



Via Electronic Mail



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October 31, 2008

LETTER OF COMMENT NO. 21

Technical Director
Financial Accounting Standards Board
401 Merritt 7, P. O. Box 5116
Norwalk, CT 06856-5116

File Reference: No.1620-100

Dear Board Members and FASB Staff:

The Mortgage Bankers Association¹ (MBA) appreciates the opportunity to comment on the *proposed FASB Statement, Amendments to FASB Interpretation No. 46(R)* (the Proposed Statement). The primary objectives of the Proposed Statement are to improve financial reporting by enterprises involved with variable interest entities (VIEs) and to provide more relevant and reliable information to users of financial statements. MBA's general and specific comments with respect to the Proposed Statement are described below. MBA's responses to questions for which the FASB solicited responses can be found in the appendix to this letter.

I. General MBA Comments

MBA believes the Proposed Statement includes a number of changes that would substantially improve the guidance in FIN 46(R). In particular, MBA believes the proposed incorporation of a qualitative analysis, which would require the primary beneficiary of a VIE to have both the characteristics of "power" *and* an exposure to risks and/or rewards, would be a significant improvement to FIN 46(R). Nevertheless, and as explained in more detail on the following pages, MBA is concerned that the manner in which the Board has defined these two characteristics in the Proposed Statement may *result in parties to many mortgage securitization transactions recognizing assets they do not control and liabilities for which they do not have a present obligation.* MBA is

¹ The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 370,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership and extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 2,400 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, Wall Street conduits, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web site: www.mortgagebankers.org.

concerned, for example, that the notions of “power” and “potentially significant” in the Proposed Statement would lead parties to many mortgage securitization transactions to consolidate VIEs with resulting deteriorations in the relevance of their financial reporting. In those circumstances, the Board’s objective of improving financial reporting would not be met.

Therefore, MBA recommends that the Board undertake a FASB study, similar to the study now being undertaken by the SEC on fair value reporting,² on the potential implications of the Proposed Statement and the related FASB Proposed Statement, *Accounting for Transfers of Financial Assets, an amendment of FASB Statement No. 140*³ (the FAS 140 Proposed Statement). MBA believes the results of a study could help the Board determine whether constituents would be best served by allocating its resources to finalizing the Proposed Statements or to advancing the Joint FASB/IAS Convergence Project.

Among other things, the study should:

- assess the costs/benefits to businesses of changing their systems and procedures to comply with potentially three different accounting models (i.e. the FAS 140 and FIN 46(R) model, the FAS 140 and FIN 46(R) Proposed Statements model, and ultimately a GAAP/IAS convergence model) for financial asset transfers within a relatively short period of time;
- determine if newly consolidated information would provide users with more useful information than would be provided through enhanced disclosures; and
- consider the extent to which the Proposed Statements, as drafted, would discourage securitization transactions and thereby reduce the availability of credit and increase interest rates.

In the near term, MBA recommends that the Board issue principles-based enhancements to the disclosure requirements for financial asset transfers, consistent with the recommendations in MBA’s October 9, 2008, letter to the Board on the proposed FASB Staff Position (FSP), *Disclosures about Transfers of Financial Assets and Interests in Variable Interest Entities* (the Proposed FSP).

If the Board decides instead to release the Proposed Statements in the near future, MBA strongly recommends that the Board adopt the changes recommended in this letter and in MBA’s letter on the FAS 140 Proposed Statement. Among the changes MBA feels most strongly about is that a linked presentation should be available to the primary beneficiary of a VIE. At a minimum, MBA believes the Board should allow such presentations for securitizations of a static pool of assets involving a VIE whose cash flows are restricted to the payment of specific liabilities, which are nonrecourse to the general credit of the primary beneficiary.

² See SEC press release at <http://www.sec.gov/news/press/2008/2008-242.htm>.

³ MBA’s comments on the FAS 140 Proposed Statement are conveyed in a separate letter.

