July 31, 2003

Ms. Suzanne Q. Bielstein
Director, Major Projects and Technical Activities
Financial Accounting Standards Board
401 Merritt 7, P.O. Box 5116
Norwalk, Connecticut 06856-5116

File Re: 1200-001

Dear Ms. Bielstein:

The Mortgage Bankers Association of America (MBA) appreciates the opportunity to comment on the Board’s Proposed Statement of Financial Accounting Standards, Qualifying Special-Purpose Entities and Isolation of Transferred Assets, an amendment of FASB Statement No. 140 (the proposed statement). MBA has studied the guidance in the proposed statement and believes it could have unintended, adverse consequences for the accounting treatment by mortgage banking companies of transactions involving transfers of mortgage loans: (1) in exchange for securities guaranteed by the secondary market agencies Fannie Mae, Freddie Mac and Ginnie Mae, and (2) in “private label” mortgage securitizations transactions. Our concerns stem from the additional restrictions that would be imposed by the proposed statement on: (1) the permitted activities of transferors, their affiliates or agents (hereby transferors) in transactions involving transfers of loans to qualifying special purpose entities (QSPEs), and (2) on the assets that QSPEs may hold, as explained herein. It is important to note that none of the transactions involve an SPE that has the ability to reissue beneficial interests.

MBA is the national association representing the real estate finance industry. 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 prospects through increased affordability; and to extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters excellence and technical know-how among real estate finance professionals through a wide range of educational programs and technical publications. Its membership of approximately 2,600 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, life insurance companies and others in the mortgage lending field. For additional information, visit MBA’s Web site: www.mbaa.org.

I. MBA Position

MBA believes the guidance in Statement No. 140 (FAS 140) provides for the appropriate reporting of transfers of loans in exchange for agency guaranteed mortgage-backed securities.
and private label mortgage (including residential and commercial) securitizations. To our knowledge, the accounting treatment of loan transfers in these circumstances has not been called into question by investors, creditors, regulators, or other interested parties. In all of these transactions, actual and effective control over the loans is transferred from lenders to trustees on behalf of the beneficial owners of the loans underlying the securities. Consequently, MBA believes the current accounting treatment for these loan transfers should be preserved under any amendment of FAS 140.

II. Assumptions in MBA’s Analysis of Proposed Statement

Our analysis of the potential implications of the proposed statement to our members is predicated on our belief that secondary market agency securitizations (hereby agency securitizations) and most private label mortgage securitizations involve QSPEs, as that term is defined in FAS 140. We mention this because some people have questioned whether some agency securitizations involve “QSPEs” if “SPEs” are not involved in the transactions. We understand that the guidance in FIN 46, Consolidation of Variable Interest Entities, may have prompted these questions since an “aggregation of assets” within an entity is not an “entity” pursuant to that standard.

We believe agency securitizations involve QSPEs, which are defined as “...a trust or other legal vehicle...” that meets the criteria of FAS 140, paragraph 35. In our view, agency mortgage pools backing agency guaranteed securities meet the definition of a trust because the agency has a fiduciary obligation, in accordance with the documents governing its responsibilities, to hold mortgages for the benefit of the securities holders. Moreover, we believe the “trusts” involved in agency securitizations meet the additional criteria in paragraph 35.

An additional point that bears mentioning is that MBA believes lenders are “transferors” of loans to QSPEs in situations involving exchanges of pools of loans for agency guaranteed mortgage-backed securities. Some of our members have questioned whether this is true as such exchanges arguably involve transfers of loans to the agencies, rather than to QSPEs. Nevertheless, we believe lenders are transferors to QSPEs because transfers to the agencies, which effectively function as their own trustees, constitute transfers to “trusts.”

