

Letter of Comment No: File Reference: 1220-001

KPMG LLP 757 Third Avenue 909-5600 New York, N.Y. 10017 9th Floor

Telephone 212-

Fax 212-909-5699

October 10, 2005

Technical Director—File Reference 1220-001 Financial Accounting Standards Board 401 Merritt 7 P.O. Box 5116 Norwalk, CT 06856-5116

FASB Exposure Draft: Proposed Statement of Financial Accounting Standards, Accounting for Servicing of Financial Assets, an amendment of FASB Statement No. 140

We appreciate the opportunity to comment on the FASB's Proposed Statement of Financial Accounting Standards, Accounting for Servicing of Financial Assets, an amendment of FASB Statement No. 140 (the Exposure Draft or Proposed Amendment). We believe that fair value is the most relevant measurement attribute for servicing rights and recognize that the Proposed Amendment is intended to advance that objective. However, while we generally support the Board's proposed approach, we believe there is a conceptual inconsistency between the proposed initial and subsequent measurement guidance for servicing rights and we have identified certain provisions of the Exposure Draft that should be clarified to ensure consistent application of the final guidance.

Paragraph 2(b) of the Exposure Draft permits entities, for each class of separately recognized servicing rights, to either (a) amortize the servicing assets or liabilities over the period of estimated net servicing income or net servicing loss and separately test those servicing rights for impairment by strata (the Amortization Method) or (b) measure the servicing assets or liabilities at fair value at each reporting date with changes in fair value reported in earnings (the Fair Value Measurement Method). As noted above, we believe that fair value is the most relevant measurement attribute for servicing rights. However, we understand that the fair value measurement alternative is intended to facilitate the Board's objective of achieving gradual improvement in the accounting standards for servicing rights, and we support that proposal as an incremental improvement over the current lower of amortized cost or market accounting model for servicing rights. However, we believe there is an inherent conceptual inconsistency in the Proposed Amendment's requirement to initially measure at fair value separately recognized servicing rights that an entity has elected to subsequently measure by applying the Amortization Method. We believe it would be more appropriate for the Board to require initial measurement at allocated carryover basis for classes of separately recognized servicing rights that an entity has elected to subsequently measure by



Technical Director – File Reference 1220-001 October 10, 2005 Page 2

applying the Amortization Method, unless the servicing rights are purchased or assumed rather than undertaken in a transfer of financial assets. We agree that initial measurement at fair value is appropriate for classes of separately recognized servicing rights that an entity has elected to subsequently measure under the Fair Value Measurement Method and for servicing rights that are purchased or assumed rather than undertaken in a transfer of financial assets.

We believe that it would be helpful for the Board to clarify the circumstances in which a separately recognizable servicing right would be deemed to exist. With respect to the recognition of servicing rights, paragraph 62 of Statement 140¹ states that "An entity that undertakes a contract to service transferred financial assets shall recognize either a servicing asset or a servicing liability, with only one exception" (emphasis added).² It further states that "Each sale or securitization in which servicing is obtained or each separate purchase or assumption of servicing results in a servicing contract... Each servicing contract results in a servicing asset or servicing liability." We believe that the reference to transferred financial assets in the first sentence of paragraph 62 is inconsistent with the later guidance in that paragraph indicating that separately recognizable servicing rights may exist even in the absence of a transfer of financial assets. As part of the clarification of paragraph 62, we recommend that the Board address whether it is appropriate to recognize a servicing right in instances in which the servicing right is acquired for consideration other than cash or other assets (e.g., by providing services to or assuming an obligation of the "seller" of the servicing right).

The Board should consider removing the phrase if practicable from paragraphs 2(a) and 3(a) of the Exposure Draft. We question whether that phrase is needed given the current impairment measurement requirements of Statement 140 that are applicable to separately recognized servicing rights.

Paragraph 3(c) of the Exposure Draft indicates that the election to apply either the Amortization or Fair Value Measurement Methods for subsequent measurement should be made separately for each class of servicing assets and liabilities and that classes should be determined based on the major asset type being serviced (e.g., mortgage loans, credit card receivables, and automobile loans). That guidance seems to suggest that, for example, all mortgage loans should be grouped together in a single class for purposes of making the election, regardless of tenor, rate, property type, or other features that

¹ FASB Statement No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities.

² Note that the quoted language includes proposed changes to Statement 140 from the FASB's Proposed Statement of Financial Accounting Standards, Accounting for Transfers of Financial Assets, an amendment of FASB Statement No. 140.



Technical Director – File Reference 1220-001 October 10, 2005 Page 3

economically differentiate such loans. We believe that the Board should consider allowing entities to make the election to apply either the Amortization or Fair Value Measurement Methods by "impairment strata," which have previously been used for disclosure and impairment testing purposes. That approach would appear to be more consistent with part of the Board's basis for providing a fair value measurement alternative for servicing rights as stated in paragraph A7 of the Exposure Draft: that is, to "eliminate the necessity for entities that manage the risks inherent in servicing rights with derivatives to qualify for hedge accounting treatment to avoid certain income statement effects that result from the use of different measurement attributes for derivatives and servicing rights."

Paragraph 6 of the Exposure Draft states that entities may make an irrevocable decision to subsequently measure an existing class of separately recognized servicing rights at fair value as of the *beginning* of any fiscal year that begins subsequent to the adoption of the Statement. The Board should clarify whether such an election could only be made on the first day of the fiscal year or whether that election could be made subsequent to the first day of the fiscal year retroactively as of the beginning of the year.

If you have any questions about our comments or wish to discuss any of the matters addressed herein, please contact either Mark Bielstein at (212) 909-5419 or Kimber Bascom at (212) 909-5664.

Sincerely,

KPMG LLP