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Technical Director
Financial Accounting Standards Board of the
Financial Accounting Foundation
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To Whom It May Concern:

On August 11, 2005, the Financial Accounting Standards Board (“FASB”) issued its exposure draft for the proposed statement of financial accounting standards, “Accounting for Servicing of Financial Assets an Amendment of FASB Statement No. 140” (“Exposure Draft”). The FASB is soliciting responses to the Exposure Draft from interested parties. The purpose of this letter is to provide the views and opinions of NetBank, Inc. with respect to the proposed accounting contained in the Exposure Draft.

**About NetBank**

NetBank, Inc. is a holding company that wholly owns the outstanding stock of NetBank, a federal savings bank. NetBank, Inc. is listed on the NASDAQ under the trading symbol “NTBK” and has a total market capitalization of approximately $400 million. Netbank, through its Internet-only banking platform, operates as an FDIC-insured, federally chartered thrift institution that currently serves more than 160,000 customers throughout the United States and in more than 80 foreign countries. In addition to its retail banking operation, NetBank also participates in mortgage banking activities through its wholly owned subsidiaries Market Street Mortgage (conforming retail mortgage originations) and Meritage Mortgage Corporation (non-conforming wholesale production network) and through its operating division Netbank Funding (conforming wholesale and correspondent production network). These operations originated $13.6 billion and $18.9 billion of mortgage loans during the years ended December 31, 2004 and 2003, respectively. In addition to producing loans, NetBank invests in mortgage servicing rights. The unpaid principal balance underlying its investment in servicing rights was $12.7 billion at December 31, 2004, and the carrying value of those servicing rights on NetBank’s balance sheet was $171 million at December 31, 2004.

NetBank hedges the accounting risks related to its investment in servicing rights using various forms of derivative instruments, including interest rate floor contracts, interest
rate swap contracts, swaptions, interest rate cap contracts, and forward purchase contracts, and through its investment in primarily government and government-agency MBS securities that it holds available for sale. NetBank currently has elected hedge accounting treatment for the derivatives portion of its servicing hedge.

Note our statement that we hedge our accounting risks related to servicing rights, not our net economic risks. We hedge our economic risks on servicing rights when viewed in isolation, but not holistically. NetBank's holistic economic exposure to interest rate risk with respect to its servicing rights is more than fully hedged by its ownership of whole loans. That is to say, we are "long on loans" (not servicing rights) on a net economic basis. However, if we do not expressly hedge the servicing rights we will be subject to wildly fluctuating accounting results because on balance sheet loans cannot be designated as a hedge of servicing rights (or vice versa). Thus, we must independently hedge the accounting risks related to the investment in servicing rights with derivative instruments. The derivatives used for this purpose lengthen asset durations. So, economically we go still "longer on loans" solely in order to mitigate exposure to volatile accounting results.

We find it interesting that generally accepted accounting principles require that we assume greater real long-term economic risks in order to mitigate the short-term shareholder risks associated with unpredictable and volatile earnings results.

Our point is that different accounting models (generally the 'historical cost', 'lower-of-cost or market' and 'mark-to-market models') are required under GAAP to be applied within the same balance sheet. Thus, managing net economic risks under a consistent balance sheet framework is the exact opposite of what is demanded under a fragmented and inconsistent GAAP accounting model. In this way, managing fully integrated net economic exposures ends up taking a back seat to managing short-term accounting results under a fragmented GAAP model.

We want to note that allowing for a changed accounting model for servicing rights (from LCOM to mark-to-market) does not address what we believe is the more important issue described above. The balance sheet model for financial institutions will still be fragmented. Even so, for the practical reasons described below, we support the proposed change.

General Comments About the Proposed Accounting Standard

NetBank supports the FASB's long-term objective of measuring financial assets and liabilities at fair value. However, the move to fair value accounting has been and will continue to be slow, and the slow transition has brought about some disparities and inconsistencies between the way we manage our business and the way the transition to fair value accounting requires us to report our business results. This is especially true in the mortgage banking segment of our business whereby we still account for two asset classes at the lower-of-cost-or-market (LCOM): loans held-for-sale and servicing assets. In the case of the latter, the three components of our net economic position in servicing, namely, servicing rights, servicing assets, and the underlying servicing rights in general, are recorded at the lower of amortized cost or market. The derivatives used to hedge the servicing
asset are accounted for at fair value, marked-to-market through the income statement. And, the mortgage-backed securities used to hedge the servicing asset are carried at fair value, with the changes in fair value marked-to-market through the equity section of the balance sheet. In order to line up the accounting NetBank has elected to treat the derivatives hedging the servicing asset as fair value hedges under FASB Statement No. 133. In doing so, NetBank incurs hundreds of thousands of dollars of expense each year conducting the required hedge effectiveness testing and other documentation requirements under FASB Statement No. 133. The proposed exposure draft focuses on transitioning the accounting for servicing assets from LOCOM to fair value and provides companies like NetBank the opportunity for relief from the burdensome documentation requirements. And, it moves financial institutions further along the path toward full fair value accounting. NetBank therefore strongly supports the proposed accounting rule.

