



March 31, 2011

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The Mortgage Bankers Association<sup>1</sup> (MBA) appreciates the opportunity to comment on the Supplementary Document on Impairment (Supplementary Document). The Supplementary Document was issued jointly by the FASB and the IASB on January 31, 2011 in an effort to gather additional information from constituents to assist the FASB and IASB in developing a converged accounting standard for the recognition and measurement of financial instrument impairment.

### **Background**

In November 2009 the IASB published the exposure draft *Financial Instruments: Amortised Cost and Impairment*, which proposed requirements for amortized cost measurement including the impairment of financial assets. In May 2010 the FASB published proposed Accounting Standards Update, *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities* (FASB's Exposure Draft), which included guidance on classification and measurement, credit impairment, and hedge accounting requirements. Both the FASB and the IASB are committed to finalizing a converged accounting standard for financial instruments, including impairment,

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<sup>1</sup> The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 280,000 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 2,200 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](http://www.mortgagebankers.org).

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by the end of 2011. Comments received on this Supplementary Document will be used by the FASB and the IASB in their joint deliberations for a converged standard on impairment.

### **General Comments on the Supplementary Document**

MBA appreciates the FASB's and the IASB's efforts to develop a converged impairment standard. However, MBA notes that it is difficult to comment on the Supplementary Document because it covers only a small portion of the impairment topic. For example, the Supplemental Document does not address impairment recognition and measurement on individual assets, the treatment of purchased loans with credit issues, troubled debt restructurings, the definition of non-accrual, and the inclusion of loan level and/or pool level insurance in the measurement of impairment. These issues are discussed more fully in the section below, *General Comments for Future Deliberations*. MBA believes that it is difficult to provide a full assessment of the impairment model until the entire impairment model as well as the classification and measurement model are exposed. MBA highly recommends that the FASB and the IASB come to agreement on the classification and measurement portions of the financial instruments project, then re-expose the classification and measurement model along with a more comprehensive discussion of the model for impairment.

The following general comments relate to the model proposed in the Supplementary Document. As discussed more fully below, MBA finds that the proposed model may not work for securities. In addition, the MBA finds some issues with respect to the timing of impairment recognition and the definition of 'bad book' assets.

### **Applicability to All Loans and Debt Securities**

It would be ideal to have an impairment model that could be applied to all financial assets, but MBA questions whether the proposed impairment approach is operational for all financial instruments. The open portfolio model appears to be appropriate for open loan portfolios, but MBA believes the exposure draft should more fully discuss the applicability of the model to closed portfolios as well as individual loans.

MBA questions the applicability of the model to debt securities. Page 14 of the Supplementary Document states: "For the FASB, the proposals in this supplementary document would be applied to open portfolios of loans and debt instruments that are not measured at fair value with changes in fair value recognized in net income." The existing classification and measurement model in the United States, which MBA supports as appropriate, provides that securities held for trading should be carried at fair value, securities held until contractual

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maturity should be carried at amortized cost, and securities held for contractual cash flows but available for sale for liquidity or other asset/liability management purposes (AFS) should be carried at fair value with changes in fair value recognized in other comprehensive income (OCI). MBA believes that this impairment model should not be applied to any securities carried at fair value, and that existing U.S. GAAP guidance for other-than-temporary impairment (OTTI) adjustments should be used for AFS securities carried at fair value through OCI.

In addition, MBA believes the final standard should allow for a variety of methods to measure impairment which could be chosen based on the nature of the instruments. Currently used methods which we believe should continue to be allowable include the use of observable market price, and the use of fair value of the collateral if the instrument is collateral dependent. In addition, MBA notes that for some investment securities, projections of future cash flows may not be relevant. For example, investment securities issued with the full faith and credit backing by a strong sovereign nation should be analyzed based on the strength of that sovereign nation's backing. Further, credit enhanced securities should be analyzed on the basis of the issuer's and the surety's strength.

