



July 13, 2009

Sir David Tweedie  
Chairman  
International Accounting Standards Board  
30 Cannon Street, First Floor  
London, EC4M 6XH,  
United Kingdom.

Dear Sir:

The Mortgage Bankers Association<sup>1</sup> (MBA) appreciates the opportunity to comment on the International Accounting Standards Board's (IASB) ED/2009/3, *Derecognition*, which contains proposed amendments to International Accounting Standard 39 and International Financial Reporting Standard 7. As a result of the proposed convergence of U.S. accounting standards with international accounting standards, the proposed international financial reporting standard (Proposed IFRS) will likely have a significant impact on MBA's members.

The purpose of the Proposed IFRS is to reduce the complexity and internal inconsistencies within IAS 39 and to move toward convergence with U.S. accounting standards on derecognition.

The following are MBA's general and specific comments.

### **MBA's General Comments**

**MBA Supports the Alternative Approach:** The Proposed IFRS indicates that five dissenting members of the IASB issued an alternative approach that MBA believes is a better model and therefore should be reviewed in more detail. MBA believes that if an entity passes through all or some of the economic benefits to another party, the entire asset should be derecognized, and assets and liabilities received in the transfer should be initially recognized at fair value. While MBA

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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 2,400 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).

believes that the alternative approach, as drafted, has merit, we have some concerns over certain issues that would need to be addressed, including the ability for an entity to “cherry pick” whole loans in its portfolio that are carried at amortized cost and have a market value above amortized cost. It could package and sell them, taking back a 99 percent pro rata share of the cash flows. This would enable the entity to attain a step-up in basis on 100 percent of the loans, while effectively selling only 1 percent. MBA recommends that IASB explore ways that the alternative view could be implemented with safeguards to prevent abuse. MBA recommends IASB consider adding provisions to the alternative approach that require the instruments received back in an exchange be demonstratively distinct from the assets derecognized in terms of risk.

If the IASB rejects the alternative approach and proceeds with the present majority approach, MBA offers the following additional general comments.

**FASB SFAS 140 Amendment Project:** The Financial Accounting Standards Board (FASB) has recently issued Statement No. 166, *Accounting for Transfers of Financial Assets, an amendment of Statement of Financial Accounting Standard SFAS 140* (“SFAS 166”). Although many of the principles embodied in the Proposed IFRS are similar to the new guidance in SFAS 166, there are still significant differences. For example, for the accounting for repurchase transactions, there appears to be a deliberate divergence between the proposed U.S. and international accounting standards. Since U.S. accounting principles may be migrating to IASB standards over the next few years, MBA recommends that FASB and IASB converge the derecognition and consolidation standards during their respective amendment processes so that companies in the U.S. will not be required to adopt back-to-back accounting changes in a short period of time. This will ultimately result in less confusion to users of financial statements and reduced cost to preparers of financial statements in the U.S.

**Continuing Involvement Filter:** MBA does not agree with the ‘continuing involvement’ filter in paragraph 17A(b) of the Proposed IFRS. It would appear that retaining any variable interest would be deemed to be continuing involvement and would preclude derecognition. A good example of this is the creation and sale of a Fannie Mae mortgage backed security (MBS). If the transferor creates an interest only (IO) strip above the normal 25 basis point servicing compensation and retains that IO strip, it appears the entire Fannie Mae security sold would be deemed not to qualify for derecognition. So, one basis point of excess servicing, which may have a value of only four basis points, would preclude derecognition of the entire principal balance sold. Or put in a different way, a .04 percent tail wags the 99.96 percent dog!

Further, paragraph IN11 indicates that the conceptual approach of the Proposed IFRS differs from IAS 39 in that it focuses on a single element (control) for

derecognition. However, the guidance in paragraph 17A(b) appears to contradict this principal, because retaining an economic interest many times has no bearing on control.

**Control and Static Asset Securitizations:** MBA believes paragraph 17A(c) is too limiting because control over the asset itself is frequently not present in static asset securitizations in the U.S. FASB has acknowledged in paragraph 9(b) of SFAS 166 that 'control' can also transfer by permitting the beneficial interest holders to exchange the assets it receives from the securitization vehicle. MBA recommends similar language for the Proposed IFRS as follows:

Each transferee (or, if the transferee is an entity whose sole purpose is to engage in securitization or asset-backed financing activities and that entity is constrained from pledging or exchanging the assets it receives, each third-party holder of its beneficial interests) has the right to pledge or exchange the assets (or third-party holder of its beneficial interests) it received, and no condition both constrains the transferee (or holder) from taking advantage of its right to pledge or exchange and provides more than a trivial benefit to the transferor.

