or performance indicator) is not required."

MBA believes this disclosure is intended to capture the affect on periodic income of a change to fair value for classes of servicing assets and liabilities. However, because the affect on income of such a change (for entities that use derivatives to hedge their servicing rights) would include the effects of changing their hedging instruments and strategies due to a change in the reported values of the hedged servicing rights, the disclosure would have to reflect the affect on income of the change in measurement of the servicing rights as well as changes in the instruments used to hedge them.

For example, servicers typically hedge their servicing rights for the risk that changes in fair value will impact their reported earnings. Under a lower of cost or market (LOCOM) approach, the impact on earnings would be more one-sided, so there would be more volatility in anticipated earnings, based on the results of hedge effectiveness testing. Under the fair value election, there would be less earnings volatility, as both unrealized gains and losses on the servicing rights and hedge instruments would impact reported earnings, regardless of hedge effectiveness. Since there would be different risks to the earnings of the company given the different accounting methods, a company would possibly hedge differently or use different hedge instruments depending on which method is used to account for their servicing assets.

As most constituents that are likely to adopt fair value accounting are entities that currently hedge their servicing rights using derivative instruments, this disclosure would require them to maintain "phantom" hedges assuming the servicing rights are still accounted for at LOCOM, including performing associated hedge effectiveness testing in order to measure the impact on income had fair value accounting not been elected. In effect, these entities would have to maintain two sets of books (and phantom hedge assumptions) in order to provide this disclosure. MBA believes this would impose an unreasonable, confusing and costly burden on reporting entities for no benefit to users of their financial information.

Indeed, the resulting disclosures would be meaningless to users of servicers' financial information as the reported impact on income would be based on conjecture rather than actual events. In fact, MBA believes the disclosure would likely be impossible to determine as an entity would have to speculate regarding the risk management actions they would take to protect an asset carried at LOCOM, rather than at fair value. Given the infinite number of scenarios that could be contemplated, any disclosure could be subject to challenge and would therefore be of no value to readers. Moreover, any attempt to perform this type of analysis would significantly add to the cost of compliance with the proposed Statement, and threaten to undermine the Board's objective of providing guidance that promotes fair value reporting of servicing rights.

For these reasons, MBA strongly recommends that this proposed disclosure be deleted in its entirety. Instead, the MBA recommends that the impact of electing fair value on beginning retained earnings be separately disclosed for financial statement readers.

B. Replace Proposed Rollforward Disclosures

MBA believes the proposed rollforward calculations in proposed paragraph 349.A. are confusing and would result in potential double-counting. For example, the "Change in value of FVSRs during period" would appear to be captured under the "Change in value recognized" category for servicing rights measured at fair value and at LOCOM. If the proposed disclosures were provided as indicated, the information would not reconcile the beginning to the ending balances.

Consequently, MBA recommends that the proposed disclosures be replaced with the following:

Tabular Disclosure of Changes in Servicing Assets and Servicing Liabilities Subsequently Measured at FV by Class

Balance Sheet disclosures

Beginning of the period amount of FVSRs	<u>XX</u>
Additions:	<u>XX</u>
Sales and Disposals:	<u>XX</u>
Change in value:	
Value realized during the period	<u>(XX)</u>
Due to changes in valuation	<u>XX/(XX)</u>
Ending balance of FVSRs	<u>XX</u>

Tabular Disclosure of Changes in Servicing Assets and Servicing Liabilities Not Subsequently Measured at Fair Value by Class

Balance sheet disclosures

	<u>Carrying Value</u>	<u>Fair Value</u>
Beginning of the period balance of SRs	<u>XX</u>	<u>XX</u>
Additions:	<u>XX</u>	
Sales and Disposals:	<u>(XX)</u>	
Amortization:	<u>(XX)</u>	
Application of valuation allowance to adjust carrying values of SRs:	<u>(XX)</u>	
FAS 133 adjustments	<u>XX/(XX)</u>	
Balance before valuation allowance at end of period	<u>XX</u>	
Valuation Allowance for Impairment of SRs		
Beginning Balance:	<u>XX</u>	
Provisions/Recoveries	<u>XX/(XX)</u>	
Application of valuation allowance to write down permanently impaired SRs	<u>XX</u>	
Ending Balance	<u>(XX)</u>	
End of the period balance of SRs	<u>XX</u>	<u>XX</u>