II. Specific Comments

A. Identification of the Primary Beneficiary

1. Definition of Power

Paragraph 14A.a. states that one of the characteristics that defines a primary beneficiary is the "power" to direct matters that most significantly impact the activities of a VIE. This suggests that a servicer, regardless of its level of discretion in making decisions, would possess the characteristic of power contemplated in paragraph 14A.a. First, MBA believes that there are certain servicer arrangements that have limited discretion which should not rise to the level of "power" requiring consolidation of a VIE (i.e., is it not relevant that a servicer may have very few, if any, decisions to make that could materially change the performance of the entity?). Second, MBA believes that any party purely acting in an agent or fiduciary role should not be deemed to have "power" under the Proposed Statement because its decisions are made entirely on behalf of third parties.

In addition, MBA disagrees with the provision that "An enterprise's determination of whether it has the power to direct matters shall not be affected by the existence of substantive kick-out rights unless a single enterprise...has the unilateral ability to exercise...." Paragraph B26 provides less than convincing support for providing a principle that conflicts with the definition of a VIE in paragraph 5.b.(1) of FIN 46(R) and EITF Issue No. 04-5, *Determining Whether a General Partner, or the General Partners as a Group, Controls a Limited Partnership or Similar Entity When the Limited Partners Have Certain Rights* (EITF 04-5). MBA believes the EITF and the Board understood that a typical entity within the scope of EITF 04-5 was also "highly structured" and that kick-out rights in those structures "typically are not exercised." Therefore, MBA recommends that the Proposed Statement be consistent with existing consolidation literature.

2. Definition of Significance

Paragraph 14A.b. of the Proposed Statement sets forth an inappropriately low threshold of "potential to be significant" in analyzing whether involvement with a VIE is significant enough to meet the second characteristic for consolidation. MBA believes that consolidation of a VIE should not be required unless the enterprise with power has a *significant* variable interest *today*. It appears that the FASB believes consolidation is an appropriate result when a potentially significant event (that has not occurred and has a remote possibility of occurring) could happen in the future. MBA believes the only reasonable way to measure whether an interest is significant should be based on the relationship of the **variable** risks and rewards of the enterprise relative to the **variable** risks and rewards of all variable interest (VI) holders of the VIE. If the FASB does not change the provision to be consistent with the above, the MBA recommends a higher threshold than "potential" such as "reasonably possible" or "more likely than not" to avoid consolidation by an entity with an insignificant VI.

Similarly, paragraph B24 provides guidance that would require an enterprise to speculate on the possible future "significance" of an entity's potential risks and rewards.

The MBA does not believe it is appropriate to hypothesize about what an enterprise may do if events occur in the future unless those events are reasonably possible of occurring. In this regard, the FASB appears to be attempting to capture SIV structures that were off-balance sheet prior to the sponsor providing financial support it was not contractually obligated to provide. MBA observes that it is potentially misleading to assume that this implicit relationship would exist on a wide-spread basis outside those unique situations. The MBA members do not know of any mortgage-backed securitization that was supported by the transferor or sponsor without a contractual requirement to do so. MBA recommends that this guidance be limited to contractual arrangements that would require the enterprise to provide financial support or those already considered an implicit VI under FIN 46(R)-5.

Additionally, paragraph 14A does not appear to limit the analysis of significance to "variable interests." The MBA believes it would be inappropriate for involvement that is not considered a VI to be considered in the consolidation analysis.

In summary, MBA believes that the characteristic in paragraph 14A.b. should only be met if the enterprise holds a significant VI based on its relative exposure to the variability in risks and rewards existing at the time of the analysis.

B. Impact on Investors Without "Power"

Paragraph 6 of the Proposed Statement defines a significant VI as a VI that is significant either to the VIE *or* to the enterprise. This definition seems inconsistent with the initial objective of paragraph 6. It is the MBA's understanding that the original objective was to allow an enterprise with no chance of consolidating an entity, if it were determined to be a VIE, to avoid applying the entire FIN 46(R) standard to determine what is already known (i.e., consolidation is not necessary). Paragraph 14 now appears to make it impossible to consolidate a VIE if the enterprise lacks the power to direct activities. Therefore, MBA recommends that an enterprise without any power to direct the activities of the VIE should be deemed not to have a significant VI. The MBA believes this would appropriately exclude passive interest holders from a VIE analysis.

