May 15, 2013

Submitted by e-mail to director@fasb.org

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


Dear Technical Director:

We appreciate the opportunity to comment on the proposed Accounting Standards Update of Topic 825-10, Recognition and Measurement of Financial Assets and Financial Liabilities (the proposed ASU). We support the FASB’s efforts to improve accounting standards for financial instruments, in particular with respect to reducing complexity in financial instruments accounting.

However, we believe that proposals related to the assessment of contractual cash flow characteristics in the ASU will result in significantly increased complexity in the evaluation of certain financial assets that may result in diversity in practice regarding how such assets are classified for financial reporting purposes. We are concerned that this increased level of complexity may result in unintended consequences, including decreased comparability of financial results between entities with similar business models that invest in similar financial assets and the potential for differences in opinion between preparers and auditors and/or
regulators regarding the accounting for financial assets. In this regard, a specific concern relates to the how the cash flow characteristics criterion (i.e. solely payments of principal and interest on the principal amount outstanding) would be applied to certain types of financial assets, including certain types of mortgage backed securities that were acquired at discounts to par value during and subsequent to the financial crisis.

Overall, we support development of an accounting standard for classification and measurement of financial instruments that is centered primarily on a business model assessment and believe that the requirement to first assess the nature of contractual cash flows should be removed from or de-emphasized in the final ASU. However, if the cash flow characteristics assessment is included in the final ASU, we urge the FASB to specifically reconsider the definition of principal used as part of the contractual cash flow assessment to include all payments of principal for the financial instrument, either at maturity or at other settlement. The assessment of principal should not be based on the purchase price of an asset.

Finally, we consider that the apparent emphasis on including additional disclosures on the face of the balance sheet will result in cluttered, less readable financial statements and we request that the FASB reconsider to allow all supplemental disclosures of fair value (for assets and liabilities accounted for at amortized cost) or amortized cost (for assets and liabilities accounted for at fair value) to be provided via notes to the primary financial statements.
Responses to "Questions for Respondents" set out in the proposed ASU

The appendix to this letter provides our responses to certain of the Board's specific questions on the proposed ASU. If you have any questions about our comments or wish to discuss any of the matters addressed herein, please do not hesitate to contact the undersigned at (212) 207-6437.

Very truly yours,

Stephen Yarad
Chief Financial Officer
MFA Financial, Inc.
Appendix – MFA Financial, Inc. responses to select questions in proposed ASU

Question 1

Do you agree with the scope of financial instruments included in this proposed Update? If not, which other financial instruments should be included or excluded from the guidance in this proposed Update and why?

MFA Response:

We have no objections to the list of items excluded from the scope of the ASU.

Question 4

Do the proposed amendments appropriately convey the principle associated with the contractual cash flow characteristics assessment? If not, why? What would you propose instead?

MFA Response:

MFA is a real estate investment trust (REIT) that invests in Agency and Non Agency residential mortgage backed securities (RMBS) with the objective of maximizing returns for our shareholders primarily through the collection of principal and interest cash flows. We invest in RMBS on a leveraged basis using repurchase agreements, among other forms of financing to facilitate our investment purchases. From time to time we will sell assets to realize gains and/or to make adjustments to the portfolio for purposes of maintaining our exemption from regulation under the Investment Company Act of 1940. As permitted under current GAAP, we designate our investments as “Available for Sale” in accordance with ASC 320. This accounting model is currently used by the vast majority of publically traded mortgage REIT in our peer group and we consider that it is well understood and accepted by analysts and investors. Further, we believe that this accounting model, which is equivalent to the “fair value through other comprehensive income” model in the proposed ASU, results in the most appropriate accounting for mortgage REITs and other investors in fixed income securities whose objective is to invest primarily with the objective of collecting contractual cash flows, but who periodically will sell assets primarily for reasons other than generating short term realized (or trading) gains and losses.

