



February 15, 2012

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

File References No. 2011-220

Dear Ms. Cospers:

The Mortgage Bankers Association<sup>1</sup> (MBA) appreciates the opportunity to comment on the proposed accounting standards update Consolidation (Topic 810) Principal versus Agent Analysis (Proposed Update).

### **Background Information**

The FASB issued its FASB Statement No. 167 (FAS 167) in June of 2009 which requires a reporting entity to perform a qualitative evaluation of its power and economics to determine whether it should consolidate a variable interest entity (VIE). For the mortgage banking industry, FAS 167 caused many residential mortgage-backed securities (MBS), previously accounted for off the balance sheet of the issuer, servicer or guarantor, to be included in the consolidated financial statements of the issuer, servicer or guarantor. Since then, the International Accounting Standards Board has been developing a consolidation standard that in some cases would yield different conclusions than FAS 167. One of the sources for differing conclusions relates to whether a decision maker in a VIE is using its power as a principal or an agent. This analysis affects the decision as to whether the entity is a VIE and whether a reporting

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<sup>1</sup> 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, REITs, Wall Street conduits, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web site: [www.mortgagebankers.org](http://www.mortgagebankers.org).

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entity must consolidate the assets, liabilities, revenues, and expenses in the reporting entity's consolidated financial statements.

Under FAS 167, if the decision-making arrangement is determined to be a variable interest and the entity is a VIE, then the decision maker is required to consolidate the VIE if it has the power to direct the activities that most significantly impact the entity's economic performance and the obligation absorb losses or the right to receive benefits that could potentially be significant to the VIE. Under FAS 167, the servicer may be identified as the party required to consolidate the VIE's assets, liabilities, revenues and expenses even though its power was granted through contract. The Proposed Update intends to provide more specific guidance on whether the decision maker is using its power in a principal or an agent capacity. If the latter, then the agent would not have to consolidate the VIE's assets, liabilities, revenues and expenses of the VIE.

Under the proposed qualitative analysis for principal versus agent, the focus would be on the rights held by other parties, the compensation to which the decision maker is entitled to, and the decision maker's exposure to variability of returns from other interests it holds in the VIE.

### **MBA's General Comments**

**MBA Generally Supports the Guidance in the Proposed Update:** MBA lauds FASB's efforts to bring clarity to Consolidation (Topic 810) as it relates to principal vs. agent relationships and to move in the direction of convergence with the IASB's standard on this issue. The resulting rule would bring clarity to existing guidance in GAAP.

As FASB works with the IASB on convergence of Topic 810, MBA requests FASB to examine the existing guidance on consolidation to see if it could be simplified. For example, the consolidation criteria for a voting interest entity and a variable interest entity are based on the same principles and, therefore, should result in the same consolidation conclusion. That is, the consolidator must have "power" as a principal. This power could exist through voting rights, contract, or by design of the entity, but there is a common theme that an entity should be consolidated only by a party that has control. This is in contrast to the original FIN 46 in which the consolidating party did not necessarily have to possess any power, but instead, consolidation was based on the party that absorbed a majority of the VIE's variability. Because the focus of existing and proposed guidance is on control, the form of the entity does not appear to be relevant. Therefore, we believe the concept of a variable interest entity (which contains the most complex provisions of Topic 810) is not relevant when determining the party that controls an entity. A reporting entity should not be required to expend effort in identifying VIEs if it is apparent that the reporting entity doesn't possess the power to control the entity. Our members have not identified circumstances in which applying the concept of control and power results in a different consolidation conclusion under a

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voting or variable interest model. If the purpose of identifying a VIE is only relevant for disclosures, the Board should reassess whether all such disclosures are necessary.

In addition, we offer the following recommendations with regard to the guidance, as proposed.

**Proposed Update Takes “Significance” Out of the Qualitative Analysis:**

Under existing accounting principles (Topic 810-10-25-38A) there is a materiality threshold:

- b. The obligation to absorb losses of the VIE that **could potentially be significant to the VIE** or the right to receive benefits from the VIE **that could potentially be significant to the VIE**.

