Washington Mutual

Letter of Comment No: 13
File Reference: 1220-001

October 10, 2005

Ms. Suzanne Q. Bielstein
Director of Major Projects and Technical Activities
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Re: File Reference No. 1220-001—Proposed Statement of Financial Accounting Standards, *Accounting for Servicing of Financial Assets*, an amendment of FASB Statement No. 140

Dear Ms. Bielstein:

Washington Mutual, Inc. is a diversified financial services company with over $320 billion in total assets as of June 30, 2005. Based on those total assets, Washington Mutual is the largest savings institution and one of the largest financial institutions in the United States. It also is one of the largest residential mortgage loan originators and mortgage loan servicers in the nation. We appreciate the opportunity to comment on the proposed amendment to FASB Statement No. 140 regarding the accounting for servicing rights.

We support the Board's proposal to permit an entity to elect to account for servicing rights at fair value. The ability to elect the fair value method of accounting would allow companies to provide greater transparency to readers of financial statements, particularly for those entities that hedge servicing rights assets. An elective approach has the advantage of providing companies with the ability to eliminate the complexity and operational burden of applying hedge accounting under FASB Statement No. 133 (as amended), *Accounting for Derivative Instruments and Hedging Activities*, while not forcing companies that do not apply hedge accounting to account for servicing rights at fair value. While an elective approach might seem to create inconsistency in reporting for servicing rights, we believe that inconsistency exists already with some companies applying hedge accounting while others do not. On the contrary, we believe that the ability to apply fair value accounting to servicing rights would improve comparability and transparency among those companies that currently hedge their servicing rights, as some of those companies currently apply fair value hedge accounting under Statement 133 while others do not. Furthermore, fair value accounting would eliminate inconsistent applications of FASB Statement No. 140, *Accounting for Transfers and Servicing of*

Financial Assets and Extinguishments of Liabilities, that occur today with regards to stratification of servicing rights for purposes of assessing impairment, amortization of servicing rights, and recognizing other than temporary impairment for servicing rights assets.

The Board has proposed several additional disclosure requirements to create transparency around the use of two different methods of accounting for servicing rights. Although we are concerned that compliance with those extensive additional disclosure requirements might be operationally burdensome for some companies, we agree that those proposed disclosures would improve comparability for readers of financial statements under the proposed elective fair value approach. We also believe that the proposed disclosures might encourage companies to use the fair value method.

While we generally support the guidance provided in the Exposure Draft (ED) of the proposed amendment of FASB Statement No. 140, *Accounting for Servicing of Financial Assets*, we do believe that certain changes would significantly improve its application in practice. Following are our suggestions for changes that we would like the Board to consider in their redeliberations of the proposed amendment.

Application to Smaller Groups of Similar Servicing Rights

The ED requires the fair value election to be applied to all servicing rights for broad classes of assets (e.g., mortgage loans or credit card receivables). We believe that requirement is too restrictive and would inhibit rather encourage many companies from electing the fair value method. Companies should be permitted to apply the fair value method to smaller groups or sub-classes of servicing rights that share similar economic risks and characteristics. Similar to the way that companies determine their hedging strategies for servicing rights, a company might want to apply the fair value method only to certain portions of its servicing rights. Another problem with requiring election at such a broad level is that some servicing rights within a broad asset class might be more difficult to value because they thinly traded or less marketable. Consequently, their values might be less reliable and subject to greater volatility. For example, it might be more difficult or complex to determine the fair value of sub-prime loans than prime loans, as there are fewer observable market inputs available for sub-prime loans. In that case, a company might be reluctant to apply the fair value method if it felt uncomfortable with the level of reliability for a certain portion of its servicing rights under a broad asset class.

Originally, this project was part of the larger project to permit a fair value accounting option to all financial (and similar) instruments. Our understanding is that the project to consider fair value accounting for servicing rights was separated in order to permit that issue to be considered and guidance issued sooner. The Board has reached a tentative conclusion under the fair value option project for all financial instruments that the

election should be made at the individual instrument level. That conclusion seems inconsistent with the Board's tentative conclusion on this project to require application on a much broader level. We see no reason why such large discrepancy should exist and believe that the gap should be narrowed by permitting companies to apply the fair value election to similar groups of servicing rights within a broad asset class. In the spirit of a principles-based approach, we believe that guidance similar to existing guidance in Statement 140 regarding stratification of servicing rights for assessing impairment would be sufficient for determining what represents a group of similar servicing rights. We believe that the main underlying objective of the proposed amendment is to promote rather than restrict the use of fair value accounting for servicing rights. Consequently, the Board's concerns that guidance would need to be developed similar to the one used to determine groups of similar assets for purposes of fair value hedge accounting under Statement 133 is unwarranted.

