



April 20, 2011

Sir David Tweedie, Chairman
International Accounting Standards
Board (IASB)
30 Cannon Street, First Floor
London, EC4M 6XH
United Kingdom

Ms. Susan M. Cospers
Technical Director
Financial Accounting Standards
Board (FASB)
401 Merritt 7, P.O. Box 5116
Norwalk, CT 06856-5116

RE: Supplement to ED/2011/1

File Reference No. 2011-100

Dear Sir David Tweedie and Technical Director Cospers:

The Mortgage Bankers Association¹ (MBA) appreciates the opportunity to comment on the exposure draft *Offsetting Financial Assets and Financial Liabilities* (Proposed Standard). The Proposed Standard was issued jointly by the FASB and the IASB on January 28, 2011 to promulgate a converged accounting standard for offsetting assets and liabilities in the balance sheet.

Background

Offsetting in this exposure draft relates to presenting, as a single net amount, an asset and liability in the statement of financial position. Today, the difference in offsetting requirements in U.S. generally accepted accounting principles (GAAP) and International Financial Reporting Standards (IFRS) accounts for the single largest quantitative difference in the amounts presented in statements of financial conditions reported in GAAP as compared to IFRS. This reduces the comparability of financial statements between the United States and IFRS reporting countries.

Under the Proposed Standard, a reporting entity would be required to offset a recognized eligible asset and a recognized eligible liability when it has an unconditional and legally enforceable right of setoff and intends either to settle

¹ The Mortgage Bankers Association (MBA) is, the national association representing the real estate finance industry, an industry that employs more than 280,000 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 2,200 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.

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the asset and liability on a net basis or to realize the asset and settle the liability simultaneously.

MBA believes that the most frequent potential application of the Proposed Standard in mortgage banking relates to derivatives used to hedge loans in process, loans held for sale, and mortgage servicing rights. For example, mortgage bankers in the U.S. frequently hedge loans in process or loans held for sale with commitments to sell Ginnie Mae, Fannie Mae or Freddie Mac mortgage-backed securities (forward sale commitments). From time to time, mortgage bankers have excess forward sale commitment coverage. To address that excess coverage, mortgage bankers may enter into like commitments to buy MBS with the same broker, for the same amount, with the same settlement date. In addition, mortgage bankers may enter into derivative transactions such as interest rate swaps and other over-the-counter derivatives in order to hedge loans in process, loans held for sale and/or mortgage servicing rights. Our comments below relate to how the Proposed Standard may impact these activities.

General Comments

Allow Offsetting on a Less Restrictive Basis

Under GAAP in the United States, offsetting of assets and liabilities is generally improper unless a right of setoff exists. A right of setoff, under U.S. GAAP, is a debtor's right, by contract or otherwise, to discharge all or a portion of the debt owed to another party by applying against the debt an amount the other party owes to the debtor."² A right of setoff exists when all of the following are met:

- a. Each of two parties owes the other determinable amounts.
- b. The reporting party has the right to set off the amount owed with the amount owed by the other party.
- c. The reporting party intends to set off.
- d. The right of setoff is enforceable at law.³

The condition in c. above is waived for the netting derivatives at fair value and a related recognized right to return cash collateral or to reclaim cash collateral.⁴

The FASB's basis for conclusion when developing the current offsetting accounting standard makes clear that the FASB considered an entity's exposure

² Financial Accounting Standards Board, FASB Interpretation No. 39, *Offsetting of Amounts Related to Certain Contracts*, pages 2-3 [now codified at ASC 210, paragraph 20].

³ Ibid.

⁴ Ibid.

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to risk in developing the conditions for offsetting. The basis for conclusion of the former FIN 39, *Offsetting of Amounts Related to Certain Contracts – an interpretation of APB Opinion No. 10 and FASB Statement No. 105*, (now ASC 210) states: "... financial reporting should provide information to help investors, creditors, and others assess the amount, timing, and uncertainty of prospective net cash inflows to the related enterprise."⁵ In addition, FIN 39 states, "The amount of credit risk exposure—the amount of accounting loss the entity would incur if the counterparties to forward, interest rate swap, currency swap, option or other conditional or exchange contracts failed to perform in accordance with the terms of those contracts—is one indicator of uncertainty of future cash flows from those instruments."⁶

It is clear that the FASB-developed accounting standards considered credit risk exposure as well as the business practices of entities which in many jurisdictions manage mutual exposures on a net basis. Further, regulatory requirements also are based on risk exposure as Basel I, II, and III allow netting under conditions in which the regulators believe a net amount is more reflective of an entity's risk exposure.

MBA believes current accounting standards are appropriate and, therefore, questions what is driving the changes presented in the Proposed Standard as this proposal significantly restricts the ability to present offsetting amounts on the face of the balance sheet. MBA is unfamiliar with financial statement users demanding a gross presentation. MBA believes presenting balances gross when that presentation does not reflect an entity's net exposure to credit risk does not provide financial statement users with the most useful information.

Operational Burden of the Proposed Standard

Dual Presentation: Where the right of set-off exists, MBA believes that whether a reporting entity presents assets and liabilities gross or net should be based upon how the reporting entity manages those assets and the risk exposure of those assets. Further, a reporting entity that presents assets and liabilities on a gross basis in the balance sheet should not be required to present them on a net basis in the notes to financial statements. Conversely, a reporting entity that presents assets and liabilities on a net basis in the balance sheet should not be required to present on a gross basis in the notes to financial statements. To require such dual reporting would result in significant operational burdens to preparers. It would require the maintenance of two sets of accounting records, significant new systems changes, and significant ongoing costs. The final requirements should not be more onerous than those in place today.