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1 The term “SPE” is not defined in FAS 140, the proposed statement, or FIN 46.
2 Paragraph 3 of FIN 46 includes the following sentence: “ Portions of entities or aggregations of assets within an entity shall not be treated as separate entities for purposes of applying this Interpretation unless the entire entity is a variable interest entity.” MBA believes the FASB should reconsider the use of the terms “entity,” “SPE” etc. in its literature as we believe these words and terms have raised a lot of questions among constituents. For example, the term “SPE” is not defined and a “trust” is not an “entity” per se.
3 A trust is an arrangement whereby property is transferred with intention that it be administered by a trustee for another’s benefit. Black’s Law Dictionary 1680 (rev. 4th ed. 1968).
4 Agency securitizations are treated as grantor trusts for tax purposes.
5 For example, Section 3.01 of Article III, Mortgages, of the Ginnie Mae Guarantee Agreement, states: “The Issuer does hereby transfer, assign, set over, and otherwise convey to Ginnie Mae all the right, title, and interest of the Issuer in and to the Mortgages identified and described in the Schedule of Pooled Mortgages for the subject pool.”
III. MBA Analysis of Potential Impact of Proposed Statement

Our analysis of the proposed statement is based on the above assumptions and its potential impact to our members' financial statements if the QSPEs used in agency and private label mortgage securitizations were rendered "nonqualifying" by virtue of the additional restrictions that would be imposed on the permitted activities of transferors, and on the assets that a QSPE may hold, as described below.

A. Potential Impact on Accounting for Exchanges of Loans for Agency Guaranteed Securities

Under FAS 140, "...mortgage-backed securities retained in a guaranteed mortgage securitization in which the special purpose entity (SPE) meets all conditions for being a qualifying SPE are classified in the financial statements of the transferor as securities that are subsequently measured under Statement 115". [See footnote 17]. Pursuant to this guidance, securities retained are only accounted for as securities provided the SPE to which the loans were transferred meets all conditions for being a qualifying SPE. Although it is unclear how such transfers should be accounted for if the SPE does not meet all the conditions for being a qualifying SPE, one could presume that the transferred loans should continue to be accounted for as loans, rather than securities, by the transferor.

In that circumstance, our members are concerned that any subsequent transfer of the "loans" to investors (although in the form of securities) would fail to meet the condition for sale treatment in paragraph 9.b. of FAS 140 because the transferee (investor) would not have the right to freely pledge or exchange the "loans" it received. Under this scenario, our members would be required to continue to account for the loans underlying the securities that have been transferred to investors as their own "loans," despite the fact that our members would control neither the securities nor the loans.

Others might conclude that lenders should reclassify loans that are transferred in exchange for guaranteed mortgage backed securities as securities given the definition of "securitization" in FAS 140: "The process by which financial assets are transformed into securities." [Glossary] In that case, lenders (as owners of the securities) would be faced with the prospect of consolidating the loans held in trust by the agencies under FIN 46, prior to transfer of the securities to investors. In that case also, subsequent transfers of the "loans" to investors would probably not qualify for sale treatment under FAS 140.

B. Potential Impact on Accounting for Private Label Commercial and Residential Securitizations

Similarly, under FAS 140, most transfers of mortgage loans in private label commercial and residential mortgage securitizations qualify as sales because the entities to which the loans are transferred are QSPEs under that statement. If, however, the proposed statement rendered as "nonqualifying" the SPEs used in these securitizations, lenders would have to retain the loans on their books as the transactions would fail the condition for sale treatment in paragraph 9.b. of FAS 140.
In summary, our members' financial statements would be grossly misstated if the guidance in the proposed statement did not recognize the trusts used in agency and private label mortgage securitization transactions as qualifying SPEs. For example, one MBA member company, which is the mortgage banking subsidiary of one of the largest banks in the country, noted that an effect of having to account for the loans underlying their agency guaranteed mortgage backed securities (both securities held for sale and those that have been sold to investors) as "loans" would increase the company's mortgage assets by $140 Billion. This number would exceed the parent bank's total existing assets, which would increase by 117% to $260 Billion under the proposed statement.