Under the Proposed Update, the wording “that could potentially be significant to the VIE” would be removed. MBA believes that this could result in the reporting entity being forced to conduct additional analysis when the reporting entity holds only an immaterial variable interest in the VIE that could never be potentially significant.

Further, in the example in 810-10-55-171, the following language would be removed: “... either of which could potentially be significant to the VIE.” Again, this gives the appearance that any variable interest, whether potentially significant to the VIE or not, could trigger the need to consolidate the VIE’s assets, liabilities, revenues and expenses in a reporting entity’s consolidated financial statements.

MBA believes that this was not FASB’s intent and recommends that FASB retain the existing threshold in Topic 810 to avoid any unintended consequences. If however, FASB intentionally desires to take the materiality threshold out, MBA notes that this major change was not included in the highlights or questions included with the exposure draft. Since this would be a major change, MBA recommends that FASB re-expose this for specific commentary from its constituents.

**Fees: Adequate Compensation or Variable Interest:** In order to simplify the consolidation analysis, we propose the guidance be revised to distinguish between a fee arrangement that is nothing more than adequate compensation for services provided and a fee arrangement that is a variable interest. The factors found in subparagraphs (a), (d), (e) and (f) of paragraph 810-10-55-37 should be incorporated into 860-10-25-39 as a basis for making this determination. If the decision maker’s fee arrangement is commensurate with the services provided, includes only customary terms and conditions, is not significant in amount and is expected to absorb no more than an insignificant amount of the variability from the VIE’s economic performance, the fee arrangement is simply adequate compensation for services provided. By definition, it does not absorb more than an insignificant amount of variability and, absent other economic interests held by the decision maker, it is not a variable interest in the VIE. MBA believes it would be contradictory to include the magnitude and variability of such

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a fee as a factor to be considered in the principal versus agent analysis. In summary, if an entity's only interest is a fee that is normal and customary, then the variability and magnitude of that fee shouldn't matter. If there are other interests in the VIE besides the fee, then the magnitude and variability of the entire interest should be considered.

**Reconsideration: Primary Beneficiary Versus Principal/Agent:** MBA notes that there appears to be an inconsistency in the proposed requirement for reconsideration of a principal/agent relationship when compared with the present reconsideration requirements for determining the primary beneficiary. Existing rules require the reporting entity to continuously perform analysis to determine if facts and circumstances have changed the previous identification of the primary beneficiary of a VIE. Under the Proposed Update, rather than perform continuous analysis of agent/principal relationship, the reporting entity would reconsider only upon changes in the purpose and design. MBA believes that the criteria for reconsideration for principal/agent relationships should be based on changes in all facts and circumstances. For example, a principal could dispose of its interests in a VIE or an agent could increase its variable interests over time. These actions are not part of the purpose and design but could be indicative of a change in the principal/agent relationship.

**Need for a Fourth Factor for Determining Principal/Agent Relationship:** The Proposed update presently has three factors to consider in determining principle/agent relationship:

1. The rights held by other parties
2. The compensation that the decision maker is entitled in accordance with the compensation agreement
3. The decision maker's exposure to variability of returns from other interests that it holds in the entity.

MBA believes a fourth factor, the scope of a decision maker's authority, is a critical element of the principal versus agent analysis and should also be considered. This additional factor will be especially critical in static re-securitizations (where the investment vehicle owns pools of securities and the issuer's duties are limited to collecting cash flows and distributing them to investors) as such transactions do not involve any decision making. Since there are no decisions to be made that could impact the economic performance of the investment vehicle, the likely conclusion is that there is no primary beneficiary in the VIE.

MBA appreciates the opportunity to share its observations with you. Any questions about MBA's comments should be directed to Jim Gross, Vice President Financial Accounting and Public Policy and Staff Representative to MBA's Financial Management Committee, at (202) 557-2860 or [jgross@mortgagebankers.org](mailto:jgross@mortgagebankers.org).

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Sincerely,

A handwritten signature in black ink, appearing to read "D.H. Stevens". The signature is written in a cursive, somewhat stylized font.

David H. Stevens  
President and Chief Executive Officer