MBA also believes that it is inappropriate to require a FIN 46(R) analysis simply because an enterprise's VI is significant *to the enterprise*. In fact, a requirement to look at the significance to the enterprise is inconsistent with the analysis under paragraph 14A(b), which only requires a consideration of the significance *to the VIE*. An enterprise could potentially have to complete the entire FIN 46 (R) analysis because its investment is large relative to its balance sheet despite the fact that there is zero chance of consolidation. Further, that enterprise would have to apply the entire FIN 46(R) standard and provide "consolidation-related" disclosures about an interest that is insignificant to the VIE. Therefore, MBA believes that the threshold of significance should be whether the VI is "significant to the VIE."

The definition of significant VI in the Proposed Statement would also require commercial banks and commercial real estate lenders to assess, and continuously reassess, if (1) an entity is or has become a VIE and (2) whether the bank is or has become the primary beneficiary. The MBA does not believe any assessment should be required by an enterprise without power, and at the very least, MBA believes a continuous assessment

should not be required due to troubled debt restructurings or operating losses alone, absent any change in contractual arrangements. This outcome would be inconsistent with the concept of the "design" of an entity, which is clearly not to incur losses.

C. Qualitative Versus Quantitative Tests

As stated in the introductory comments, MBA is in support of the proposed qualitative tests. The quantitative tests under the existing guidance are difficult to apply and the guidelines are subject to broad interpretation. In this regard, it is unclear when, if ever, the paragraph 14C quantitative calculation would be utilized. Paragraph 14B of the proposed statement makes it clear that you must have the power to consolidate and shared power results in no primary beneficiary. If this is the FASB's intention, it does not appear that there is ever a path to paragraph 14C within the framework. Unless there is a clear application of paragraph 14C, the MBA recommends the section be deleted to avoid confusion or the misapplication of the provision by default.

D. Emerging Irrelevance of VIE Concept

Currently, Accounting Research Bulletin No. 51, *Consolidated Financial Statements* (ARB 51), and FIN 46(R) are clearly different consolidation models frequently resulting in a different determination of which party would consolidate an entity. ARB 51 is purely a control based model, whereas FIN 46(R) was issued to address when "certain types of entities may not identify the party with a controlling financial interest because the controlling financial interest may be achieved through arrangements that do not involve voting interests" (paragraph 1 of FIN 46(R)). Therefore, FIN 46(R) separated itself from a control-based model; instead, it required consolidation when an enterprise absorbs a majority of the risks and/or rewards of an entity. The Proposed Statement appears to be much more consistent with the concept of control in ARB 51. Consequently, MBA questions whether two consolidation models are necessary. It appears that the same party would consolidate under a carefully constructed consolidation framework that requires consolidation by the party that has: (1) the power and (2) a significant VI consistent with the MBA's comments in II. A. Identification of the Primary Beneficiary above.

Further, the definition of a VIE in paragraph 5 of FIN 46(R) remained unchanged in the Proposed Statement. As a result, there appears to be an emerging disconnect and contradiction between the reasons an entity is a VIE and which party, if any, consolidates the VIE's assets and liabilities under paragraph 14. There are numerous examples of the irrelevance of the paragraph 5 criteria to determine whether an entity is a VIE, some of which are as follows:

- Paragraph 5.a. of FIN 46(R) appears inconsistent with paragraph 14 of the Proposed Statement, because it provides that an entity is a VIE if it does not have sufficient equity at risk. Assume that an equity holder invests 5% of the equity structure and has unilateral control over the entity under ARB 51. Further assume that it is determined that the entity needed 7% equity to be sufficient and therefore is determined to be a VIE under paragraph 5.a.. Is there relevance to this decision? The MBA presumes that the FASB would consider 5% to have the "potential of being significant as defined in paragraph 14A.b. of the Proposed

Statement and would therefore be consolidated by the equity holder.⁴ Therefore, why would it matter if the entity was a VIE or not if the equity holder had “control” or “power?” Further, if there were multiple equity holders with shared power, power would be shared and no party would consolidate, which is the identical conclusion under ARB 51. In short, paragraph 5.a. seems to have lost its relevance, especially for entities that meet the definition of a business.