The guidance in the proposed statement gives rise to innumerable other accounting, as well as regulatory capital, concerns. For example, it is unclear how our members would be required to account for servicing rights on agency guaranteed securities received in exchange for pools of loans (that will be classified as available for sale or trading securities) if the "exchanges" are not accounted for by reclassifying the loans as securities. It is unclear also whether, when and how the bank regulators would revise their capital rules in response to institutions' increased holdings of "loans."

For these reasons, we are gravely concerned about provisions in the proposed statement that would deny QSPE status to trusts used in agency and private label securitizations, as described in more detail below.

IV. Analysis of Impact of Specific Provisions of Proposed Statement

A. Analysis of Impact of Prohibition on Transferor Financial Guarantees

New paragraph 35.e. of the proposed statement would deny QSPE status to trusts if a transferor is committed "...to deliver additional cash or other assets to an SPE or its Beneficial Interest Holders (BIHs)..." under financial guarantees. As written, a "financial guarantee" would include "servicing advances" that are not recoverable by the transferor/servicer as well as the types of "standard representations and warranties" that lenders are subject to under agency and most other loan transfer agreements. As explained below, most SPEs involved in mortgage securitizations would fail to be QSPEs under the proposed statement because transferors generally are subject to one or both of these types of financial guarantees.

1. Servicing Advances

The proposed statement indicates that servicing advances are a type of prohibited financial guarantee under proposed new paragraph 35.e. and, therefore, a restricted activity of the
transferor. However, pursuant to a footnote to this paragraph: “This prohibition does not include a commitment for servicing advances if the servicer can choose not to make the advance if it believes recovery of the advance from collections on the assets of the SPE is in doubt.” We had to make two critical assumptions about this guidance in considering its implications to our members.

First, the guidance does not indicate a threshold amount below which an unrecoverable amount would not be deemed to be a prohibited financial guarantee. Consequently, we have assumed there is no threshold amount. This would mean that a servicing advance is a restricted activity of a QSPE unless a servicer can choose not to make an advance if it may not be 100% recoverable.

Second, the term “servicing advance” is not defined in the proposed amendment or FAS 140. As a result, we had to assume that the term could include advances of: (1) principal and interest payments to investors only; or (2) principal and interest payments to investors, as well as all payments made on behalf of the SPE and BIHs to preserve and protect the value of the underlying collateral, including advances of tax and insurance payments, fees paid to foreclosure attorneys, property maintenance costs, etc.

Nevertheless, as explained below, we believe that even the narrower definition (relating to P&I only) would render as “nonqualifying” the SPEs used in all of the secondary market agency and some private label mortgage securitization programs.

Ginnie Mae Securitization Program

Ginnie Mae securities are backed by loans insured by the Federal Housing Administration (FHA loans) or guaranteed by the Department of Veterans Affairs (VA loans). Servicing of FHA insured loans and VA guaranteed loans are subject, respectively, to FHA and VA guidelines.

Servicer advances of interest on defaulted FHA insured loans are often not fully recoverable because servicers are required to pass-through the stated coupon interest rate to security holders but are entitled to reimbursement at a potentially lower “debenture interest rate” until the loan is removed from the pool: (1) through a servicer buyout (servicers have the option of buying a loan out of the pool at the ninetieth day of default), or (2) when it is liquidated through foreclosure sale.

Under the broader definition of servicing advances, servicers of FHA insured and VA guaranteed loans may forfeit the right to receive reimbursement for advances of foreclosure attorney fees and property preservation costs if they exceed the relevant government agency’s printed schedule of approved fees. Moreover, FHA servicers are only entitled to reimbursement of two-thirds of their foreclosure costs (three-quarters of foreclosures costs for servicers ranked Tier 1 by FHA) even if their costs are within the prescribed range of approved fees under FHA guidelines.