Regarding the principle associated with the contractual cash flow characteristics assessment, we believe that most (if not all) of the users of our financial statements would consider that cash flows from our RMBS portfolio would be solely from the principal and interest of the underlying loans that are the collateral for the RMBS. Accordingly, we are concerned that application of certain of the proposed amendments could result in a determination that the cash flows for certain of our RMBS, (i.e. those purchased at a discount to par value) are not solely principal and interest, due to the current definition of “principal” (See our response to Question 5 below for further discussion). We believe that the solely principal and interest concept should not consider the purchase price of the asset, but should be evaluated based on whether the cash flows received
are consistent with principal and interest as defined in the agreements governing the financial instrument.

**Question 5**

The proposed amendments define principal as the amount transferred by the holder at initial recognition. Should the definition of principal be expanded to include repayment of the principal amount at maturity or other settlement? If so, what instruments would fail (or pass) the contractual cash flow characteristics criterion as a result of this change?

**MFA Response:**

As noted in our response to Question 4 above, we are concerned that the definition of principal in the ASU could result in RMBS that are purchased in the secondary market at a discount to par value being required to be classified at fair value with all changes in fair value being recognized in net income (FVNI).

MFA’s portfolio of Non-Agency RMBS had a market value at March 31, 2013 of $5.4 billion. The majority of these assets were acquired since the end of 2008 at discounts to par value. At March 31, 2008 these Non-Agency MBS had an average amortized cost of 73.2% of par value. Our Non-Agency MBS represent primarily the senior tranches in securitizations that were issued at par, but whose market value declined during significantly during the credit crisis and to a lesser extent over the last six to nine months of 2011 due to a number of factors, including negative news regarding housing in the United States, as well concerns about the sovereign debt exposure of the European banking system and the desire of broker dealers to reduce inventories. The underlying collateral for the RMBS are relatively high quality residential mortgage loans that were originated primarily in the 2005-2007 period. These loans generate principal and interest cash flows that fund the principal and interest payments of the RMBS. The loans can also generate cash flows due to “voluntary” (e.g. the borrower refinances or otherwise pays off the mortgage loan balance) or “involuntary” (e.g. due to foreclosure and liquidation of the mortgage loan collateral) pre-payments. At the purchase date and on a regular basis for the period that MFA holds the Non Agency MBS, we estimate the principal and interest cash flows we expect to receive as well as the amount of cash flows not expected to be collected due to defaults on the underlying loan collateral. Voluntary prepayments of underlying loans will result in MFA collecting a higher amount of principal on its RMBS than previously estimated, as will involuntary prepayments when the actual loss severity (i.e. amount of underlying loan principal balance that is charged off when collateral is liquidated) is lower than previously forecasted.

Since the end of 2011 through the end of the first quarter of 2013 the weighted average fair value of our Non-Agency RMBS portfolio has increased significantly. During this period, our estimate of expected credit losses in our Non-Agency RMBS portfolio has declined. The increase in the fair value of our Non-Agency RMBS, while reflective of the market’s perception of improvement in the credit risk in the portfolio is also influenced by non-credit related factors,
including liquidity and the fact that such assets offer superior risk adjusted returns (in terms of asset yield) in the current interest rate environment.

With this as background, we submit that the definition of principal that should be used in the consideration of the contractual cash flow characteristics should be based on the actual contractual arrangements underlying the financial instrument being evaluated, and not based on the amount that the holder paid for the financial instrument. Using the example of Non-Agency RMBS similar to those held by MFA and discussed above, it is clear that while prepayments of the underlying mortgage loans result in the collection of potentially more or less principal and interest than previously estimated, such receipts are from principal and interest payments of the underlying collateral. The fact that Investor A acquired, say in 2009 an asset at a purchase price of 75% of par value, while Investor B with an identical business model purchased the same asset at a different price, say at 93% of par value, should not result in contractual cash flows for these assets being assessed differently by Investor A or B. If the RMBS was to prepay at par (which would only occur if all of the underlying loans collateralizing the RMBS prepaid either due to the borrower refinancing or due to foreclosure with 0% loss severity, then both Investor A and Investor B would recover their investment from principal and/or interest of the underlying loan collateral. Consequently, it would not make sense for Investor A to be required under the proposed ASU to classify its investment at fair value, while Investor B would likely be permitted to classify their investment at amortized cost or fair value through other comprehensive income, solely because the assets were acquired at different purchase prices.

