October 10, 2005

Technical Director
Financial Accounting Standards Board
401 Merrit 7
P.O. Box 5116
Norwalk, CT 06856-5116

File References: 1225-001 Accounting for Transfers of Financial Assets, an amendment of FASB Statement No. 140

1220-001 Accounting for Servicing of Financial Assets, an amendment of FASB Statement No. 140

1210-001 Accounting for Certain Hybrid Financial Instruments, an amendment of FASB Statements No. 133 and 140

Dear Technical Director:

Countrywide Financial Corporation ("Countrywide")\(^1\) appreciates the opportunity to comment on the above referenced Exposure Drafts. We have consolidated our comments for each of these Exposure Drafts into this letter.

We support the Board's objectives to (1) revise and clarify the derecognition requirements for financial assets and the initial measurement of interests related to the transferred financial assets held by the transferor, (2) amend the accounting for servicing of financial assets, and (3) reconsider the interim guidance in Statement 133 Implementation Issue No. D1, "Application of Statement 133 to Beneficial Interests in Securitized Financial Assets" ("Issue D1"). However, we believe that certain of the Exposure Drafts' provisions should be clarified or require further revision as discussed herein.

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\(^1\) Countrywide Financial Corporation through its subsidiaries provides mortgage banking and diversified financial services in domestic and international markets. Countrywide sold loans totaling $201 billion (approximately 78% utilizing securitizations) for the six months ended June 30, 2005 and serviced loans totaling $964 billion at June 30, 2005.
Accounting for Transfers of Financial Assets

Transfer of Portions of Financial Assets

Paragraph 8A(b) refers to dividing the cash flows received among the participating interests “in proportion to the share of ownership represented by each, except for servicing fees representing adequate compensation and, if applicable, a share of the contractual interest representing all or a portion of the gain.” Because the Servicing of Financial Assets Exposure Draft requires that servicing rights be initially recorded at fair value, we recommend that the phrase “representing adequate compensation” be removed from paragraph 8A(b) such that the entire servicing fee is excluded. If the language is not revised, the Board should clarify how servicing rights, in excess of adequate compensation, are recorded. Clarification is critical since paragraph 8A(b) may be interpreted as requiring a plain-vanilla loan sale, where servicing is retained by the transferor, to have the loans first transferred into a qualifying SPE since more than adequate compensation is retained. We also recommend the Board clarify what is meant by the phrase “a share of the contractual interest.”

Paragraph 8A(c) states that “participating interest holders have no recourse to the transferor (or its consolidated affiliates or agents) or to each other, and no participating interest is subordinated to another.” The Board should clarify that standard representation and warranties made by the transferor are not considered recourse as included in paragraph 8A(c).

Under the proposed guidance, a transfer of a portion of a financial asset that does not meet the definition of a “participating interest” would only be able to be recorded as a sale if the entire asset is transferred to a qualifying SPE. As noted in the background section of the Proposed Statement (paragraphs A22–A25), some Board members did not believe that the isolation requirement would be met unless that entire asset is transferred to a qualifying SPE, whereas others were of the opinion that the contractual terms and legal assessment would be sufficient to determine whether a financial asset has been isolated. While we understand the Board’s concerns noted in paragraph A24, we believe that appropriate support for the determination that a financial asset has been isolated can be obtained, as described in paragraph A22, through reliance on the “contract terms and a legal assessment to determine whether a portion of a financial asset is isolated.” The changes proposed in the Exposure Draft do not enhance the legal analysis related to isolation. We ask the Board to reconsider the criteria set forth in this Proposed Statement to allow the legal isolation requirement for portions of financial assets to be governed by a principled legal analysis of the contractual terms without additional arbitrary requirements.

