



LETTER OF COMMENT NO. 13

By Electronic Mail

November 5, 2007

Mr. Robert H. Herz
Chairman
Financial Accounting Standards Board
401 Merritt 7
Norwalk, CT 06856

Dear Mr. Herz:

The Mortgage Bankers Association¹ respectfully requests that the effective dates of Statements of Financial Accounting Standards (SFAS) 157, *Fair Value Measurements*, and 159, *The Fair Value Option for Financial Assets and Financial Liabilities*, be delayed by one year to fiscal years beginning on or after November 15, 2008, with earlier application permitted as of their current effective dates. Although MBA welcomed the release of SFAS 159 earlier this year due to its potential to reduce our members' loan hedge accounting costs, many mortgage banking companies feel unprepared to adopt the Statement due to questions that have been raised about the application of the guidance in SFAS 157, upon which the application of the guidance in SFAS 159 relies. This is true despite industry efforts this year to address questions relating to the proper application of the guidance in SFAS 157.

Earlier this year, for example, MBA sponsored an industry working group to develop an industry consensus position on valuing loans held for sale under SFAS 157. Within a short period of time, however, three points of view emerged, as described in the attached MBA letter to the FASB staff. In informal conversations with representatives of the Big Four accounting firms, MBA learned that they also were uncertain which of the three views, or possibly other views, should be relied upon by mortgage lenders in valuing their loans.

MBA sponsored a second working group this September to address questions that have been raised about valuing loans under SFAS 157 when market data becomes less available, reliable

¹ The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 500,000 people in virtually every community in the country. 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 and extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 3,000 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, Wall Street conduits, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web site: www.mortgagebankers.org.

and relevant. Questions about valuing loans in the absence of an active market had increased over the course of the summer as the market for 'subprime' and other 'nonconforming'² residential mortgage loans diminished dramatically. The conclusions of the working group are reflected in a paper³ that was also shared with the FASB staff.

Despite these industry efforts, many MBA members are still uncertain how they should be measuring the fair values of their loans. Regarding consensus, there continues to be active discussion among our members and their external accountants concerning many fundamental issues, including:

Principal (or most advantageous) market – Should the market be considered from an immediate or planned delivery standpoint (i.e. do fair values of loans have to be measured based on a hypothetical sale at or near the measurement date or based on a likely future sale) and how should differences between the 'principal' or 'most advantageous' markets be addressed in practice (i.e. if the two markets are not the same)?

In-use versus in-exchange concepts – Does the in-use concept support a valuation approach that relies on the ultimate form of an asset's delivery into the market (i.e. as collateral for a security) as opposed to its current form?

Fair value hierarchy – How is the hierarchy properly viewed within the context of the concepts in FAS 157? For instance, does level 1 of the hierarchy suggest that the principal market should be viewed as the market into which the asset will be delivered in its current form?

Active market – How is an active market distinguished from an inactive market and what implications do the distinctions have for the valuations of assets? For example, if a market is not active, to what extent can a preparer adjust available market prices?

Distressed market – How is a distressed market distinguished from an inactive market and what implications do the distinctions have for valuations of assets? For example, if a market is distressed, to what extent can a preparer rely more heavily on internal valuation assumptions and methodologies?

Some MBA members argue that because SFAS 157 is a principles-based standard, a certain amount of diversity in the application of the Statement is to be expected and should be acceptable. They also note that it is unreasonable to expect that the FASB could or should provide specific guidance to address all possible valuation scenarios and issues. MBA, in fact, has told the FASB staff that it would be both inappropriate and impractical for the FASB to attempt to develop rules-based valuation guidance (see attached letter).

Others note, however, that auditors and regulators are likely to question the application of different measurement practices by different entities in substantially similar situations. They point, for example, to the establishment of the FASB's recently established Valuation Resource Group as evidence that auditors and regulators are already questioning diversity in practice in valuing assets and liabilities. The recent news that some accounting firms are seeking clarification from the FASB regarding the deductibility of "transformation costs" (in estimating the

² Loans that are ineligible for delivery as collateral for mortgage-backed securities guaranteed by the secondary market agencies Fannie Mae, Freddie Mac and Ginnie Mae.

³ See http://www.mortgagebankers.org/files/News/InternalResource/57297_MBAFAS157WhitePaper.pdf

values of loans that will be delivered to buyers in the future, as whole loans or as collateral for mortgage-backed securities) has reinforced their concerns.