In summary, we believe that the definition of principal used for purposes of consideration of the contractual cash flow characteristics should not be determined by reference to the purchase price of the asset, but rather should be evaluated based on the contractual provisions of the financial instrument which we consider should include payments of principal amounts paid at maturity or at any time prior to the maturity of the financial asset.

Question 6

Do the proposed amendments contain sufficient application guidance and illustrations on implementing the cash flow characteristics assessment? If not, why?

MFA Response:

While the illustrations on pages 52-55 of the proposed ASU are helpful, in our view the guidance in paragraphs 825-10-55-17 through 825-10-55-20 that address contractual terms or that introduce leverage that modifies the economic relationship between principal and interest or changes in the economic relationship between principal and interest are likely to be very difficult to apply in practice and our concern would be that these provisions may result in may relatively “plain vanilla” financial instruments being required to be measured at FVNI. See our response to Question 7 below for further discussion.
Question 7

Should a financial asset with a contractual term that modifies the economic relationship (see paragraphs 825-10-55-17 through 55-20) between principal and interest be considered to contain cash flows that are solely payments of principal and interest? Should this be the case if, and only if, the contractual cash flows could or could not be more than insignificantly different from the benchmark cash flows as discussed in paragraph 825-10-55-19? If not, why? What would you propose instead?

MFA Response:

As noted in our response to Question 6 above, we believe that the identification of contractual terms that potentially modifies the economic relationship between principal and interest will be a challenging task for many preparers. Furthermore, when such contractual terms are identified, it will likely be difficult for preparers to objectively demonstrate that the cash flows on the financial instrument being assessed are not insignificantly different from a benchmark instrument (either real or hypothetical). This leads to the concern that a number of financial instruments that currently are not considered to contain embedded derivatives that require bifurcation and are currently not accounted for at FVNI, will, on adoption of the ASU, be required to be accounted for at FVNI, solely due to the practical difficulties that could preclude less sophisticated financial statement preparers from being able to compile the required analysis.

In comparing the proposed guidance to current guidance regarding identification of embedded derivatives that require bifurcation, in our view the proposed guidance adds complexity and it is not clear what “problem” in current GAAP application of this guidance is in fact intended to solve. Consequently, we favor retention of current guidance on embedded derivatives in ASC 815.

Question 8

Do the proposed amendments contain sufficient application guidance in paragraphs 825-10-55-17 through 55-20 on assessing a modified economic relationship? If not, why?

MFA Response:

See responses to Question 6 and 7 above.
Appendix – MFA Financial, Inc. responses to select questions in proposed ASU

Question 9

For beneficial interests in securitized financial assets, the proposed amendments would require an entity to look through to the underlying pool of instruments in determining whether the tranche contains payments of solely principal and interest. Do you agree with this look-through approach? If not, why? What would you propose instead?

MFA Response:

As a preparer of financial statements who invests exclusively in securitized financial assets, we are comfortable with applying a look-through approach, but note that application of this approach may present significant challenges for other financial statement preparers who invest in securitized financial assets on a more limited basis and may not have the ability to utilize a look-through approach. In particular, it appears that the requirement in paragraph 825-10-55-26 imposes the need for a preparer to perform a quantitative assessment of exposure to credit losses in the underlying pool of financial instruments compared to the tranche of beneficial interest held by the preparer. We recommend that the application guidance be amended to make it clear that a qualitative assessment is sufficient.

Question 10

Do the proposed amendments appropriately convey the principle associated with the business model assessment? If not, why? What would you propose instead?

MFA Response:

The ASU appropriately conveys the principle associated with the business model assessment.

Question 11

Do the proposed amendments provide sufficient application guidance and illustrations on how to distinguish among the three business models, including determining whether the business model is to manage assets both to collect contractual cash flows and to sell? Do you agree with the proposed guidance provided to describe those business models? If not, why?