Transferee’s Ability to Pledge or Exchange

In Paragraph 9(b) the Board has added the following proposed language: “If the transferee is a qualifying SPE, each holder of beneficial interests issued by that qualifying SPE (including the transferor itself if it holds a beneficial interest) has the right to pledge or exchange its beneficial interests, and no condition both constrains the holder from
taking advantage of its right to pledge or exchange and provides more than a trivial benefit to the transferor. If the transaction involves a series of steps designed to isolate the transferred financial assets (as described in paragraph 83), each entity that receives the transferred financial assets is a transferee, and each must meet this condition." Requiring satisfaction of the additional language in paragraph 9(b) at each step of a multi-step securitization is problematic as currently worded. Each of the entities in a multi-step securitization is limited on what it can do with the assets being transferred. For example, in a two-step structure, the Bankruptcy Remote Special-Purpose Corporation (BRSPC), wholly owned by the transferor, is required to transfer the assets obtained from the transferor to the qualifying SPE Trust Issuer. That “constraint” could be interpreted as providing more-than-trivial benefit to the transferor. As these interim entities are usually not qualifying SPEs, the transferor could be considered as not surrendering control over the transferred assets and thus not obtaining sale accounting even though control has been surrendered in the securitization. We recommend that the Board consider removing the proposed wording and require that transferability be considered only at the level of the ultimate transferee. If the Board decides to include the proposed language, we recommend that bankruptcy remote special-purpose entities be excluded from the requirement that “each entity that receives transferred financial assets is a transferee, and each transfer must meet this condition.” If this exception is not included, transferors utilizing two-step structures, as described in paragraphs 27 and 83, would be precluded from obtaining sales accounting even though control over the transferred assets has been clearly surrendered.

Under the current literature, in a two-step securitization, a true sale and nonconsolidation opinion are only required between the transferor and the BRSPC and not between the BRSPC and a qualifying SPE. As is described in paragraph 83(b), this transfer “might not be judged to be a true sale at law.” We ask the Board to clarify that true-sale and non-consolidation opinions are not required for the transfer between the BRSPC and qualifying SPE.

**Legal Isolation**

Paragraph 9(d) states that “the isolation analysis must consider any arrangement or agreement made in connection with a transfer even if it was not entered into at the time of transfer.” We recommend that the Board remove paragraph 9(d) in its entirety as paragraph 55 already requires the transferor to re-recognize transferred financial assets if subsequent events bring those assets within the transferor’s control. If the Board decides to retain paragraph 9(d) we then recommend that the Board add a reference to paragraph 55 to clarify the accounting if the qualifying SPE fails the isolation test subsequent to the initial transfer.

Paragraph 9(e) requires that the isolation analysis required by paragraphs 9(a) and 9(d) consider arrangements or agreements made between any holder of beneficial interests issued by a qualifying SPE and the transferor as if the same arrangement or agreement “had involved the qualifying SPE instead of its beneficial interest holders.” This would require the legal isolation opinions to include analyses of hypothetical events. Our understanding is that attorneys have traditionally expressed reluctance to provide a legal
opinion based partly on hypothetical factors (i.e., assuming different relationships than those that actually exist). We recommend that the Board limit the true sale and nonconsolidation opinions to arrangements or agreements that are actually in place at the time of the transfer of financial assets rather than requiring accounting based on fictional transaction features that do not exist.

We recommend that the Board remove paragraph 9(e) in its entirety for the reasons mentioned in the previous paragraph. If the Board retains paragraph 9(e), its requirements should relate only to arrangements and agreements “made in connection with a transfer” and not all arrangements and agreements between the parties by adding the following underlined text:

“If the transferee is a qualifying SPE, no arrangement or agreement, made in connection with a transfer, is made between any holder of beneficial interests issued by that qualifying SPE and the transferor, or its consolidated affiliates or agents....”

We recommend that the Board include parameters to consider when determining when an arrangement or agreement is “made in connection with a transfer” if it elects to retain either paragraph 9(d) or 9(e). Also, we recommend that if either of those paragraphs are retained, they be included as additions to paragraph 9(a) to avoid any potential confusion and emphasize that there is a single principle of legal isolation involved in the accounting analysis of a transfer of financial assets.

**Determination of “More-than-Trivial” Benefits for Servicing Rights**

In a two-step non-qualifying SPE structure, the BRSPC, wholly owned by the transferor, transfers the assets obtained from the transferor to the SPE Trust Issuer. Although the BRSPC has the right to pledge or exchange the transferred assets, it must transfer the assets to the SPE Trust Issuer, which could be interpreted as a constraint. That “constraint” could be interpreted as providing more-than-trivial benefit to the transferor. When the BRSPC is constrained from pledging or selling those financial assets, how is the retention of servicing rights by the transferor evaluated to determine whether a more-than-trivial benefit has been obtained? One approach would have the transferor compute what the servicing right value would be if the financial assets were sold in a whole loan transaction rather than included in a securitization. If the difference in value of the servicing rights between the securitization and a whole loan sale would not be more-than-trivial, the transaction where the loans are sold to the SPE with constraints would meet the requirements of 9(b). However, even with this approach the term “more-than-trivial” is subject to inconsistent application since the term is not defined. We ask the Board to provide clarification and examples of involvements and combinations of involvements that could be considered to be more-than-trivial. This will help improve the consistency of the application of the term and improve comparability among companies. Additionally, we request clarification of the term “more-than-trivial incremental benefit” as used in paragraph 45A of the Transfers of Financial Assets Exposure draft.
What a Qualifying SPE May Hold—Passive Derivative Financial Instruments