* The Department of Housing and Urban Development establishes the “debenture interest rate.” The debenture interest rate may be higher or lower than the coupon rate on any given security at any point in time.
Servicers of FHA insured loans also may forfeit the right to receive reimbursement for advances (e.g. for property preservation) if they fail to inspect a property within the window provided by FHA guidelines. Similarly, if a servicer fails to initiate foreclosure by the FHA deadline (within six months of the date of default) then the servicer forfeits the right to receive debenture interest; that is, the servicer would not be reimbursed for interest advances to security holders that would otherwise accrue from the required start of foreclosure until the property conveyance (which could be fifteen months or more in some states).

In the case of the VA guaranteed home loan program, the VA may pay the guarantee or pay the outstanding indebtedness and take conveyance of the property upon foreclosure sale. When the "net value" of a property is deemed to be less than the unguaranteed portion of the indebtedness, the VA will not specify a bid at the foreclosure sale and thus will not take conveyance of the property (called a VA "no-bid"). In this case, the lender risks losing a portion of its investment if the amount of the guarantee plus the proceeds from the sale of the property is less than the outstanding indebtedness (principal, interest, foreclosure, preservation and administration costs). To reduce losses, lenders will frequently "buydown" a portion of the principal or absorb accrued interest in order for the VA to take conveyance of the property.

**Freddie Mac Securitization Program**

Servicer advances of interest to Freddie Mac guaranteed security holders are not fully recoverable to the extent a borrower makes a large, unscheduled payment (i.e. curtailment) on their mortgage loan during a month. For example, if a borrower makes a $50,000 payment on their mortgage loan during a given month, the servicer is required to advance interest to the security holders in the following month based on the loan's balance prior to the curtailment. However, the servicer in that instance receives interest from the borrower based on the adjusted, lower principal balance. Servicers are not entitled to reimbursement from Freddie Mac for the difference between the pass-through interest payment and the borrower's adjusted interest payment.

**Fannie Mae Securitization Program**

Servicers of Fannie Mae loans also are not entitled to reimbursement from Fannie Mae for the difference between the pass-through interest payment and the borrower's adjusted interest payment in the event of an unscheduled curtailment of a borrower's mortgage balance.

Moreover, servicer advances of interest to Fannie Mae security holders are not fully recoverable to the extent a borrower pays off their loan during a month. In that circumstance, the servicer is required to advance an entire month's interest to the security holder even though they received interest on the loan through the payoff date. Servicers are not entitled to reimbursement from Fannie Mae of the difference between the pass-through interest payment and the borrower's interest payment in the month a loan is paid off. (Freddie Mac's security agreements require

* "Net value" is the fair market value of the property, minus the total costs the VA estimates would be incurred by the VA resulting from the acquisition and disposition of the property for property taxes, assessments, liens, property maintenance, administration and resale. 38 CFR 36.4301.
faster remittances of pay-off funds to investors, which in turn relieves servicers of this interest pass through differential).

It is important to note that under both Fannie Mae's and Freddie Mac's loan securitization programs, servicer advances (e.g., costs of foreclosure) also may not be recoverable to the extent that a servicer has elected to assume some of the credit risk on the loans in return for a lower, negotiated guarantee fee. The majority of our members account for these recourse arrangements by recognizing a liability at fair value, pursuant to the guidance in FAS 140, at the time a security is sold to investors. In the past, if a security was held for investment or available for sale, our members recognized their recourse obligations as liabilities under FAS 5, Accounting for Contingencies, or as reductions in the values of any associated servicing rights. Today, our members believe the guidance in recently released FIN 45, Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others, requires them to recognize their recourse arrangements as liabilities at fair value. It is unclear how the proposed amendment would affect the treatment of these arrangements.

As indicated by the above agency examples; the prohibition against transferors entering into commitments with SPEs or DII is to make potentially unrecoverable servicing advances would render as "nonqualifying" the SPEs used in the secondary market agency securitization programs. Given the guidance in FAS 140, this would have the perverse effect of requiring our members to continue to account for loans transferred in those securitization transactions as their own loans. We recommend that the FASB forestall this possibility by clarifying that servicing advances are not financial guarantees under proposed new paragraph 35.e. provided that the advances are made under guaranteed mortgage securitization programs.