- Many operating entities have been determined to be VIEs under paragraph 5.b.(2) due to a contractual arrangement or guarantee that protects the equity holders from expected losses. However, in many cases, the protecting party has no “power” which makes the contractual arrangement moot to the consolidation analysis.
- Paragraph 5.c. of FIN 46(R) has many times been referred to as the “anti-abuse provision”, because it requires an entity that was designed with shared power but disproportionate economics to apply a risks and rewards model ignoring the notion of control. However, paragraph 14A.b. of the Proposed Statement indicates that shared power results in no primary beneficiary. Example 8 of Appendix A of the Proposed Statement drives home this point with a joint venture example that results in no party consolidating due to the existence of shared power. Therefore, the determination of the primary beneficiary under paragraph 14A. is inconsistent with the focus of paragraph 5.c.. Consider an example where Enterprise A holds 70 percent of the vote (and 10 percent of the profits and losses) and Enterprise B holds 30 percent of the vote (and 90 percent of the profits and losses) in a VIE under paragraph 5.c. Enterprise A would likely be the party that would consolidate under the Proposed Statement rather than Enterprise B (the party with “disproportionately few voting rights” that caused the entity to be a VIE). This result is the exact opposite conclusion that FIN 46(R) was designed to reach.

The above indicates that the FASB would be well served by spending more time researching the interplay between why an entity is a VIE and the consolidation conclusion, including whether two separate consolidation standards are even needed. One of the two primary drivers of which party consolidates under the Proposed Statement is the “power” to direct matters that most significantly impact the activities of the VIE. If this is a prerequisite to consolidation, the MBA believes that should be the first question in any consolidation framework. If an enterprise is determined to have no power, the consolidation analysis should stop immediately. The enormous amount of time required to go through the rigorous documentation of the FIN 46(R) analysis for each entity seems irrelevant if consolidation or even a reasonable chance of future consolidation is impossible under paragraph 14 of the Proposed Statement.

E. Transition Rules

Paragraph 21(a) of Appendix A in the Proposed Statement states in part that “...the primary beneficiary shall initially measure assets and liabilities that it has transferred to

⁴ On the other hand, if the FASB believes that an equity owner with insufficient equity should be determined to not be significant under paragraph 14A(b) of the Proposed Statement, it should make that intention clear.

that variable interest entity at, after, or shortly before the date that the entity became the primary beneficiary at the same amounts at which the assets and liabilities would have been measured if they had not been transferred.” It is not clear whether this provision applies to previous transfers prior to the adoption of the standard or only transfers subsequent to the effective date. MBA believes that upon the effective date of the Proposed Statement, the assets and liabilities of the VIE should be reflected at their previous carrying value, to the extent determinable consistent with paragraph 37 of FIN 46(R). However, MBA also believes an enterprise should be allowed to elect the fair value option consistent with FAS 159.

In addition, MBA believes that the FIN 46(R) Proposed Statement will result in a number of enterprises de-consolidating VIEs (especially businesses currently consolidated under FIN 46(R) by enterprises with no “power”). MBA recommends that the guidance be clear on the accounting in transition for deconsolidated VIEs, such as a requirement that an enterprise should apply FASB Statement No. 160, *Noncontrolling Interests in Consolidated Financial Statements – an amendment to ARB No. 51*.