We strongly support the proposed changes that allow a qualifying SPE to hold passive derivative financial instruments that pertain to all beneficial interest issued by the qualifying SPE, including those issued to the transferor, its affiliates, or its agents; however, we believe that the Board should remove paragraph 40. The current restrictions placed on a qualifying SPE from holding passive derivative financial instruments were intended to prevent the abusive use of structures designed to circumvent the accounting for derivative instruments in accordance with Issue D1. The proposed changes in the Exposure Draft, “Accounting for Certain Hybrid Financial Instruments, an amendment of FASB Statements No. 133 and 140,” no longer provide for the Statement 133 scope exemption for beneficial interests in securitized financial assets and will require the holders of those beneficial interests to apply Statement 133. With the proposed changes, the requirements to analyze beneficial interests in securitized financial assets will no longer allow companies to circumvent the accounting for financial derivative instruments in accordance with Statement 133. We therefore believe paragraph 40 is no longer needed and should be removed.

If paragraph 40(b) is to remain in the Statement, we recommend that the Board clarify that the analysis required to determine that the “notional amount does not initially exceed the amount of those beneficial interests issued and is not expected to exceed them subsequently” is a one-time requirement at the time the beneficial interests are issued and is not required to be performed on an ongoing basis.

If paragraph 40(c) is to remain in the Statement, we recommend that the phrase “not excessively” be clarified.

Accounting for Servicing of Financial Assets

Definition of a Class of Servicing Assets

The Exposure Draft provides that the election of the subsequent measurement method for servicing assets and liabilities shall be made separately for each class of servicing assets and liabilities. Paragraph 3(c) of the Exposure Draft states that the class “shall be determined based on the major asset type being serviced as described in paragraph 17(h) (for example, mortgage loans, credit card receivables, and automobile loans).”

We do not believe that the example for major asset types includes an appropriate breakout for mortgage loans. For example, a mortgage loan portfolio may consist of residential, commercial, and home equity lines of credit, each of which has different characteristics that affect the market value of the servicing. We ask the Board to consider either (1) clarifying that a company can exercise judgment in determining major asset types based on predominant market characteristics of the loans or (2) allowing mortgage loans, at a minimum, to be broken out into single-family residential mortgage loans, multifamily and commercial mortgage loans, and home equity lines of credit loans. Allowing additional asset categories will also allow companies to convert certain asset
types to fair value accounting at dates earlier than if more broad categories were used. For example, if a broad mortgage loan category were required, a company that has a comprehensive hedging program for its residential servicing rights but not its commercial servicing rights may defer changing to fair value accounting. However, if more granular categories are allowed, the company may change to fair value accounting for the residential servicing rights at an earlier date.

**Disclosures**

Paragraphs 17(e)(3) and 17(f)(3) describe the content to include in the disclosure of activity in the balance of each class of servicing assets and liabilities. One of the requirements is to disclose “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.” Because the contractual amount of servicing rights would not be part of the activity in the balance of the servicing assets/liabilities, we recommend that this disclosure be removed from paragraphs 17(e)(3) and 17(f)(3) and be included as a separate disclosure within paragraphs 17(e) and 17(f).

**Implementation and Transition Guidance**

The transition guidance in paragraph 4 states that the requirement to initially “measure all separately recognized servicing rights at fair value shall be applied prospectively for transactions occurring in the earlier of the first fiscal year that begins after December 15, 2005, or fiscal years beginning during the fiscal quarter in which the Statement is issued.” If the statement is issued subsequent to the first quarter of 2005, it is unclear whether previous quarters of that year would have to be restated for servicing rights recognized during those quarters. For example, if a company has a December 31 year end and the statement became effective on April 30, 2006, would servicing rights initially recognized during the first quarter 2006 be required to be restated? We recommend that the transition language be clarified. Alternative language that would clarify the transition guidance would be to have the initial recognition of servicing rights be applied in a specified quarter subsequent to the Statement being issued. Paragraph 5 also requires the same clarification.

**FASB Questions**

**Question 1**

Do you believe that transition provisions permitting the transfer of securities classified as available-for-sale to the trading category without calling into question an entity’s treatment of such securities under Statement 115 are necessary? If so, do you believe there should be restrictions on the ability to make such transfers?