Many members are reluctant to adopt policies, procedures and systems changes for measuring the fair values of their loans if management decisions could be overturned by future interpretive guidance.⁴ They also are still working to address operational challenges associated with capturing the right disclosure information for instruments that could move in or out of level 3 of the fair value hierarchy. Many companies that are dependent on third party software to capture and track the level into which a particular asset falls in order to make the required disclosures note that the software is still being developed.

Some MBA members report, for example, that a popular loan valuation/hedging system that is used by companies throughout the mortgage banking industry is being upgraded currently to include a field to track levels 1/2/3, but that the proposed upgrades will not capture the information required for disclosure purposes under Statements FAS 157 and 159. As a consequence, companies will have to develop their own procedures to capture the information. However, as the planned system upgrades have not been made available yet, companies will have limited time to test and build their procedures.

In summary, MBA believes there is sufficient basis for a delay in the effective dates of Statements 157 and 159, with earlier adoption permitted as of their current effective dates. MBA believes such a delay would give mortgage lenders and others additional time to resolve outstanding interpretational questions and to make the necessary systems and procedural changes to adopt the Statements. MBA believes an additional amount of time is warranted for mortgage lenders in particular given the numbers of issues that have surfaced due to the recent, unprecedented disruption in the mortgage markets.

For all these reasons, MBA urges the FASB to delay the effective dates of Statements 157 and FAS 159 by one year, with earlier application permitted as of their current effective dates. For additional information about the comments in this letter, please contact Alison Utermohlen, Staff Representative to MBA's Financial Management Committee, at (202) 557-2864 or autermohlen@mortgagebankers.org.

Most sincerely,



Jonathan L. Kempner
President and Chief Executive Officer

Attachment

⁴ Several issues that are relevant to valuing loans, for example, are on the agenda of the FASB's new Valuation Resource Group (VAG) which was formed this summer to assist the Board in addressing valuation issues.



VIA Electronic Mail

April 18, 2007

Mr. Brian Stevens
Practice Fellow
Financial Accounting Standards Board
401 Merritt 7, P.O. Box 5116
Norwalk, CT 06856

Dear Brian:

Thank you for your recent inquiry regarding the Mortgage Bankers Association's¹ (MBA) efforts to develop industry consensus positions on the valuations of loans and loan commitments under FASB Statement No. 157, *Fair Value Measurements* (FAS 157). MBA appreciates the FASB's interest in better understanding our members' views on these subjects and the types of FAS 157 implementation issues they are dealing with in practice. This letter responds to your inquiry and offers some general thoughts and recommendations regarding the need for more detailed valuation guidance.

I. MBA Position on the Need for Detailed Valuation Guidance

MBA believes the current conceptual valuation guidance in FAS 157 is sufficient for estimating the values of loans and loan commitments for financial reporting purposes. MBA believes any effort by the FASB to develop *detailed* valuation guidance is unnecessary and could be counterproductive to the extent it discouraged the exercise of professional judgment in estimating the values of these instruments which, by their nature, do not lend themselves to "one size fits all" valuation techniques. Any such effort also would be contrary to the Board's stated goal of making future accounting guidance principles-based. Moreover, because the values of loans and loan commitments change frequently in response to marketplace changes (including the development of new valuation techniques), any FASB project to develop detailed valuation guidance would likely not keep pace with the evolution of valuation practices and therefore would likely become a maintenance project because any new guidance could become outdated quickly.

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II. MBA Positions on Valuing Loans and Loan Commitments

Earlier this year, MBA formed a “Loan and Loan Commitment Working Group” (see attached list) to address questions about the proper valuation of loans and loan commitments under FAS 157. Although the Working Group’s objective was to develop consensus positions on both topics, three views emerged with respect to the proper valuation of loans held for sale and one view emerged with respect to the proper valuation of loan commitments. In addition, when we shared our thoughts on the proper valuation of loans with knowledgeable partners at the Big 4 accounting firms, we discovered that -- although some common themes emerged from their comments --- their views were also quite diverse.²

The results of the Working Group’s discussions are described below.

A. Valuing Loans Held for Sale

Background

In undertaking the project, the members of the Working Group decided to limit their discussions to loans that are held for sale (generally within ninety days) due primarily to time constraints. Three views emerged regarding their valuation under FAS 157 as described below.

MBA Views on Valuing Loans Held for Sale

View #1 - Principal Market less Transformation Costs Model

Proponents of this view believe the guidance in paragraph 8 of FAS 157 on the principal (or most advantageous) market requires reporting entities to look to the market into which they will deliver loans. They think it would be incorrect to look to another market into which the loans will *not* be delivered. They also believe that the “in-use” valuation premise applies to loans that will be delivered into the market as collateral for securities and, thus, the loans should be valued on that basis. Consequently, they believe a reporting entity that routinely sells loans into the whole loan market should value the loans by reference to the forward loan market whereas a reporting entity that routinely sells loans into the securities market should value the loans by reference to the forward securities market.