F. Related Parties

The change to paragraph 17 (by adding e) does not clarify the related party analysis or reduce diversity in application. Since the Proposed Statement has provided for a qualitative framework in paragraph 14, the MBA believes paragraph 17 should follow the same framework. Therefore, the MBA believes that 17a-d should be deleted requiring the party within a related party group that more closely meets criteria a and b in paragraph 14A be determined the primary beneficiary. Lastly, the MBA believes the FASB should provide for a preference between power and benefits/losses to avoid a continuation of the diversity that currently exists in practice.

G. Examples in Appendix A

MBA appreciates the examples provided by the FASB to assist in the application of the proposed consolidation framework. However, MBA believes that additional examples are necessary to test the functionality of the Proposed Statement. The following are more specific observations or recommendations that will hopefully serve to assist FASB in making the examples in the proposed guidance more useful:

- An example where the transferor securitizes loans and retains only a servicing obligation with typical servicer discretion and an example where the servicer also retains a most-senior excess (IO) strip or senior security would be helpful. The example should clarify that the transferor would not consolidate because (a) the servicing fee and retained interests are senior in priority to most other liabilities of the VIE and (b) the variable interests are not expected to absorb a significant amount of variability. In this situation, the servicer is performing its servicing obligation as an agent on behalf of third parties with minimal exposure to credit losses.
- Several examples indicate that a hired manager with a performance-based fee is deemed to be the Primary Beneficiary of the VIE. As stated earlier, MBA believes it is inappropriate for a hired manager with a performance fee to

consolidate the VIE's assets and liabilities unless the performance fee is significant relative to the aggregate of all VIs in the VIE. The receipt of a performance fee should not be a strong indicator towards consolidation because the manager is limited to upside for performing the tasks it was hired to do.

- Paragraph A36 of Appendix A in the Proposed Statement states, "The Sponsor determined that it has an implicit financial responsibility and that such obligation could potentially be significant." This statement belongs in the facts, not in the analysis, because it implies that an enterprise would frequently presume that an implicit arrangement exists without such arrangement being mentioned in the facts of the entity.

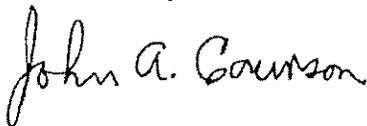
III. Conclusion

MBA believes the Proposed Statement would be an improvement over existing guidance on consolidations of VIEs. MBA is concerned, however, that the Proposed Statement would nevertheless require parties to many securitizations to recognize assets they do not control and liabilities they do not have a present obligation for because of the manner in which the Board has defined the two characteristics of a controlling financial interest in paragraph 14A of the Proposed Statement. In this circumstance, the Board's objective of improving financial reporting would not be met.

Therefore, MBA recommends the Board perform a study on the benefits/costs of the Proposed Statement. If the Board decides to proceed without performing a study, MBA recommends that the Board adopt the changes recommended in this letter and our letter on the FAS 140 Proposed Statement. At a minimum, MBA believes a linked presentation should be available to primary beneficiaries involving VIEs with static pools of assets whose cash flows are restricted to the payment of specific liabilities, which are nonrecourse to the general credit of the primary beneficiary.

MBA appreciates the opportunity to share these comments with the Board. Any questions about MBA's comments should be directed to Jim Gross, Associate Vice President of Accounting and Tax Policy and Staff Representative to MBA's Financial Management Committee, at (202) 557-2860 or jgross@mortgagebankers.org.

Most sincerely,



John A. Courson
Chief Operating Officer
Mortgage Bankers Association

APPENDIX

1. Will the proposed Statement meet the project's objectives to improve financial reporting by enterprises involved with variable interest entities and to provide more relevant and reliable information to users of financial statements?

MBA Response: See section I. General MBA Comments of accompanying MBA letter.

2. What costs do you expect to incur if the Board were to issue this proposed Statement in its current form as a final Statement? How could the Board further reduce the costs of applying these requirements without significantly reducing the benefits to users of financial statements?

MBA Response: See sections I. and II. of MBA's letter.

