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October 3, 2006

Mr. Robert Herz  
Chairman  
Financial Accounting Standards Board  
401 Merritt 7  
Norwalk, CT 06856



LETTER OF COMMENT NO. 8

RE: Impact of SFAS 155 on securitizations

Dear Mr. Herz:

The American Bankers Association is concerned about the potential impact of the recently released Statement of Financial Accounting Standards No. 155, *Accounting for Certain Hybrid Financial Instruments* (SFAS 155), on certain types of securitizations. Since the release of SFAS 155, many of the Financial Accounting Standards Board's (the Board) various constituents have been analyzing the standard to determine whether the standard applies to certain types of investments in securities, including mortgage-backed securities (MBSs) and collateralized mortgage obligations (CMOs). It is our understanding that some who have studied the release, including possibly some Board members, believe that MBSs and/or CMOs will be subject to SFAS 155. Such application, along with its potential results (mark to market for either a portion of the security or for the whole security, with changes in values reported in earnings), has taken many by surprise. If this is the Board's anticipated outcome, it is imperative that this be fully explored with a robust level of due process. To require fair value in part or in whole for these securities raises accounting issues and risk management issues that could have a significant impact on important public policy issues.

#### Background

These securities (MBSs and CMOs) were previously granted an exemption from the bifurcation (and mark to market) requirements of Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities* (SFAS 133), by Derivatives Implementation Group (DIG) Issue No. D-1 (DIG D-1). In DIG D-1, the accounting guidance for these securitized assets was Statement of Financial Accounting Standards No. 140, *Accounting for Transfers of Financial Instruments* (SFAS 140).

#### Analysis

Paragraph 305 of SFAS 133 states that "[m]any hybrid instruments with embedded derivatives that bear a close economic relationship to the host contract were developed many years ago, for reasons that clearly were not based on achieving a desired accounting result. Prepayable mortgages and other prepayable debt instruments are examples of such familiar compound instruments with embedded derivatives" (emphasis added). Additionally, paragraph 305 states that "only an embedded derivative that is not considered to be clearly and closely related to its host contract should be accounted for separately." Our understanding of this paragraph is that MBSs and CMOs, which are prepayable debt instruments, were to remain exempt from the bifurcation requirements of SFAS 133 and were not subject to the "clearly and closely related" tests of Paragraphs 13(a) and 13(b) of SFAS 133.

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Based upon the SFAS 155 changes to another DIG Issue, *Embedded Derivatives: Application of Paragraph 13(b) to Call Options That Are Exercisable Only by the Debtor* (DIG B-39), it appears that the Board may have departed from DIG D-1. SFAS 155 uses Example 6 of DIG B-39 to specify that “in situations in which the cash flows associated with the embedded call feature are disproportionately allocated to different classes of interest holders, all interests in that MBS would be subject to the conditions in paragraph 13(b) with respect to that embedded call feature”. *Disproportionate allocations, which are common in CMO and present in some MBS structures, would trigger the “clearly and closely related” evaluation. Due to this very broad definition of “clearly and closely related”, a large portion of these securitized structures would fail the test and be relegated to bifurcation or full fair value measurement.*

Potential Impact

If an exemption for MBSs and CMOs is not, in fact, what the Board intended, the result will be the potential to increase volatility in earnings for security holders. Widespread aversion to this volatility, due to negative market perceptions and a higher cost of capital for investing companies, will likely lead to either a decreased appetite for these securities and reduced liquidity or significant changes in risk management by investors. Either of these events could hamper the ability of banks and others to manage risk.

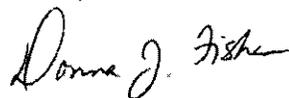
Conclusion

If the Board intended for MBSs and CMOs to be subject to the bifurcation and fair value recognition requirements of SFAS 155, it has failed to communicate this adequately during the deliberation and exposure process to the user and preparer communities. The amendment to DIG B-39 was not included in either the exposure draft or the fatal flaw document that would have prompted constituent comment and possibly further deliberation. We request that the Board extend the protection of DIG D-1 until this issue can be vigorously debated publicly. It is important to provide a robust comment process – simply providing a short comment period in order to proceed with such a major change as this would not provide adequate time for proper review and comment.

If the Board intended for MBSs and CMOs to be exempt from bifurcation and fair value, then we ask that the Board clarify this as soon as possible so that the public markets for these securities are not disrupted unintentionally.

Thank you for your consideration of this matter. Please contact me with any questions.

Sincerely,



Donna J. Fisher

Cc: Leslie Seidman  
Edward Trott  
George Batavick  
Thomas Linsmeier  
Donald Young  
Michael Crooch