**Agency Definition and Seniority of Servicing Fees:** MBA agrees with the Proposed IFRS carve-out of true agency relationships like retention by the transferor of the right to service the transferred asset as not constituting "continuing involvement." However, MBA notes that the definition of such relationship in the Proposed IFRS is different from the definition of an agency relationship in IASB's ED 10, *Consolidated Financial Statements* as highlighted in the table below.

<b>"Agency" Per Proposed IFRS</b>		<b>"Agency" Per ED 10</b>
Fees paid and terms are customary.		Fees must be normal for similar services negotiated at arms length.
Fees are senior in priority to any payment to transferee.		No equivalent in ED 10.
Transferee has right to terminate the servicing contract with the transferor.		Removal rights can indicate an agency relationship.

No equivalent in Proposed IFRS.	Agent must use decision making authority to act in best interest of the principal.
No equivalent in Proposed IFRS.	Are fees large relative to expected returns of the entity to which the services are provided?
No equivalent in Proposed IFRS.	Compare expected volatility of servicing fees relative to the total volatility of returns for the entity for which the services are provided.
No equivalent in Proposed IFRS.	Is agent required to refund prior fees based on the performance of the value of the fund?

When MBA reviewed and commented on ED 10, it noted that the criteria for determining if a relationship is an agency relationship calls for a review of existing facts and circumstances. MBA believes that the agency criterion enumerated in ED 10 properly characterizes many of the servicing relationships in residential and commercial mortgage-backed securities (MBS) market in the U.S. MBA believes that the criteria in the Proposed IFRS are less robust and more rules-based vs. principles-based. The best example of this is the rule on servicer “kick-out rights”. The Proposed IFRS would conclude that a servicing relationship is “continuing involvement” in the absence of transferee having kick-out rights. Under ED 10, removal rights are one of many facts and circumstances to consider when determining if an agency relationship exists. MBA recommends that IASB conform the language in the Proposed IFRS to the language in ED 10.

Further, the requirement that servicing fees be senior in priority may be problematic for MBS securitizations in the U.S. where there is pool insurance. For example, MBA believes that payment of insurance amounts to Fannie Mae and Freddie Mac are senior in priority to the servicing fee. Therefore, MBA recommends the language be amended to require the servicing fees to be senior to the cash flows paid to the investors of the vehicle.

**Derecognition Irrespective of Legal Form:** The Proposed IFRS allows for derecognition irrespective of the legal form of the transfer. In contrast, U.S. derecognition standards call for legal isolation of the transferred assets. MBA believes that the Proposed IFRS definition of transfer as the passing or agreement to pass to another party some or all of the cash flows or other economic benefits underlying the asset is an enlightened approach, and MBA is highly supportive of this principle.

**Servicing Assets Valuation:** The principles in the Proposed IFRS call for assets retained in a transfer to be valued at allocated cost, while new assets obtained in the transfer be initially valued at fair value (this is contrary to the new guidance issued in SFAS 166). MBA would like to confirm with the IASB that a servicing asset created by a transfer is deemed to be a new asset obtained in a transfer rather than one retained. Further, MBA recommends the IASB consider permitting companies to elect the fair value option for servicing assets subsequent to the transfer. This election is permitted under U.S. GAAP and is an important provision due to the significant hedging activity related to changes in value of servicing rights.

**Onerous Disclosure Requirements:** MBA believes the Proposed IFRS contains several onerous disclosure requirements. These include:

- Paragraph 42D(d) requires an entity to disclose at the reporting date the fair value of derecognized financial assets in which the entity has continuing involvement. We do not find this disclosure to be useful. Instead, we believe that a requirement to track the fair value of assets an entity owns as more appropriate, including assets related to continuing involvement. However, accumulating the current fair value of each tranche of each bond issuance over a period of years will be extremely time-consuming and costly. If the transferor is no longer the servicer of those assets, it may not even have access to current information on the remaining principal balance still outstanding or other information useful in estimating fair value including delinquency, default and loss severity information.
- Paragraph 42(e) requires an entity to disclose undiscounted cash outflows to repurchase derecognized assets. It is unclear whether the intent of this is to be a historical summary or a projection. This could involve a significant amount of work each reporting period. As an alternative, in U.S. GAAP, preparers are required to estimate, record and disclose reserves related to guarantees.