3. The Board decided to adopt a more principles-based approach to determine the primary beneficiary of a variable interest entity. Do you believe the proposed principles in paragraphs 14-14B of Interpretation 46(R), as amended by this proposed Statement, are sufficiently clear and operational?

MBA Response: See sections I. and II. of MBA letter.

4. The Board concluded that it would be helpful to provide examples of the application of the principles in this proposed Statement. Do you believe that the examples in Appendix A clearly indicate how the principles in paragraphs 14-14B of Interpretation 46(R), as amended by this proposed Statement, would be applied? If not please articulate what additional information or guidance is necessary, considering the basis for the Board's conclusions.

MBA Response: See section II. G. of MBA letter.

5. This proposed Statement retains the quantitative analysis for situations in which an enterprise cannot determine whether it is the primary beneficiary through the qualitative analysis in paragraph 14A of Interpretation 46(R), as amended by this proposed Statement. In Appendix A, each example either identifies a primary beneficiary or concludes that no primary beneficiary exists through a qualitative analysis. The Board may consider removing the quantitative analysis for determining whether an enterprise is the primary beneficiary of a variable interest entity. Do you believe that the quantitative analysis is necessary based on the proposed amended guidance for determining the primary beneficiary? Do you believe that the quantitative analysis would be performed in many situations? Why or why not?

MBA Response: See section II. C. of MBA letter.

6. For the reasons stated in paragraphs B6-B15 of this Proposed Statement, the Board decided to require ongoing assessments to determine whether an entity is a variable interest entity and whether an enterprise is the primary beneficiary of a variable interest entity. Do you agree with the Board's decision to require ongoing assessments? If not, please provide reasons (conceptual or otherwise)

as to why you disagree with these requirements considering all of the proposed amendments in this proposed Statement.

MBA Response: The proposed guidelines require an enterprise to continuously reassess to determine if the decision as to whether it is the Primary Beneficiary of a VIE is still valid. MBA does not have a problem with the intent of the requirement with the exception of allowing an entity to subsequently become a VIE due to a troubled debt restructuring or losses in excess of expectation. As discussed further in section II. B. of MBA's letter, this outcome would be inconsistent with the concept of the "design" of an entity.

7. Do you believe that any exceptions to this proposed Statement should be made for private or not-for-profit entities? If so, please articulate the conceptual basis and reasons for the exceptions.

MBA Response: MBA believes that all enterprises within the scope of FIN 46(R) and former QSPEs should be required to apply the Proposed Statement. However, the MBA urges the FASB to consider one consolidation model as discussed in II. D. of MBA's letter and consider revising the definition of a "significant variable interest" to relieve the burden of FIN 46(R) for investors without any "power" (see also II.B. of MBA's letter).

8. Financial statement users indicated that the information disclosed in accordance with the Interpretation 46(R) about an enterprise's involvement or involvements with variable interest entities and the associated risks are often insufficient and untimely. Do you believe the disclosure requirements in this proposed Statement address those concerns?

MBA Response: The disclosures contained in the Proposed Statement are similar to the proposed disclosure requirements of the Proposed FSP FAS 140-e and FIN 46(R)-e (Proposed FSP). MBA commented on October 15 to the Proposed FSP and incorporates those comments herein by reference. In summary, MBA believes the proposed disclosures would result in providing readers of financial statements with an unnecessary volume of data that would obfuscate important and meaningful information in the financial statements. In addition, many of the proposed disclosures would require information that is not currently tracked or aggregated, and the proposed disclosures for passive investors in MBS's would be extremely burdensome. The proposed disclosures in many cases would require an enterprise to speculate. MBA believes that speculation has no place in GAAP. In addition, the issue of potential over-disclosure is compounded by the way that "significant VI" is defined in paragraph 6 as discussed in II. A. 2 of MBA's letter.

9. Should the elements of a consolidated variable interest entity be required or permitted to be classified separately from other elements in an enterprise's financial statements?

MBA Response: See section I. of MBA's letter.