C. Recommended Wording Changes

Finally, MBA recommends that the Board adopt the following wording changes:

Change #1: Revise paragraph 6 under **Effective Date and Transition** on page 27 as follows:

~~"6. The requirements regarding initial recognition of servicing assets and servicing liabilities shall be applied prospectively to all transactions after the effective date of this Statement. Servicing assets and servicing liabilities that were recognized in connection with transactions that occurred prior to the effective date of this Statement shall continue to be recognized under the previous accounting standards."~~

MBA believes this paragraph is intended to address the initial recognition of servicing assets and liabilities only, rather than their initial recognition and ongoing accounting treatment. However, the second sentence of this paragraph suggests that servicing rights that were recognized prior to the adoption of the Statement must be accounted for in accordance with previous accounting standards. As that message is inconsistent with the rest of the guidance in the draft, we recommend that the sentence be deleted in its entirety and that "initial" be added to the first sentence.

Change #2: Revise paragraph 3.c. on page 3 under **Summary** and paragraph 2.c. on page 8 under **Scope** as follows:

~~"c. An acquisition or assumption that does not relate to financial assets that have been owned or previously are owned by the servicer or its consolidated affiliates."~~

MBA believes this condition is intended to preclude entities that currently own the assets from recognizing both the assets being serviced and the servicing rights as separate assets. However, as written this sentence would preclude entities that previously sold financial assets (such as mortgage loans) from later recognizing the servicing rights on those loans as their own assets if such servicing rights are acquired separately through direct purchase, or through acquisitions and mergers. As MBA does not believe this was the Board's intent, we recommend that the sentence be revised.

III. Conclusion

Again, the MBA greatly appreciates the FASB's work on this important change in accounting treatment of servicing rights. MBA believes this change represents a hallmark event in the evolution of the accounting treatment of servicing rights which will significantly reduce many of our members' costs of doing business while improving the accuracy of their financial reporting results. MBA urges the FASB to complete work on the proposed Statement as soon as possible to ensure that the fair value election can be elected, pursuant to the effective date and transition guidance in the draft, beginning January 1, 2006, for calendar year companies.

In completing work on the proposed Statement, MBA again urges the Board to:

- Delete the proposed disclosure in paragraph 8.A. of the draft and to replace it with a requirement that companies disclose the impact of the cumulative effect adjustment to retained earnings of the fair value election for classes of servicing rights. For reasons explained herein, the proposed disclosure would be very costly to provide and would add no value to readers of servicers' financial statements;

- Revise the proposed rollforward disclosures for servicing rights measured at fair value and at LOCOM as suggested to ensure that the beginning and ending balances reconcile;
- Eliminate the second sentence in paragraph 6. on page 27 to clarify that servicing rights recognized previous to the adoption of the guidance in the proposed Statement are not subject to pre-existing guidance;
- Revise the third condition in paragraphs 3.c. on page 3 and 2.c. on page 8 to clarify that servicers that acquire servicing rights through acquisitions of servicing portfolios, or through mergers and acquisitions, related to loans they previously owned, but no longer own, can be recognized as servicing assets.

Finally, MBA notes that the date on the draft is March 2006 whereas the date on the proposed Statement, *Accounting for Investments in Certain Hybrid Instruments*, is February 2006. If the second Statement is, in fact, intended for release next month, MBA urges that the proposed Statement on servicing rights be released next month also. An earlier release date will be extremely helpful to our members that intend to elect to report their servicing rights at fair value as of January 1, 2006, by reducing the potential for additional work in connection with meeting their March 31st quarter-end reporting deadlines.

If you have any questions about our comments or suggestions, please do not hesitate to contact me at autermohlen@mortgagebankers.org or directly by phone at 202/557-2864.

Sincerely,



Alison B. Utermohlen, CPA
Senior Director, Government Affairs