Reclassification of Available for Sale Securities to Trading

A significant benefit of the fair value election is to permit companies to provide more transparency through symmetrical accounting between servicing rights and the financial instruments used to hedge those assets. One major type of financial instrument used by many companies to hedge servicing rights is investment securities (e.g., mortgage-backed securities and U.S. Treasury and Agency bonds). Due to the mixed accounting model that currently exists, most companies have classified investment securities used to economically hedge servicing rights as *available for sale.* That way, changes in fair value do not need to be recognized in earnings until the investments are sold to offset changes in the value of economically hedged servicing rights that are recognized in earnings (e.g., impairment).

When companies elect to apply the fair value method, we believe that they should be permitted to reclassify those securities used to economically hedge servicing rights that are classified as *available for sale* to *trading* without jeopardizing the classification of other available for sale securities. FASB Statement No. 115, *Accounting for Marketable Debt and Equity Securities*, states that transfers to *trading* should be rare. As the fair value election for servicing rights would be based on new accounting guidance that could not have been foreseen when the investment securities originally were classified as available for sale, we believe that permitting those securities to be reclassified as *trading* would be consistent with the notion that such transfers should be rare and based on unforeseen events.

The Board has expressed concern that it might be difficult for companies to distinguish which securities were designated as economic hedges of servicing rights. In order to properly evaluate its risk exposure to impairment losses on servicing rights, a company must know what investment securities are designated as economic hedges of those assets. If that designation is not properly documented such that those securities are clearly

identified, then an economic hedge probably does not exist. Nevertheless, the inability of some companies to demonstrate which investment securities are acting as economic hedges of servicing rights should not result in all companies being penalized and prohibited from redesignating investment securities acting as economic hedges of servicing rights from *available for sale* to *trading* and achieving symmetrical fair value accounting.

Another factor that should be considered is that by permitting companies to redesignate investment securities used to economically hedge servicing rights to *trading* upon election of the fair value method, the accounting for those securities would become more transparent and represent a preferable method of accounting. As such, we believe that a company's ability to clearly distinguish which securities were being used to economically hedge its servicing rights should be less of a concern and would be outweighed by the benefits of fair value accounting. We also believe that permitting *available for sale* securities to be reclassified as *trading* would be consistent with the Board's tentative conclusion in the fair value option project to permit entities to elect to account for individual financial instruments at fair value.

If the Board does decide to permit entities to reclassify securities acting as economic hedges from *available for sale* to *trading* upon the election of the fair value method for a certain group of servicing rights, we believe that the recognition of the unrealized gains or losses in other comprehensive income related to those securities should be part of the cumulative effect of adopting the fair value method rather than be reflected in earnings.

Preference Disclosure

Although the fair value method would be deemed preferable such that an election to that method would be irrevocable, presumably both methods of accounting for servicing rights still would be deemed acceptable under the proposed amendment. If that is the case, we do not see the need for a company to disclose why it has chosen to apply one method versus the other. There are many other elective methods under generally accepted accounting principles (e.g., depreciation, inventory, amortization in certain cases, and income recognition in certain cases). In none of those cases are companies required to explain why they chose one method over another. Furthermore, in this case, companies would not have chosen from both methods when the servicing rights were originated. Currently, companies are required to apply the amortization method. Under the ED, companies would need to elect a change to the fair value method. Consequently, the reason for companies using the amortization method already is self-evident. It was the method prescribed before Statement 140 was amended. Furthermore, since the fair value method is deemed preferable to the amortization method, it also would be self-evident why a company would elect to change to that method. Therefore, we do not see a need for companies to disclose additional reasons why they elected to use one method versus the other.

Washington Mutual

Summary

We support an elective fair value accounting approach for servicing rights and believe that it would provide greater transparency through more symmetrical accounting and relieve companies from the complexity and burden of applying hedge accounting under Statement 133. If one of the Board's main intentions is to promote the application of the fair value method for servicing rights, we believe that the guidance should be changed to permit a lower level of application. Otherwise, many companies might be inhibited from electing the fair value method.

We appreciate this opportunity to comment on the ED. If you have any questions regarding our comments, please contact me at 206/377-3684 or larry.gee@wamu.net.

Very truly yours,

Lawrence R. Gee
Senior Vice President and Deputy Controller