2. Advances of Interest in Private Label Mortgage Securitization Programs

In many non-agency commercial mortgage securitization transactions, it is common for servicers to advance a full month of interest on underlying loans that prepay during a given month. The interest advance is treated as a deduction of the servicing fee, which is not subject to reimbursement, in the month the payoff is received. Because such payments are capped at the amount of the servicing fee received in a given month, the servicer is not at risk of losing more than a month's servicing fee. Parties to these types of securitizations take the probability of such advances into account in establishing a servicing fee prior to the securitization of the loans, which is intended to provide the servicer with an adequate return for servicing the loans even in the event of prepayments.

MBA recommends that the FASB revise the proposed amendment to clarify that interest advances of this type are not financial guarantees entered into with the transferor because the servicer is ultimately compensated for any advances through the established servicing fee.

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10 Paragraph 11 requires: "Upon completion of a transfer of assets that satisfies the conditions to be accounted for as a sale ... the transferees shall recognize all assets obtained and any liabilities incurred and initially measure them at fair value..."
3. Standard Representations and Warranties

The guidance in the proposed statement would deny QSPE status to SPEs used in agency securitizations as well as private label commercial and residential mortgage securitizations because those securitizations generally commit transferors under standard representations and warranties. These guarantees commit transferors to repurchase or replace loans, or otherwise indemnify BIHs against losses on loans that did not meet specified underwriting, pooling and other criteria at the transfer date.

We believe the bank regulatory agencies' rules on recourse arrangements draw a reasonable distinction between standard representations and warranties relating to the quality of loans at the transfer date and other obligations relating to the ongoing credit quality and performance of the loans. The agencies' rules on the capital treatment of recourse transactions (Federal Register, Vol. 60, No. 230) read as follows:

"The final rule is consistent with the agencies' longstanding recourse treatment of representations and warranties that effectively guarantee performance or credit quality of transferred loans. However, the agencies also recognize that banking organizations typically make a number of factual warranties unrelated to ongoing performance or credit quality. These warranties entail operational risk, as opposed to the open-ended credit risk inherent in a financial guarantee, and are excluded from the definitions of recourse and direct credit substitute. Warranties that create operational risk include: warranties that assets have been underwritten or collateral appraised in conformity with identified standards, and warranties that provide for the return of assets in instances of incomplete documentation, fraud, or misrepresentation." [italics added]

Consistent with the above passage, we believe there is an important distinction between transferors' obligations under standard representations and warranties, and financial guarantees that involve commitments relating to the ongoing performance of transferred assets. The relevant distinction is that the objective of a standard representation and warranty is to ensure that the asset being transferred is what it is purported to be at the transfer date, which is inherent in all asset sales, whereas the objective of a financial guarantee is to ensure a specified return on the asset being transferred, which is not inherent in any asset sales. For these reasons, we believe the distinction between these types of commitments should be drawn by the FASB for purposes of distinguishing QSPEs.

B. Analysis of Impact of Prohibitions on Assets a QSPE May Hold

The proposed statement would further restrict the types of assets that a QSPE may hold for reasons that are not clear to the MBA. These additional restrictions would deny Q status for many SPEs used in private label commercial and multifamily mortgage securitizations. This would materially distort our commercial and multifamily members' financial statements by disallowing sales treatment for their loan transfers in loan securitization transactions because the transferees (i.e. the SPEs) would not be able to freely pledge or exchange the transferred loans under paragraph 9.b. of FAS 140.
1. Prohibition on QSPE Holding Equity Instruments

Under the proposed statement, paragraph 35.c. (1) of FAS 140 would be amended to permit a QSPE to hold only: "Financial assets transferred to it that are not equity instruments and that are passive in nature."