### **'Bad Book' Trigger**

Although MBA does not have a consensus among members, many MBA members agree with segmenting open portfolios into good and bad books. MBA is concerned, however, with the proposed definition of the 'bad book' and believes that definition could be interpreted broadly leading to significant variances in application. MBA proposes that an instrument be transferred to the 'bad book' when it is probable that the creditor will be unable to collect all amounts due according to the contractual terms of the instrument's agreement. This definition is consistent with current accounting guidance identifying an instrument as impaired. As discussed further below, although MBA's members are not unanimous on this, the majority of MBA's members believe that once 'bad book' accounting is triggered, impairment should be based upon expected principal losses on an undiscounted basis and that interest cash flows should be addressed through a non-accrual policy. For modified loans where the interest rate is reduced to preserve principal, an approach to capture foregone interest would be needed. The current approach in U.S. GAAP of discounting expected principal and interest cash flows at the pre-modification effective interest rate should be considered by the FASB and the IASB for these circumstances.

### **Foreseeable Future**

If the FASB and the IASB proceed with requiring classification of good and bad book instruments, then for 'good book' assets, expected lifetime credit losses

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would be recognized at the higher of an amount determined under a time-proportional approach or amount of credit losses expected to occur within the foreseeable future. For short and medium-term loans, the losses expected to occur in the foreseeable future and the lifetime expected losses may frequently be the same depending on the length of the foreseeable future. For longer term financial assets, the foreseeable future may be shorter than the expected life of the assets but may be interpreted by some as significantly more than one year. Thus, losses over a longer time-frame might be booked upon origination. Some MBA members are concerned that such accounting may not provide for appropriate matching of an expense with the periods in which the entity benefits from the asset.

From various discussions in the Supplementary Document, it is apparent that FASB's view is from a balance sheet standpoint whereas IASB, in its initial exposure draft, seemed to be taking an income statement view. MBA's members are not unanimous on the income statement view vs. balance sheet view; however, MBA's members do foresee some inconsistencies in practice arising from various interpretations of "foreseeable future." MBA believes regulators, particularly from various geographic areas, may interpret the time period for the foreseeable future very differently leading to inconsistencies in application of the proposed standard. Likewise, each reporting entity may also interpret the time period for the foreseeable future differently. Some MBA members believe the "foreseeable future" could be better defined as the period over which a reporting entity's impairment losses would not vary significantly from forecast, thereby leaving less room for misinterpretation.

### **General Comments for Future Deliberation**

#### **Impact of Loan Level and Pool Level Insurance**

MBA notes that the impairment model in the Supplementary Document seems to focus on contractual cash flows from the debtor. However, many asset-backed securities and individual loans carry insurance at the loan level and/or at the pool level. For example, in the United States, FHA-insured and VA-guaranteed loans are pooled into Ginnie Mae mortgage-backed securities. Such securities and underlying loans have the full faith and credit backing of the United States government. The rate of interest earned on those pools is based upon the guarantee or insurance. To exclude consideration of the guarantees and insurance would misalign the recording of impairment and the recording of risk-adjusted interest. It would cause a reporting entity to reserve for credit losses not actually expected. MBA recommends that such loan level guarantees and pool insurance be considered in the estimation of expected losses and foreseeable losses in the final converged impairment standard.

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### **Purchased Loans with Credit Concerns**

The Supplementary Document is not clear what impairment accounting model the IASB and the FASB would propose with respect to portfolios of purchased loans with credit concerns. Under purchase accounting in the United States, such loans would be initially recognized at fair value. The fair value adjustments from amortized principal generally include three components: discount or premium related to interest rate, discount related to credit risk, and a discount or premium related to market liquidity. Ideally, the special model for purchased loans should be replaced with the new impairment model that is applicable to all loans. This would make the accounting for originated and purchased loans consistent and significantly easier to explain and present, which would be beneficial for users of the financial statements and for preparers. MBA believes the next exposure draft should discuss the impairment recognition and measurement of purchased loans with credit concerns in those cases when the allowance for credit losses established by the purchaser are in excess of the credit discount.

### **Get Rid of TDR Trigger for Impairment in U.S. GAAP**

In the United States a “troubled debt restructuring” (TDR) is a trigger for the recognition of impairment. MBA believes that under the proposed impairment model TDRs should be subject to the recognition and measurement of impairment in a manner similar to any other instrument. Therefore, the specific requirement that modification or restructuring of an instrument automatically results in impairment recognition should be eliminated upon the issuance of the final impairment standard. MBA acknowledges that it is important for financial statement users to understand modification activities and recommends that preparers disclose the number of and amounts of modifications.