- Paragraph B30 elaborates on the the paragraph 42D(e) disclosure requirement requiring maturity analysis of cash flows required to be paid, cash flows an entity may be required to pay, and cash flows an entity might choose to pay. MBA recommends that disclosures be limited to contractual arrangements (except in cases where an entity has provided support that it was not contractually obligated to provide) and events that are at least reasonably possible of occurring.

The relevance of disclosures is severely compromised when they are based on extremely remote events or on speculation. Meaningful disclosures, on the other hand, provide information about risks that are at least reasonably possible to occur and could cause significant impact in the near future. Eliminating rules-based specific disclosures and permitting entities to use their judgment will benefit financial statement users most through increasingly meaningful disclosures and by avoiding information overload.

**Concept of Control:** The concept of control in the Proposed IFRS requires an entity to have access to the future economic benefits embodied in that asset and generally must be able to deny or regulate others' access to those benefits. Thus, under the Proposed IFRS, an entity that purchased a financial asset that is restricted by the transferor from selling the asset to a third party would be deemed to not have control of the asset, precluding derecognition by the transferor. However, such sale restriction does not preclude the transferee from enjoying the full economic benefits from holding the financial asset and keeping all of the cash flows generated by the asset.

Further, the definition of control forces the transferor to do an analysis from the perspective of the transferee. MBA questions why the Proposed IFRS does not require the analysis be performed from the transferor's own perspective. That is, the MBA believes the principle should be that the transferor must not have access to the future economic benefits embodied in the asset and has no ability to deny or regulate others' access.

**Disproportionate Cash Flows:** In identifying the asset to be analyzed for derecognition, the Proposed IFRS requires the asset to be defined as the entire asset if the asset actually transferred is a disproportionate cash flow. MBA agrees with IASB's dissenting Board members that indicate in paragraph AV12 that contracting parties know which cash flows they have relinquished and acquired and that agreement is not arbitrary. The fact that the values of retained interest and the part transferred are interdependent should be reflected in the valuation of the retained interest, but should not preclude derecognition of the portion of the asset transferred.

**Linked Presentation:** In response to both FASB's and IASB's consolidation projects, MBA consistently expressed its members' belief that the reporting entity required to consolidate the assets and liabilities of certain structured entities should be allowed to present those assets and liabilities in a linked fashion in its financial statements. MBA notes that disclosures required under paragraph BC99 of the Proposed IFRS require disclosure of "linked presentation of transferred assets and associated liabilities when the counterparty to the associated liabilities has recourse only to the transferred assets." This is similar to MBA's proposed linked presentation. The attached letter to FASB contains a description of a proposed linked presentation model relating to residential and commercial mortgage-backed securities, which are primarily backed by a static pool of mortgages that is closed-ended. MBA recognizes that there may be similar models that work for asset-backed securities that are not static pools. The principle underlying the model is that financial assets and liabilities that are directly related such that cash flows from the assets can only be used to pay the liabilities and the liabilities can only be paid by the specified assets are deemed to be "linked" and should be presented as such in the statement of position by the primary beneficiary. MBA once again requests IASB to consider linked presentation on the face of the balance sheet rather than only in the notes to financial statements.

**MBA's Response to IASB's Specific Questions:**

**Question 1:** Do you agree that the determination of the item (i.e. the Asset) to be evaluated for derecognition and the assessment of continuing involvement should be made at the level of the reporting entity?

**MBA Response:** MBA agrees. The determination should be made at the level of the reporting entity that financial statements are to be issued.

**Question 2:** Do you agree with the criteria proposed in paragraph 16A for what qualifies as the item (i.e. the Asset) to be assessed for derecognition?

**MBA Response:** MBA generally agrees with the criteria for what qualifies as the Asset for derecognition analysis purposes. However, see MBA's general comment above under disproportionate cash flows.

**Question 3:** Do you agree with the definition of a transfer proposed in paragraph 9?

**MBA Response:** Since the term *transfer* in the context of the proposed IFRS does not necessarily result in qualification for derecognition, the definition appears to be appropriately broad.