The following are specific questions and comments related to the proposed accounting.

**Specific Comments About the Proposed Accounting Standard**

1. The Exposure Draft requires all servicing rights to be measured at inception at fair value. Subsequent to inception date, the exposure draft gives the entity the option to elect to carry the asset at either LOCOM or fair value. Presumably, this optional approach was taken to accommodate each of those who hedge using derivatives, those who hedge using available for sale securities and those who use other macro hedging strategies.

   Since the Exposure Draft does not presently provide for special transition rules to reclassify certain securities from available-for-sale to trading account (without calling into question an entity's treatment of those securities under FASB Opinion No. 115), the Exposure Draft will lead many who hedge primarily with available-for-sale securities no choice but to continue to account for their servicing rights at LOCOM, whereby neither the servicing asset nor the mortgage-backed securities economically hedging the servicing asset are marked-to-market through the income statement. Netbank endorses the inclusion in the accounting standard special transition rules for the optional re-classification of specific available-for-sale securities to trading account securities. We recommend that such reclassification be optional since some companies specifically earmark such securities as an economic hedge and others include servicing assets in the overall macro asset/liability management strategy for the entity.

   We believe that the transition rules for this one-time election should parallel the transition rules for the election of fair value accounting through a cumulative effect adjustment in the income statement during the period of election.

2. The election of fair value vs. LOCOM must be made for each major class of servicing assets and liabilities. Those major classes are delineated by example in paragraph 17 (h), "...for each major asset type (for example, mortgage loans, credit card receivables, and automobile loans)...". We believe that the proposed
accounting standard should allow a bit more granularity in the asset types for purposes of making the fair value vs. LOCOM election as relates to mortgage assets. We would suggest distinguishing residential 1-4 family mortgage loans from multi-family and other commercial mortgage loans. We would also suggest distinguishing first lien from second lien and open ended HELOC loans. Finally, most companies manage their prime mortgage servicing separate from subprime due to vastly different prepayment and default behaviors, so we would like to see that separation allowed under the proposed accounting standard. We believe that this additional granularity is necessary due to differences in the quality and quantity of data available to determine fair value for each class and the differences in risk behavior of servicing rights for each of these major mortgage classifications.

3. Paragraph 17 e (3) of the proposed standard for servicing assets and liabilities subsequently measured at fair value would require what appears to be a “roll-forward” of the balance of capitalized servicing rights from beginning of period to end of period. It states:

(3) The activity in the balance of each class of servicing assets and each class of servicing liabilities (including description of where changes in fair value are reported in the statement of income for each period for which results of operations are presented) including:

(a) The beginning and ending balances
(b) Additions (through purchase, assumption or asset transfer)
(c) Disposals
(d) Changes in fair value
(e) The amount of contractual servicing fees earned for each period for which results of operations are presented, including a description of where each source of activity is reported in the statement of income.

If the intent is for a comprehensive roll-forward of the balance in capitalized servicing assets, the list in (3) (a) through (e) above is not an exhaustive list of the likely changes in value. For example, (2) (a) appears to be attempting to delineate what NetBank calls the “time decay” of the asset. Time decay represents the value that is expected to be realized with the passage of each specific period of time. It would include more than just “contractual fees earned”. Time decay would also include ancillary income earned, benefit of escrow balances realized, the cost of servicing the underlying mortgage loans, and the cost of making required servicing related advances on delinquent loans and advances on the payment of property taxes or insurance. We recommend that the FASB add some additional granularity to (3) (e) to encompass the time decay of all kinds of value or make the language in (3) (e) more general to accommodate all elements of time decay.

If one of the intended benefits of the proposed accounting standard is to provide companies relief from the documentation and paperwork requirements of FAS 129, the existence of paragraph (3) (e) may very well put in place a more documentation and paperwork requirement that is equally onerous. In drafting the final rule under (2), we ask that the FASB keep the documentation and disclosure
requirements as simple as possible. Perhaps (3) (e) should be worded in such a way to allow for a one line disclosure of the “net value of servicing realized during the quarter”. That could be supplemented by a qualitative disclosure of the line items in the income statement where each major component of servicing revenue and expense is included.

4. Likewise, paragraph 17 f (3) of the proposed standard for servicing assets and liabilities subsequently measured at LOCOM would require what appears to be a “roll-forward” of the balance of capitalized servicing rights from beginning of period to end of period. NetBank’s comments with respect to paragraph 17 e (3) above apply equally to paragraph 17 f (3).

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In summary, we strongly support the purpose and conclusions of the proposed accounting for servicing rights. We believe that it will serve to simplify the accounting for mortgage servicing rights and related hedges by putting both under the same accounting model, fair market valuation. Likewise, the proposed accounting represents a further step along the road to fair value accounting. However, the accounting for our business will not link up with the economics of our business until every financial instrument in our balance sheet is on one consistent accounting model (either fair value, amortized cost, or LOCOM).

We appreciate the opportunity to comment on the proposed statement of accounting standards for servicing of financial assets. If you have any specific question related to NetBank’s response in this letter, feel free to call me at (803) 462-8160.

Yours truly,

[Signature]

James P. Gross
Corporate Controller