### **Define Non-accrual in Accounting Literature**

In the United States accounting practice “non-accrual” thresholds are established, wherein a financial asset that reaches a certain stage of delinquency ceases accruing additional interest income and previously accrued, but unpaid interest is reversed. This concept was developed primarily by bank regulators and is not discussed in a formal accounting pronouncement issued by FASB. As mentioned previously, MBA believes that impairment should be defined as expected undiscounted principal loss, and interest cash flows should be addressed by requiring financial statement preparers to establish a non-accrual policy as described above.

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The MBA appreciates the opportunity to share these comments with the FASB and the IASB. Any questions about MBA's comments should be directed to Jim Gross, Associate Vice President and Staff Representative to MBA's Financial Management Committee, at (202) 557-2860 or [jgross@mortgagebankers.org](mailto:jgross@mortgagebankers.org).

Sincerely,

A handwritten signature in cursive script that reads "John A. Courson". The signature is written in black ink and is positioned below the word "Sincerely,".

John A. Courson  
President and Chief Executive Officer

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## **Appendix A**

### **Question 1**

Do you believe the proposed approach for recognition of impairment described in this supplementary document deals with this weakness (ie delayed recognition of expected credit losses)? If not, how do you believe the proposed model should be revised and why?

**MBA Response:** Because the proposed approach addresses the delayed recognition of credit losses by eliminating the current incurred loss threshold and by permitting credit losses to be based on expected lifetime estimates, it appears that the Supplemental Document at least partially addresses this weakness. However, some MBA members have concerns about potential diversity in the application of the model with regard to the definition of the 'bad book', the definition of the foreseeable future and the requirement for a two step calculation (i.e. time-proportionate amount and the foreseeable future amount).

### **Question 2**

Is the impairment model proposed in the supplementary document at least as operational for closed portfolios and other instruments as it is for open portfolios? Why or why not?

Although the supplementary document seeks views on whether the proposed approach is suitable for open portfolios, the boards welcome any comments on its suitability for single assets and closed portfolios and also comments on how important it is to have a single impairment approach for all relevant financial assets.

**MBA Response:** Given the short time period allotted for comments, the MBA members have not had sufficient time to test the proposed model on closed portfolios. Therefore, it is unclear whether the model could be applied to closed portfolios, particularly in all circumstances.

See general comments above entitled *Applicability to All Loans and Debt Securities* and *Purchased, Defaulted Loans* above for further details.

### **Question 3**

Do you agree that for financial assets in the 'good book' it is appropriate to recognize the impairment allowance using the proposed approach described above? Why or why not?

**MBA Response:** See general comments "*Foreseeable Future*" above.

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**Question 4**

Would the proposed approach to determining the impairment allowance on a time-proportional basis be operational? Why or why not?

**MBA Response:** See MBA's response to Question 1.

**Question 5**

Would the proposed approach provide information that is useful for decision-making? If not, how would you modify the proposal?

**MBA Response:** MBA believes the proposed model is complex due to the broad definitions and the two-step calculation requirement. Therefore, MBA questions the decision-making usefulness of the proposed standard.

**Question 6**

Is the proposed requirement to differentiate between the two groups (i.e. 'good book' and 'bad book') for the purpose of determining the impairment allowance clearly described? If not, how could it be described more clearly?

**MBA Response:** See MBA's general comment above entitled '*Bad Book*' *Trigger*.

**Question 7**

Is the proposed requirement to differentiate between the two groups (ie 'good book' and 'bad book') for the purpose of determining the impairment allowance operational and/or auditable? If not, how could it be made more operational and/or auditable?

**MBA Response:** Provided the definition of 'bad book' is more clearly defined, the majority of MBA members generally agree that the requirement to differentiate 'good book' and 'bad book' financial assets for purposes of impairment analysis is operational for most loans. See MBA's general comment above entitled '*Bad Book*' *Trigger*.

**Question 8**

Do you agree with the proposed requirement to differentiate between the two groups (i.e. 'good book' and 'bad book') for the purpose of determining the impairment allowance? If not, what requirement would you propose and why?