**Question 4:** Do you agree with the ‘continuing involvement’ filter proposed in paragraph 17A(b), and also the exceptions made to ‘continuing involvement’ in paragraph 18A?

**MBA Response:** See MBA’s general comment above under continuing involvement filter.

**Question 5:** Do you agree with the proposed ‘practical ability to transfer’ derecognition test in paragraph 17A(c)? Do you agree with the ‘for the transferee’s own benefit’ test proposed as part of the ‘practical ability to transfer’ test in paragraph 17A(c)? If not, why? What would you propose instead, and why?

**MBA Response:** MBA agrees with the ‘practical ability to transfer’ test. As noted in MBA’s general comments above, MBA also supports the assertion that an entity can overcome the “practical ability to transfer” hurdle relating to contractual prohibitions of the transferee subsequently disposing of the asset if the asset is fungible and can be readily obtained in the marketplace.

**Question 6:** Do you agree with the proposed accounting (both recognition and measurement) for an interest retained in a financial asset or a group of financial assets in a transfer that qualifies for derecognition?

**MBA Response:** See MBA’s comments with respect to servicing assets valuation in general comments above.

**Question 7:** Having gone through the steps/tests of the proposed approach to derecognition of financial assets (Questions 1–6), do you agree that the proposed approach as a whole should be established as the new approach for determining the derecognition of financial assets? If not, why? Do you believe that the alternative approach set out in the alternative views should be established as the new derecognition approach instead, and, if so, why? If not, why? What alternative approach would you propose instead, and why?

**MBA Response:** MBA believes that the alternative approach should be established as the new derecognition standard. MBA believes that if an entity passes through all or some of the economic benefits to another party, the entire asset should be derecognized, and assets and liabilities received in the transfer should be initially recognized at fair value.

As discussed above in the general comments, MBA believes that the Proposed IFRS places far too much emphasis on servicer kick-out rights in determining whether an agency relationship exists for purposes of assessing continuing involvement. Servicing of mortgage loans in the U.S. generally is done by the

issuer/transferor of mortgages or MBS. The servicer generally earns a small servicing fee (generally from 25 to 44 basis points of principal) and must follow specific servicer guidelines. MBA believes the guidelines in ED 10 for determining agency/servicer relationships are more robust and principles-based than those in the Proposed IFRS. MBA recommends both standards utilize the definition from ED 10.

Related comments to this issue also are included in MBA's remarks regarding the continuing involvement filter above. It would appear that any retention of a variable interest would preclude derecognition no matter how small.

MBA's comments under control and static asset securitizations are also relative to this discussion. The Proposed IFRS does not appear to take into consideration the existence and static nature of special purpose entities.

**Question 8:** In December 2008, the Board issued an exposure draft ED 10 Consolidated Financial Statements. As noted in paragraphs BC28 and BC29, the Board believes that its proposed approach to derecognition of financial assets in this exposure draft is similar to the approach proposed in ED 10 (albeit derecognition is applied at the level of assets and liabilities, whereas consolidation is assessed at the entity level). Do you agree that the proposed derecognition and consolidation approaches are compatible? If not, why? Should the Board consider any other aspects of the proposed approaches to derecognition and consolidation before it finalises the exposure drafts? If so, which ones, and why? If the Board were to consider adopting the alternative approach, do you believe that that approach would be compatible with the proposed consolidation approach?

**MBA Response:** MBA notes that both ED 10 and the Proposed IFRS may result in an entity including in its balance sheet assets that it does not own or liabilities that it does not owe. MBA believes that in those situations where financial assets and liabilities that are directly related such that cash flows from the assets can only be used to pay the liabilities and the liabilities can only be paid by the specified assets are deemed to be "linked" and should be presented as such in the statement of position by the primary beneficiary. MBA once again requests IASB to consider linked presentation on the face of the balance sheet not just in the notes to financial statements.

**Question 9:** Do you agree with the proposed amendments to the principle for derecognition of financial liabilities in paragraph 39A?

**MBA Response:** MBA generally agrees with the principles for derecognition of a financial liability contained in the Proposed IFRS.

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**Question 10:** Do you agree with the proposed amendments to the transition guidance in paragraphs 106 and 107?

