



December 7, 2006

Mr. Larry Smith
Director of Technical Application & Implementation Activities
Financial Accounting Standards Board
401 Merritt 7
Norwalk, CT 06856-5116

Re: File Reference: Proposed Issue B40

Dear Mr. Smith:

Countrywide Financial Corporation (Countrywide) is a diversified financial services company that is involved in mortgage lending, banking, and insurance with approximately \$190 billion in total assets. It is one of the largest residential mortgage loan originators and servicers and financial institutions in the nation. We would like to comment on the Exposure Draft of the Proposed Statement 133 Implementation Issue No. B40, "Embedded Derivatives: Application of Paragraph 13(b) to Securitized Interests in Prepayable Financial Assets."

Generally, we support the proposed guidance, as we believe that it would greatly reduce complexity in both accounting and reporting as well as eliminate seemingly inconsistent guidance created by the amendment to Statement 133 Implementation Issue No. B39, "Application of Paragraph 13(b) to Call Options That Are Exercisable Only by the Debtor," under FASB Statement No. 155 (FAS 155), *Accounting for Certain Hybrid Financial Instruments*, with respect to embedded prepayments options from securitized mortgage loans that are not under the control of the holders of the related mortgage-backed securities (MBS).

However, for the reasons noted below, we believe that the guidance in Statement 133 Implementation Issue No. B39 should not have been amended. Accordingly, we believe that the effect of a prepayment option in the underlying loans that is passed through to an investor of an MBS should not be subject to an evaluation under paragraph 13(b) of FASB Statement No. 133 (FAS 133), *Accounting for Derivative Instruments and Hedging Activities*, as amended, to determine whether it is clearly and closely related to the MBS and an embedded derivative under any conditions.

We believe that paragraph 13(b) of FAS 133 was intended primarily to prevent unrelated derivative instruments from being placed in non-derivative host contracts to avoid fair value accounting. That is not the case with the pass-through of cash flows from securitized mortgage loans, which contain (borrower controlled) prepayment options, to the holders of the related MBS. As the original guidance in Statement 133 Implementation Issue B39 suggested, the prepayment option held by a borrower is not under the control of an investor in the MBS. Consequently, such an investor cannot control any benefits derived from that prepayment option.

Generally, the borrower of an underlying mortgage loan would tend to exercise a prepayment option when market interest rates decline in order to refinance that loan at a lower rate. At the same time, an MBS would have a higher fair value, as the coupon rate would be higher than current market interest rates, and an investor would not want such a prepayment option to be exercised by the borrower. In other words, the exercise of that prepayment by the borrower reduces the return to the investor by shortening the period for which a higher than market interest rate is received.

In most cases, an MBS would fail the test in paragraph 13(b) only under a severe and unrealistic scenario. For example, if an MBS was purchased at even a small discount and then market interest rates dropped immediately to an extremely low level (e.g., one percent or less) such that all of the underlying loans were prepaid, it would be possible for that discount to result in a doubling of the initial rate of return and the then-current market rate of return related to that MBS. Without the proposed guidance in Statement 133 Implementation Issue B40, the MBS would be deemed to contain an embedded derivative that was not clearly and closely related to the MBS even though the action giving rise to that outcome was beyond the control of the MBS investor and the MBS investor probably would prefer to hold the MBS longer, as the rate on the MBS would be much higher than current market interest rates. In that case, it would seem that the result of applying paragraph 13(b) of Statement 133 would be inconsistent with what we believe to be the underlying principle (i.e., to record an unrelated derivative instrument controlled by an investor that is embedded in a host contract to avoid fair value accounting).

We believe that a prepayment option in an underlying mortgage loan of an MBS should be exempt from the requirements of paragraph 13(b) of FAS 133 even when other embedded derivatives exist in that MBS because such a prepayment option still is not under the control of the MBS investor and is not required to be bifurcated as an embedded derivative by the borrower or lender of that loan. The accounting for a prepayment option should not change merely because the rights to the cash flows from the related mortgage loan are sold and passed through to another investor even if another embedded derivative is added to the MBS. We believe that the original conclusions reached in the Statement 133 Implementation Issue B39 were correct and should not have been amended under FAS 155. Nevertheless, we support the proposed guidance in Statement 133 Implementation Issue B40 as being at least a good step in the right direction.

Thank you for the opportunity to comment on the proposed guidance. We would be glad to discuss any of our comments in more detail. If you have any questions, please contact me at 818/225-3536 or “anne_mccallion@countrywide.com” or Larry Gee, Managing Director—Technical Accounting at 818/871-4211 or “larry_gee@countrywide.com.”

Very truly yours,

Anne McCallion
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Countrywide Financial Corporation