This prohibition would deny Q status for commercial/multifamily mortgage securitizations in which the structure of the transaction involves the right of a party to the securitization, typically a special servicer, to foreclose on equity securities (representing ownership of the borrower) in the event a loan goes into default. For example, stock of a single proper company may be held as collateral for a commercial real estate loan in lieu of a mortgage on the real estate and may be foreclosed upon. The ability of the servicer to seize control of the borrower's equity securities provides additional control and assurance to BIHs that the assets held by a QSPE are properly safeguarded. MBA does not understand why the right of a servicer to foreclose on a borrower's equity securities should affect whether a transferor can treat loans as sold under FAS 140 since the transferor, in that instance, would not be in a position to control the defaulted loans, or the borrower.

MBA recommends that the FASB revise paragraph 35.c. (1) to clarify that a QSPE may hold equity instruments provided those instruments were obtained by a servicer upon default of a loan.

2. Prohibition on QSPE Entering Into Passive Derivative Instruments with Transferor

Paragraph 35.c. (1) of FAS 140 would be amended to prohibit a QSPE from holding: "Passive derivative financial instruments entered into with counterparties other than the transferor, its affiliates, and agents that pertain to beneficial interests (other than another derivative financial instrument) issued or sold to parties other than the transferor, its affiliates, or its agents (paragraph 39 and 40)."

This prohibition would deny Q status for commercial/multifamily mortgage securitizations involving derivative instruments in which the transferor, its affiliates or agents provide protection against differences between the interest rate on a security and the interest rate on a loan that is collateral for the security. These derivative instruments provide liquidity to the securities market by enabling lenders to originate loans with a range of interest rates and conditions. However, this flexibility does not constitute continued control since the transferor could never regain control of the transferred loans under the derivative contracts.

MBA recommends that the FASB revise paragraph 35.c. (2) to clarify that a QSPE may hold passive derivative financial instruments entered into with the transferor, its affiliates or agents provided those instruments could not cause those parties to regain control over transferred loans.

The transferor is presumed to be a party other than the entity that would be required to foreclose on the borrower's equity instruments.
Conclusion

MBA believes the guidance in the proposed statement would result in grossly misstated financial statements for our members that exchange loans for agency guaranteed securities and that transfer loans in commercial and residential mortgage private label securitization transactions. We believe this would be the case because the prohibition against transferors entering into financial guarantees with SPEs or BIHs would render as “nonqualifying” the SPEs used in those securitizations, and because of the additional prohibitions on the types of assets a QSPE may hold. The effects of these changes would be that our members would have to carry on their books loans that are collateral for agency guaranteed and private label mortgage backed securities.

To ensure that our members’ loan securitization transactions are properly and accurately represented going forward, we recommend that the FASB revise the guidance in the proposed statement:

- To clarify that financial guarantees under proposed new paragraph 35.e. of FAS 140 do not include: (1) servicing advances made under a guaranteed secondary market agency mortgage securitization program; (2) interest advances made under a private label mortgage securitization program that are deducted from servicing fees; and, (2) standard representations and warranties that relate to compliance of asset quality at the transfer date and do not commit the transferor to the ongoing performance of the transferred loans;

- To clarify that QSPEs may hold equity instruments that it receives after the transfer date under paragraph 35.c. (1);

- To clarify that QSPEs may hold passive derivative financial instruments entered into with the transferor, its affiliates and agents provided those parties could never regain control of the transferred loans under the terms of the derivative contracts under paragraph 35.c. (2).

We believe these changes are necessary to ensure that our members’ financial statements are consistent with the underlying economics of their business transactions.

MBA greatly appreciates the opportunity to comment on FASB proposals of concern to our members. If you have questions or comments about the information herein, please do not hesitate to contact Alison Utermohlen, staff representative to MBA’s Financial Management Committee, at 202/557-2864.

Most sincerely,

Jonathan L. Kempner
President & Chief Executive Officer