



VIA ELECTRONIC MAIL

October 10, 2005

Mr. Lawrence W. Smith
Director, Technical Application and Implementation Activities
Financial Accounting Standards Board
401 Merritt 7, P. O. Box 5116
Norwalk, Connecticut 06856-5116

File Reference: 1210-001

Dear Mr. Smith:

The Mortgage Bankers Association¹ appreciates the opportunity to comment on the FASB Exposure Draft, *Accounting for Certain Hybrid Financial Instruments* (the ED), which would amend Statement 140, *Accounting for Transfers and Servicing of Financial Assets & Extinguishments of Liabilities* (FAS 140) to permit holders of beneficial interests that contain embedded derivatives (hybrid financial instruments) to irrevocably elect to measure those interests at fair value, and to require that holders evaluate beneficial interests to determine whether they are hybrid financial instruments. MBA has studied the guidance in the ED and would like to offer a few recommendations for the Board's consideration.

I. MBA Position

MBA strongly supports the proposed "instrument-by-instrument" fair value election for hybrid financial instruments although we believe some of the background information describing the Board's rationale in developing the election is confusing and should be clarified. MBA also believes the fair value election should be permitted to be applied to existing, as well as new, hybrid instruments. Finally, MBA believes the guidance in the ED should be expanded to address how instruments that are reported at fair value should be reported in the financial statements.

¹ The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 500,000 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 2,900 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.

II. MBA Responses to Questions Raised in ED

Q1: Do you support the Board's decision to permit fair value remeasurement for hybrid financial instruments that contain an embedded derivative that otherwise would require bifurcation?

MBA Response: Yes. MBA supports the proposed elective approach because it will give holders the opportunity to elect a more simplistic method of accounting for these instruments.

Q2: Should this proposed Statement provide implementation guidance on how to evaluate whether an instrument contains an embedded derivative that would require bifurcation? If so, what type of guidance do you believe the Board should consider?

MBA Response: No. MBA believes the guidance on separating embedded derivatives from host contracts in FAS 133 is sufficient for the purpose of evaluating hybrid instruments. MBA believes additional implementation guidance might raise questions which should be addressed by holders and their auditors given their specific knowledge of the instruments.

Q3: This proposed Statement requires evaluation of instruments for identification of embedded derivatives and permits but does not require fair value measurement for instruments that contain embedded derivatives that otherwise would require bifurcation. Are the requirements for evaluating and accounting for interests issued by qualifying SPEs clear and understandable? Is the guidance for evaluating how the existence of embedded derivatives would affect whether an entity is a qualifying SPE clear and understandable? If not, what additional clarifying guidance should the Board consider?

MBA Response: MBA believes some of the guidance in the ED is confusing and should be clarified as explained below.

According to paragraph A.22, the Board decided not to define beneficial interests in securitized financial assets "...based on the presence of a defined securitization vehicle." This suggests that the securitized assets do not have to be held by a "qualifying special purpose entity" which is a type of "defined securitization vehicle." However, the term "beneficial interest" is defined in the Glossary of the ED as "A right to receive all or portions of specified cash inflows to a qualifying SPE..." MBA recommends that the Board address the apparent conflict in the information in paragraph A22 and the definition of a beneficial interest in the Glossary.

Similarly, the second to last sentence of paragraph A.22 states that the Board "...considered and rejected definitions that might have clarified what interests would be considered beneficial interests in securitized financial assets." This suggests that the Board purposely decided not to define beneficial interests; however, as mentioned above, the Glossary in the ED includes a definition of a beneficial interest. MBA recommends that this sentence be clarified also.

Paragraph A. 22 also indicates that the accounting for an interest by a purchaser should not be affected by whether the transaction was accounted for as a sale by the transferor. This suggests that the same interest could be accounted for as an asset by two entities: a purchaser of a beneficial interest and a transferor of assets in a securitization. If this is true, the guidance would appear to be in conflict with guidance in FASB Concept Statement No. 6, *Elements of Financial Statements*, which states: "Every asset is an asset of some entity; moreover, no asset can simultaneously be an asset of more than one entity..." (See paragraph 183). MBA recommends that the Board clarify whether it intended to convey that two parties could report the same assets as their own.

In addition, the guidance in paragraph 3.b. of the ED would amend paragraph 14.A. of FAS 140 to require a holder of a beneficial interest in securitized financial assets to determine whether the interest is a freestanding derivative or contains an embedded derivative. However, paragraph 3.b. would require issuers, as well as holders, of beneficial interests to obtain sufficient information to determine whether they contain embedded derivatives. MBA recommends that the Board clarify whether it intended to require all issuers, including those that are not holders, of beneficial interests to make this determination.