Proponents of this view also believe that loans that are valued by reference to forward security prices should be adjusted for future transformation costs (i.e. costs related to transforming loans into security form, which could include attorneys’, rating agencies’ and underwriting fees, among other costs). These costs would be lowest for agency (Fannie Mae, Freddie Mac, and Ginnie Mae) mortgage securitizations and highest for highly structured transactions. They also believe transformation costs are analogous to transportation costs under paragraph 9 of FAS 157.

Additionally, proponents of this view believe that the guidance in paragraph 6 of Statement 157, which states that the fair value measurement should consider attributes specific to the asset or liability (i.e. including the “...condition and/or location of the asset or liability and restrictions, if any, on the sale or use of the asset at the measurement date”), requires reporting entities to

² Those partners indicated they were not speaking on behalf of their firms. The Working Group has not discussed the valuation of loan commitments with partners at the Big 4 firms.

adjust forward security prices for the costs to convert loans to securities since the assets being valued at the measurement date are loans.

Proponents of View 1 also believe that because forward security prices would reflect what would be received by the reporting entity, no further adjustment of the prices (i.e. beyond deductions for transformation costs pursuant to the transportation costs analogy) would be appropriate. For example, they disagree that "carry value" (as described under View 2 below) should be added to forward security prices because it would not be received upon delivery of the loans (as collateral for securities). Additionally, they believe that using forward security prices reflects that it takes time to deliver loans into their principal market as they must be prepared for delivery, pooled and securitized. Moreover, because forward security prices reflect the next possible delivery dates for loans into the secondary mortgage market (i.e. the principal market), the forward prices reflect the current conditions of the loans.

In summary, View #1 would result in the recognition of income (or loss) at the measurement date of the loans, which would represent the total expected gain (or loss) on the sale of the loans as whole loans or as collateral for securities³ (inclusive of the estimated values of the servicing rights, retained interests and assumed liabilities, if applicable). Proponents of this view believe this approach is consistent with the exit price concept within FAS 157 which reflects a presumption that, if a loan is recorded at fair value by reference to its principal market, there should be no gain or loss on sale at the time the loan is sold.

View #2 - Principal Market less Fair Value Adjustments Model

Proponents of this view also believe the valuation of loans held for sale should begin by reference to prices in the reporting entity's principal market (i.e. either the forward whole loan or securities markets) and that the "in-use" valuation premise is relevant to loans that will be sold as collateral for securities. Proponents of this view, however, believe adjustments of forward loan and security prices should be made to determine the exit prices for the loans at the measurement date. More specifically, they believe forward prices should be adjusted for factors a third party would consider in bidding on the loans at the measurement date, which could include costs to convert and deliver the loans as collateral for securities, carry value (i.e. the net interest income on the loans from funding/purchase of the loans until their sale), risk premium, the embedded servicing rights, any interests to be retained (or liabilities to be assumed) upon the sale of the loans and any other factors as determined by the entity under the circumstances.

In summary, View #2 would result in the recognition of income (or loss) at the measurement date of the loans, which would represent the expected gain (or loss) on sale of the loans as whole loans or as collateral for securities⁴ adjusted for the factors a third party would consider in pricing the loans at the measurement date.

³ The valuation of the loans would depend upon whether the reporting entity intends to sell them as whole loans or as collateral for securities, pursuant to the 'principal market' guidance in FAS 157.

⁴ See footnote 4 above.

View #3 - Whole Loan Model

Proponents of this view believe the valuation of loans held for sale should follow a fair value hierarchy approach, which approach should not assume repackaging or modification, consistent with explicit guidance in IAS 39⁵ and the principles of SFAS 157, as follows:

- First -- rely on current quoted market prices for identical loans if available
- Second - rely on current quoted market prices for similar loans if available
- Third – use a valuation technique. Such a technique could rely on forward whole loan prices -- or if unavailable, forward security prices -- adjusted for factors that a market participant would consider in valuing the loan at the measurement date, which could include carry value, risk premium, the embedded servicing rights, interests to be retained (and liabilities to be assumed) upon the sale of the loans and any other factors as determined by the entity under the circumstances.

Proponents of this view believe the principal market is the loan market at the measurement date because a loan is a loan, and not a security consistent with the guidance in paragraph 6 of Statement 157, which states the fair value measurement should consider attributes specific to the asset or liability, such as the "...condition and/or location of the asset or liability and restrictions, if any, on the sale or use of the asset at the measurement date."