⁵ Ibid, FASB Interpretation No. 39, Basis for Conclusions, pages 6-7.

⁶ Ibid FASB Interpretation No. 39, Basis for Conclusions, page 7.

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Transition Requirements: MBA generally disagrees with retrospective or comparative transition requirements. In the case of the Proposed Standard, MBA believes that retrospective application would be quite difficult and burdensome, if not impossible. To go back and review contracts in effect in the past would take an inordinate amount of time. Re-creating market conditions and other factors in existence during a past period may not be possible. MBA also believes that most users would not find the disclosures related to prior periods particularly useful, especially since the changes relate to balance sheet classification, not to net income or shareholders' equity.

As to the effective date, MBA believes that if the FASB and the IASB move forward with retroactive reporting, the only practical way reporting entities can accommodate this would be to capture it live in the future. Thus, MBA recommends a five year transition period. If, however, the transition period is prospective, an approximately three year transition period would be appropriate.

Right of Setoff

Under the Proposed Standard, the debtor must have an unconditional and legally enforceable right of setoff. MBA believes this requirement could cause inconsistency in presentation and, as a result, a lack of comparability in financial statements because bankruptcy and insolvency laws vary. Further, MBA is unsure whether existing laws and rules are consistently enforced by bankruptcy courts in all jurisdictions.

MBA is also concerned that in practice the proposed accounting standard may require entities to seek outside legal opinions. Our members' concerns arise from experience with true sale opinions that outside auditors have required for sales or securitizations of financial assets. These opinions proved to be expensive---and especially cost prohibitive for smaller reporting entities. We are concerned that some external auditors would require an opinion from outside counsel for each contract entered into by an entity.

Simultaneous Settlement

MBA notes that the Proposed Standard regarding simultaneous settlement is extremely rigid. For example, paragraph C11 on page 14 of the Proposed Standard states: "Similarly, realization and settlement of an asset and a liability at the same stated time but in different time zones is not simultaneous settlement," implying that settlements within the same day would not qualify as simultaneous settlement. We are also concerned that some transactions with clearing houses may not qualify under the proposed simultaneous settlement standard. Other than an intent to forbid offsetting, regardless of risk exposure or settlement provisions, MBA sees no reason for settlement criteria to be so rigid. MBA recommends that the FASB and the IASB consider less onerous alternatives with respect to simultaneous settlement.

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Again, MBA emphasizes that it is important that the balance sheet reflect an entity's exposure to risk and how management manages that exposure to risk, among other objectives, in order to provide the most useful information to financial statement users. MBA strongly encourages the Boards to consider the needs of financial statement users when evaluating this Proposed Standard and believes that current U.S. accounting standards for offsetting best reflect the most useful financial statement presentation.

Other Net Presentation Accounting Principles

Various accounting pronouncements specify accounting treatments in circumstances that result in offsetting or in a presentation in a statement of financial position that is similar to offsetting. For example, under certain circumstances a reporting entity is allowed to report loans net of participations sold. This is deemed to be a sale resulting in de-recognition not an offset of a liability against an asset. MBA wants the FASB and IASB to confirm in the final pronouncement that the offsetting principles do not apply if other accounting standards otherwise prohibit or permit the offsetting or presentation that appears like offsetting.

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

Sincerely,



John A. Courson
President and Chief Executive Officer
Mortgage Bankers Association

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Appendix A

Question 1: The proposals would require an entity to offset a recognized eligible asset and a recognized eligible liability when the entity has an unconditional and legally enforceable right to setoff the eligible asset and eligible liability and intends either:

1. To settle the eligible asset and eligible liability on a net basis
2. To realize the eligible asset and settle the eligible liability simultaneously.

Do you agree with this proposed requirement? If not, why? What criteria would you propose instead and why?

MBA's Response: See MBA's general comments above, *Allow Offsetting on a Less Restrictive Basis, Simultaneous Settlement, and Operational Burden of the Proposed Standard*.

Question 2: Under the proposals, eligible assets and eligible liabilities must be offset if, and only if, they are subject to an unconditional and legally enforceable right of setoff. The proposals specify that an unconditional and legally enforceable right of setoff is enforceable in all circumstances (that is, it is enforceable in the normal course of business and on the default, insolvency, or bankruptcy of a counterparty) and its exercisability is not contingent on a future event. Do you agree with this proposed requirement? If not, why? What would you propose instead and why?

MBA's Response: MBA believes the principles in the Proposed Standard are too restrictive. See general comments above entitled *Allow Offsetting on a Less Restrictive Basis, Right of Setoff and Simultaneous Settlement*.

Question 3: The proposals would require offsetting for both bilateral and multilateral setoff arrangements that meet the offsetting criteria. Do you agree that the offsetting criteria should be applied to both bilateral and multilateral setoff arrangements? If not, why? What would you propose instead, and why? What are some of the common situations in which a multilateral right of setoff may be present?

MBA's Response: No response.

Question 4: Do you agree with the proposed disclosure requirements in paragraphs 11–15? If not, why? How would you propose to amend those requirements and why?

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MBA's Response: MBA believes that the disclosures required in paragraph 12d are unnecessary. See MBA's general comment above, *Operational Burden of the Proposed Standard*.

Question 5: Do you agree with the proposed transition requirements in Appendix A? If not, why? How would you propose to amend those requirements and why? Please provide an estimate of how long an entity would reasonably require to implement the proposed requirements.

MBA's Response: MBA generally disagrees with retrospective or comparative transition requirements. It especially believes that retrospective transition for the Proposed Standard would be operationally burdensome. See MBA's general comment above, *Operational Burden of the Proposed Standard*.