MBA also finds paragraph A.28 confusing. The paragraph states that:

"...The Board decided to eliminate the prohibition on a QSPE from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative instrument. That prohibition was included in Statement 140 to preclude a QSPE from holding a derivative that, because of the Implementation Issue D1 exemption, might not be accounted for as a derivative by the QSPE's beneficial interest holders."

Based on the information in paragraph 187 of FAS 140, the prohibition referred to in the first sentence of this excerpt refers to a concern that a transferor could avoid accounting for a derivative under FAS 133 by having the QSPE enter into the derivative on its behalf. We believe the above passage would be clearer if the last sentence were revised to state: "That prohibition was included in Statement 140 to ensure that transferors could not avoid accounting for their derivatives under FAS 133 by arranging for the QSPEs to enter into the derivatives on their behalf."

Q4: This proposed Statement would be applicable to all instruments obtained or issued after the earlier of fiscal years beginning after December 15, 2005, or fiscal years that begin during the fiscal quarter in which the Statement is issued, if applicable. Do you believe that the effective date provides sufficient time for implementation by calendar-year reporting enterprises?

MBA Response: MBA believes that the effective date provides sufficient time for implementation by calendar-year reporting enterprises. MBA also believes, however, that the prospective election should be permitted to be applied to existing instruments, as well as new instruments, on an instrument-by-instrument basis.

According to paragraph A.30 of the ED, the Board decided to restrict the fair value election to new instruments primarily as a result of concerns related to the Board decision that if the election were made available to existing instruments it should be applied on an "all or none" basis instruments, rather than to only certain bifurcated hybrid

financial instruments selected by the reporting entity.”² Under an “all-or-none” approach, however, holders that have designated bifurcated derivatives as hedging instruments would be precluded from continuing to designate the derivatives as hedge instruments. Further, a recombination of the derivatives and host contracts could raise questions about the appropriate accounting for gains and losses on the contracts. The Board acknowledged also that under an “all-or-none” approach holders would be required to perform bifurcation evaluations of all existing instruments that had not been bifurcated previously, which could be burdensome.

MBA appreciates these concerns but notes that they are predicated on the belief that a fair value election for existing instruments should be imposed on an “all-or-none basis,” rather than an “instrument-by-instrument basis” which would be applicable for new instruments. MBA believes it would be inappropriate to require holders to apply to different standards for measuring their hybrid instruments, depending upon when they were acquired. Further, an “all-or-none” approach to existing instruments is inconsistent with the Board’s recent decision, as part of the Fair Value Option Project: “...that no eligibility criteria should be imposed on the election of the fair value option because the broad availability of the fair value option is more consistent with the fundamental objectives of the project,” one of which is to expand the use of fair value for measuring financial instruments

For these reasons, MBA recommends that the Board amend the ED to permit the fair value election to be applied to new and existing instruments on an “instrument-by-instrument” basis.

III. Classification of Hybrid Financial Instruments

MBA believes the ED should be expanded to include some guidance on how hybrid instruments that are reported at fair value under the ED would be required to be reported in their financial statements. Specifically, our members have questioned whether they should be reported with the host contract or with other derivatives. As the values of hybrid instruments are affected by both features, it is unclear which classification would be considered more appropriate.

IV. Conclusion

MBA strongly supports the proposed fair value election described in the ED. However, MBA believes the information in paragraph A.22 which is intended to explain the basis for the Board’s decisions relating to the election is confusing and should be clarified. MBA also believes the Board should amend the guidance in the ED to permit holders to apply the fair value election to existing hybrid instruments. Finally, MBA believes the guidance in the ED should be expanded to address how hybrid instruments that are measured at fair value should be reported in holder’s financial statements.

² Although it is not entirely clear, the reference to *all* hybrid instruments appears to be a reference to all *existing* hybrid instruments.

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For more information about our comments on the ED, please contact Alison Utermohlen, Senior Director of Government Affairs and Staff Representative to MBA's Financial Management Committee. Alison can be reached directly at (202) 557-2864 or autermohlen@mortgagebankers.org.

Most sincerely,

A handwritten signature in black ink, reading "Jonathan L. Kempner". The signature is written in a cursive style with a large initial 'J' and a long, sweeping underline.

Jonathan L. Kempner
President and Chief Executive Officer