**MBA Response:** MBA did not achieve a consensus of its members on this issue.

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### Question 9

The boards are seeking comment with respect to the minimum allowance amount (floor) that would be required under this proposed model.

Specifically, on the following issues:

- (a) Do you agree with the proposal to require a floor for the impairment allowance related to the 'good book'? Why or why not?
- (b) Alternatively, do you believe that an entity should be required to invoke a floor for the impairment allowance related to the 'good book' only in circumstances in which there is evidence of an early loss pattern?
- (c) If you agree with a proposed minimum allowance amount, do you further agree that it should be determined on the basis of losses expected to occur within the foreseeable future (and no less than twelve months)? Why or why not? If you disagree, how would you prefer the minimum allowance to be determined and why?
- (d) For the foreseeable future, would the period considered in developing the expected loss estimate change on the basis of changes in economic conditions?
- (e) Do you believe that the foreseeable future period (for purposes of a credit impairment model) is typically a period greater than twelve months? Why or why not? Please provide data to support your response, including details of particular portfolios for which you believe this will be the case.
- (f) If you agree that the foreseeable future is typically a period greater than twelve months, in order to facilitate comparability, do you believe that a 'ceiling' should be established for determining the amount of credit impairment to be recognized under the 'floor' requirement (for example, no more than three years after an entity's reporting date)? If so, please provide data and/or reasons to support your response.

**MBA Response:** MBA did not achieve consensus on this issue. Many members support a foreseeable future threshold, however these members have different views on the period of that foreseeable future and are concerned with how others may define the concept. Some MBA members support defining foreseeable future as the period over which a reporting entity's impairment losses would not vary significantly from forecast. MBA believes that a clearly defined principle would result in more consistency in practice, more utility for the financial statement user, and no unnecessarily prescriptive ceilings which might not be applicable in all circumstances. See MBA's general comments "*Foreseeable Future*" above for additional details.

### Question 10

Do you believe that the floor will typically be equal to or higher than the

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amount calculated in accordance with paragraph 2(a)(i)? Please provide data and/or reasons to support your response, including details of particular portfolios for which you believe this will be the case.

**MBA Response:** MBA's members have not had sufficient time to model because of the relatively short exposure period of the Supplemental Document and reporting priorities due to year end; however MBA believes that the floor may be higher or lower than the time proportional expected losses for longer-term portfolios like mortgage loans depending on how the foreseeable future floor is defined. For shorter-term portfolios, such as some consumer loans, MBA believes the foreseeable future floor may often be higher than the time proportional expected losses.

#### **Question 11**

The boards are seeking comment with respect to the flexibility related to using discounted amounts. Specifically, on the following issues:

(a) Do you agree with the flexibility permitted to use either a discounted or undiscounted estimate when applying the proposed approach described in paragraph B8(a)? Why or why not?

(b) Do you agree with permitting flexibility in the selection of a discount rate when using a discounted expected loss amount? Why or why not?

**MBA Response:** As noted in MBA's general comments above, MBA did not achieve consensus on this issue but many MBA members believe that impairment recognition should be based upon principal cash flows only.

#### **Question 12**

Would you prefer the IASB's approach for open portfolios of financial assets measured at amortized cost to the common proposal in this document? Why or why not? If you would not prefer this specific approach, do you prefer the general concept of the IASB's approach (ie to recognize expected credit losses over the life of the assets)? Why or why not?

**MBA Response:** Please read MBA's prior comment letters to the FASB and the IASB on their respective impairment models. MBA had concerns about both proposals and, as stated in this letter, is concerned with many elements of this Supplemental Document.

#### **Question 13**

Would you prefer the FASB's approach for assets in the scope of this document to the common proposal in this document? Why or why not? If

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you would not prefer this specific approach, do you prefer the general concept of the FASB's approach (i.e. to recognize currently credit losses expected to occur in the foreseeable future)? Why or why not?

**MBA Response:** Please read MBA's prior comment letters to the FASB and the IASB on their respective impairment models. MBA had concerns about both proposals and, as stated in this letter, is concerned with many elements of this Supplemental Document.