**Countrywide Response**

We believe that transition provisions permitting the transfer of securities classified as available-for-sale to the trading category should be allowed without calling into question
an entity's treatment of such securities under Statement 115. As is indicated in the Exposure Draft, companies may currently use securities classified as available-for-sale to offset the income statement impact of changes in fair value of servicing rights. We believe that a one-time election permitting the transfer should be allowed only at the effective date of the amended Statement 140. If a company does not elect to change to the fair value measurement method, transfers should not be allowed. This treatment would be consistent with previous statements, such as Statement 133, that allowed a one-time transfer without restriction.

Question 2

If you currently use securities classified as available-for-sale to offset the income statement effect of changes in fair value of servicing assets or liabilities, is there a company-specific mechanism to designate certain securities classified as available-for-sale for this purpose?

Countrywide Response

We currently do not use securities classified as available-for-sale to offset the income statement effect of changes in fair value of servicing assets or liabilities. However, in the past, when available-for-sale securities were used in our interest rate risk management activities related to mortgage servicing rights, these securities were specifically identified for that purpose and the amount of such securities was disclosed in the financial statements.

Accounting for Certain Hybrid Financial Instruments

Effective Date and Transition Guidance

The effective date and transition guidance in paragraph 5 states that "This Statement shall be effective for all instruments obtained or issued after the beginning of the earlier of an entity's first fiscal year beginning after December 15, 2005, or the entity's fiscal year that begins during the fiscal quarter in which the Statement is issued, if applicable. Provisions of this Statement shall not be applied to instruments that an entity holds at the effective date." If the Statement is issued subsequent to the first quarter of 2005, it is unclear whether the Statement can be applied to hybrid financial instruments obtained or issued during the previous quarters of that year. For example, if a company has a December 31 year end and the Statement became effective on April 31, 2006, would the Statement be applicable to hybrid financial instruments obtained or issued during the first quarter of 2006? If so, would the first quarter require restatement? We recommend that the transition language be clarified. Alternative language that would clarify the transition guidance would be to have the Statement apply to hybrid financial instruments obtained or issued in a specified quarter subsequent to the Statement being issued.

The transition guidance states that the Statement shall not be applied to instruments held as of the effective date. FASB should consider allowing a one-time election permitting the transfer of hybrid financial instruments classified as available-for-sale to the trading
category without calling into question a company's treatment of such securities under Statement 115. This would allow Companies to bring instruments already held in line with the new guidance in the Statement. We believe that a one-time election permitting the transfer should be allowed only at the effective date of the Statement. This treatment would be consistent with previous statements, such as Statement 133, that allowed a one-time transfer without restriction.

**FASB Questions**

**Question 1**

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?

**Countrywide Response**

Yes, we support the Board decision as it results in the hybrid financial instruments to being measured at fair value, which is consistent with FASB's direction on other financial instruments projects.

**Question 2**

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?

**Countrywide Response**

We believe that the guidance included in Statement 133 and related Derivatives Implementation Group issues provide sufficient guidance on how to evaluate an instrument containing an embedded derivative that would require bifurcation.

**Question 3**

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?

**Countrywide Response**

We believe that the information included in paragraphs 12 and 13 of Statement 133 provide sufficient guidance on how to evaluate and account for instruments containing embedded derivatives that are issued by qualifying SPEs.

We believe that the guidance for evaluating how the existence of embedded derivatives would affect whether an entity is a qualifying SPE is not clear. The Board should clarify
if liabilities with embedded derivatives (i.e., beneficial interests issued with embedded derivatives) should be evaluated to determine whether an entity is a qualifying SPE. Paragraph 35(c) addresses what a qualifying SPE may hold. If the liabilities should be evaluated, additional clarifying guidance would be required.

**Question 4**

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?

**Countrywide Response**

For larger institutions, with the systems and personnel required to evaluate whether an instrument contains an embedded derivative and to value those derivatives, the effective date should not pose an issue. However, for less sophisticated entities, it may take additional time, greater than the currently prescribed effective date, to ensure that the systems and personnel are in place to meet the requirements.

**Effective Dates**

We strongly recommend that if the Exposure Draft for Certain Hybrid Financial Instruments is issued prior to the Exposure Draft for Transfers of Financial Assets the changes proposed to paragraph 40 in the Exposure Draft for Transfers of Financial Assets should be moved to the Exposure Draft for Certain Hybrid Financial Instruments.

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Countrywide appreciates the opportunity to provide comments on the exposure drafts. If you have any questions concerning our comment letter, please contact me at (818) 871-4269.

Sincerely,

Laura K. Millman
Senior Managing Director, Chief Accounting Officer