In summary, View #3 would recognize income to the extent there is a difference between the cost of the loan and quoted market prices for identical or similar loans. If quoted market prices are unavailable, income would be recognized if there is a difference between the cost of the loan and the value produced using a valuation approach. To the extent the valuation approach relies on whole loan or forward delivery prices, this view would result in the recognition of gain (or loss) on the sale of the loans, adjusted as described in the third bullet point above.

B. Valuing Loan Commitments

Background

Unlike loans, MBA's Working Group acknowledged there is no ready market for the transfer of loan commitments⁶ (including commitments to purchase and originate loans) and they generally (but not exclusively) are transferred through the purchase of one entity by another. The Working Group acknowledged, however, that lenders are not indifferent to the transfer of their

⁵ See AG 71 of IAS 39 states: "A financial instrument is regarded as quoted in an active market if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis. Fair value is defined in terms of a price agreed by a willing buyer and a willing seller in an arm's length transaction. The objective of determining fair value for a financial instrument that is traded in an active market is to arrive at the price at which a transaction would occur at the balance sheet date in that instrument (i.e. without modifying or repackaging the instrument) in the most advantageous active market to which the entity has immediate access. However, the entity adjusts the price in the more advantageous market to reflect any differences in counterparty credit risk between instruments traded in that market and the one being valued. The existence of published price quotations in an active market is the best evidence of fair value and when they exist they are used to measure the financial asset or financial liability..."

⁶ By reference to 'loan commitment,' MBA is referring to "interest rate locked commitments" for the origination or purchase of loans that will be held for sale. Loan commitments for the open extension of credit at uncertain rates sometime in the future would have no measurable value.

commitments to originate or purchase loans at the rate lock date or thereafter.⁷ Moreover, some members of the Working Group acknowledged their companies recognize liabilities at the commitment date (using in-house valuation techniques) for loan commitments to originate or purchase loans at below market interest rates.

MBA View on Valuing Loan Commitments

The Working Group believes loan commitments should be valued using valuation techniques that consider what a third party would pay to acquire the instruments, or would demand to be paid to assume the instruments, at the inception of the instruments and thereafter. This valuation approach conflicts with the guidance in SEC Staff Accounting Bulletin No. 105, Application of Accounting Principles to Loan Commitments, which precludes the inclusion of inputs for the value a market participant would attribute to the strip of interest that *may* be retained as compensation for servicing the loan upon the sale or securitization of the loan. MBA is concerned that unless SAB 105 is withdrawn, public entities will be forced to decide between complying with that Bulletin or with GAAP.

The Working Group believes a multitude of inputs are considered in estimating the values of these instruments, which depend in part on the loans to be originated or purchased (e.g. commercial, multifamily, 1-4 residential, acquisition-related, or other types of loans). The valuation of loan commitments, therefore, is likely to vary among entities depending upon the inputs used, and the assumptions underlying the inputs, as determined based on the facts and circumstances.

The Working Group cited the following inputs that could be included in valuing commitments:

- Expected remaining costs to underwrite, process, close, package and deliver loans to investors
- Expected remaining fees to be received from borrowers
- Expected price for sales of loans to investors
- Expected prices of servicing rights,⁸ retained interests, liabilities to be assumed upon sale or securitization of loans
- For purchase loan commitments, the expected servicing release premium to be paid to a third party for a loan
- Risk premium, to include the risk a loan may not close (or be purchased) as expected
- Profit margin, to provide the market participant with a return on their investment.

The Working Group believes FAS 157 requires that, to the extent a third party would include any of the above inputs in bidding on a loan commitment, the inputs should be included in the valuation of the loan commitment as of the commitment date and thereafter. The Group believes reporting entities are in the best position to determine the appropriate valuation inputs.

III. Conclusion

Thank you again for inquiring about our thoughts on these matters. If you have any questions about our views, please free to contact me at (202) 557-2864 or by responding to this email.

⁷ This is true regardless of whether the commitments are for the origination and sale of loans at interest rates that are at, above, or below market rates.

⁸ SAB 105 precludes the inclusion of servicing rights in the valuation of loan commitments.

Mr. Brian Stevens
April 18, 2007
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Feel free also to contact Jennifer Williams, who handles financial reporting and capital market issues for MBA's commercial members, at (202) 557-2918.

Sincerely,



Alison B. Utermohlen
Senior Director, Government Affairs

Attachment

Cc: Timothy S. Kviz, Practice Fellow, Securities & Exchange Commission