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Via Email to derivatives@fasb.org


Ladies and Gentlemen:

Fannie Mae appreciates the opportunity to comment on the proposed Statement 133 Implementation Issue No. B40 Embedded Derivatives: Application of Paragraph 13(b) to Securitized Interests in Prepayable Financial Assets. We applaud the Board’s rapid response to the concerns of constituents regarding DIG Implementation Issue No. B39, as amended by FASB Statement No. 155, Accounting for Certain Hybrid Financial Instruments (“Statement 155”). We support a scope exception from paragraph 13(b) of Statement 133 for securitized interests that contain an embedded derivative that is tied to the prepayment risk of the underlying prepayable financial assets. However, we have two concerns about the proposed issue. First, we are concerned that the criteria for meeting the scope exception in the proposed issue require access to information that is often not publicly available. Second, we are concerned that the scope exception criteria may result in unexpected conclusions that do not appear to be consistent with the objective of Statement 155.

With respect to our first concern, we note that criterion (b) of the scope exception requires an analysis of the underlying financial assets to determine whether or not those assets contain an embedded derivative that requires bifurcation. The proposed issue and Statement 155 require different instruments to be evaluated for embedded derivatives. Specifically, Statement 155 requires that the beneficial interest owned be evaluated, whereas the proposed issue requires the financial assets underlying the beneficial interest be evaluated. This difference has significant ramifications, including the potential that it may not be possible to obtain the information necessary to conclude whether criterion (b) has been met.

For purposes of analyzing the underlying financial assets individually for embedded derivatives, a simple understanding and assessment of the nature of the underlying financial assets may not be sufficient to support a conclusion that an individual underlying financial asset does not contain an embedded derivative that requires bifurcation. It appears that collateral level detail
(e.g., documents related to individual mortgage loans underlying a mortgage-backed security) would need to be analyzed in each circumstance to determine whether criterion (b) is met. Such an evaluation may not be possible for investors that were not involved in the securitization transaction because loan level data is not commonly available to investors. Therefore, it is very possible that in these circumstances companies will not be able to conclude whether they meet criterion (b) due to the lack of publicly available information about the underlying financial assets. Further, even if information is publicly available, the additional requirement to evaluate the underlying financial assets for embedded derivatives creates a significant burden that goes beyond the requirements of Statement 155, which does not necessitate a conclusion about the underlying financial assets in a securitization arrangement.

With respect to our second concern, we believe that scope exception criterion (b) will create instances where a beneficial interest that includes only a prepayment related embedded derivative, and for which the investor has no control over the acceleration of the settlement, will not meet the scope exception.

This instance could occur when underlying financial assets have embedded derivatives that require bifurcation—hence failing criterion (b)—but the beneficial interest owned in those securitized financial assets does not contain an embedded derivative (other than the prepayment option embedded in the underlying financial assets). In this case, the beneficial interest owned would be subject to the conditions in paragraph 13(b) of Statement 133 even though that beneficial interest only includes a prepayment related embedded derivative. We believe this result is counterintuitive and inconsistent with the objective of Issue B40.

We believe that both of our concerns described above can be resolved by removing criterion (b) from the scope exception requirements. If removed, we believe Issue B40 will be applied more consistently and achieve results that match our understanding of the FASB's intent. Of less significance, we observe that criterion (c) appears to be duplicative of the requirements of Statement 155 and therefore we suggest that this criterion also be removed. We believe that the only criteria for the scope exception should be criterion (a) because it appears to be the only item relevant to the consideration of prepayment risk.

We would be pleased to discuss any aspect of this letter and provide further assistance in your deliberations on the proposed guidance. Thank you for considering our views.

Sincerely,

R. Scott Blackley
Senior Vice President – Accounting Policy

cc: Robert T. Blakely, Executive Vice President and Chief Financial Officer