MFA Response:

We have no objection with the proposed guidance provided to describe the three business models.
Appendix – MFA Financial, Inc. responses to select questions in proposed ASU

Question 12

Should the classification and measurement model for financial instruments contain an explicit tainting notion or should it rely on the principle and exercise of professional judgment? Why?

MFA Response:

In our view the guidance should contain an explicit tainting notion; however, reasonable judgments should be permitted regarding the application of the guidance. Our main concern with the proposed guidance is that the impact of a determination that sale activity is not consistent with the objective of amortized cost classification is not clear. The proposed guidance should include clarification regarding the extent to which an amortized cost portfolio is required to be reclassified to either FVOCI or FVNI and what “time-out” period is required to elapse before an entity can again use the amortized cost category, either for existing assets or for newly acquired assets.

Question 16

Should financial liabilities subsequently be measured at amortized cost, unless certain exceptions are met? If not, why?

MFA Response:

We support accounting for the vast majority of financial liabilities at amortized cost, with the retention of current guidance with respect to embedded derivatives.

Question 17

The proposed amendments would require a nonrecourse financial liability that is settled with only the cash flows from the related financial assets (see paragraph 825-10-35-11) to be measured on the same basis as those assets. Do you agree with the proposed amendments? If not, why? What would you propose instead?

MFA Response:

While we accept the technical merits of the argument that non-recourse financial liabilities that are settled only with cash flows from related financial assets should be measured on the same basis as those related assets, we disagree that with the mandatory requirement to measure such liabilities on the same basis as the related assets. In our view this requirement adds unnecessary complexity to the accounting for such financial liabilities that does not sufficiently improve financial reporting from a cost benefit perspective.
Appendix – MFA Financial, Inc. responses to select questions in proposed ASU

We would support amending the proposed guidance to permit giving preparers the option, via an accounting policy election, to account for such financial liabilities on the same basis as the related assets. To the extent that a preparer does not make this accounting policy election, we would propose that this be clearly stated in that entity’s accounting policy footnote.

Question 21

Under the amendments in this proposed Update, hybrid financial assets would not be required to be analyzed for bifurcation under Subtopic 815-15 and would be assessed in their entirety on the basis of the proposed classification requirements. In contrast, hybrid financial liabilities would be assessed for bifurcation and separate accounting under Subtopic 815-15, and the financial liability host contract would be subject to the proposed amendments. Do you agree with this proposal? If not, why? What would you propose instead?

MFA Response:

We do not agree with the proposal. In our view the guidance in ASC 815-15 should be retained for hybrid financial assets. The proposed guidance does not significantly improve current GAAP for those financial assets that contain features that would be assessed as being embedded derivatives due to the complexity of applying the cashflow characteristics assessment. Refer to our response to Question 7 for further discussion.

Question 22

The proposed amendments would require reclassification of financial assets when a change in business model occurs and prescribes how those changes should be subsequently accounted for. Do you agree with the proposed amendment on reclassifications? If not, why?

MFA Response:

We have no objection to the guidance in the ASU around the requirement to reclassify assets when a change in business model occurs and how those changes should be subsequently accounted for.
Question 29

Do you agree with the proposed disclosure requirements? If not, which disclosure requirement would you change and why?

MFA Response:

We do not agree with the requirement to include additional disclosure on the face of the balance sheet. In our opinion the proposed requirements would serve to only further clutter the primary financial statements and render them less readable. The required disclosures in paragraphs 825-10-50-33 through 825-10-50-42 should be permitted to be provided via notes to the financial statements.

Question 31

Should the effective date be the same for both public entities and nonpublic entities?

MFA Response:

We believe that the effective date should be the same for all entities.

Question 32

How much time is needed to implement the proposed guidance?

MFA Response:

If the cash flow characteristics assessment criterion is maintained as proposed, we believe that the time to analyze and document the results of this analysis will be significant for many entities. In addition, we expect that significant implementation questions will emerge in the period between the release of the ASU and the effective date. In order to allow preparers, auditors and regulators sufficient time to perform the required analysis, we believe the effective date for the ASU should not be before January 1, 2016 at the earliest.