**MBA Response:** It appears that the transition rules provide for prospective application, and MBA supports this approach. However, the MBA questions whether companies in the U.S. will benefit from such transition, because of never applying IAS 39 previously. MBA recommends that transactions entered into prior to the effective date of the Proposed IFRS that would have previously met the IAS 39 rules (even if IAS 39 did not previously apply for the company) would be permitted to analyze under the prior rules.

MBA also does not understand how the transition rules would work with respect to the Proposed IFRS 1 and U.S. GAAP.

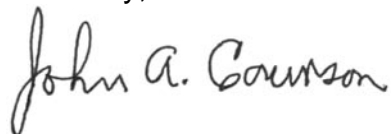
As stated in the general comments above, MBA recommends that FASB and IASB converge the derecognition and consolidation standards during their respective amendment processes so that companies in the U.S. will not adopt back-to-back accounting changes in a short period of time. This will ultimately result in less confusion to users of financial statements and reduced cost to preparers of financial statements in the U.S. In the case of the transition rules, convergence may preclude entities operating under U.S. accounting standards from having to do significant analysis of sales transactions that occurred prior to the effective date.

**Question 11:** Do you agree with the proposed amendments to IFRS 7?

**MBA Response:** See MBA's general comment above related to what MBA believes are onerous disclosure requirements.

The MBA appreciates the opportunity to share these comments with the Board. 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,



John A. Courson  
President and Chief Executive Officer  
Mortgage Bankers Association



VIA Electronic Mail (director@fasb.org)

March 12, 2009

Technical Director  
Financial Accounting Standards Board  
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Norwalk, CT 06856-5116

File Reference: No.1620-100 and No. 1610-100

Dear Board Members and FASB Staff:

The Mortgage Bankers Association (MBA)<sup>1</sup> appreciates the opportunity to share additional comments on the projects to amend Statement 140 and Interpretation 46(R). The minutes of the December 17, 2008, Board meeting for re-deliberation of proposed amendments to Statement 140 state:

The Board is reluctant to reconsider linked presentation in the short-term project; however, the Board asked the staff to bring back the issue of linked presentation for re-deliberation if the Board receives additional information about a workable model.

The following are principles and guidelines that MBA believes the Board and staff should consider for a workable model.

### **MBA's Proposed Guidelines for Linked Presentation Model**

The following model relates to residential and commercial mortgage-backed securities, which are primarily backed by a static pool of mortgages that is closed-ended. This represents a very large segment of asset-backed securitizations in the United States. MBA recognizes that there may be similar models that may work for asset-backed securitizations that are not static.

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***Proposed Linked Presentation Framework:***

*Principle:* Assets and liabilities of a VIE should be presented “linked” by the primary beneficiary when the following criterion are present:

- The beneficial interest holders of the Variable Interest Entity (VIE) have no recourse to the general credit of the primary beneficiary other than standard representations and warranties;
- The VIE’s assets can be used only to settle the obligations of the VIE;
- There are no explicit arrangements or implicit variable interests that could require the primary beneficiary to provide financial support (for example, liquidity arrangements and obligations to purchase assets) to the VIE, other than servicing advances, which are only required if the servicer deems them to be collectible; and
- If the primary beneficiary is the transferor, the transfer meets the criteria for sale accounting under FAS 140, as amended.

***Linked Presentation Rationale:***

*Principle:* Assets and liabilities that meet these criteria for linked presentation are not assets that are owned or liabilities that are owed by the primary beneficiary. Therefore, these assets should be reported on the face of the statement of financial position net of the related liabilities as “net interests in the assets [or liabilities] of consolidated VIEs.”

MBA feels strongly that FASB should address the residential and commercial mortgage-backed securities accounting model first with a confined, rational, and straight-forward framework and principle for linked presentation because it is the largest segment of the asset-backed securitization market, and its static pool nature makes it easiest to conceptualize and implement in a linked presentation model. MBA understands that some Board members believe that presenting “gross assets in consolidated VIEs” and “gross liabilities in consolidated VIEs” on the asset and liability sides of the balance sheet, respectively, should be considered instead of linked presentation. MBA believes that, although this presentation would be preferable to line by line presentation of the VIE’s assets and liabilities, a linked presentation is superior, because it most-appropriately presents financial ratios and liabilities owed from the general credit of the primary beneficiary, may preclude any market dislocation related to the hundreds of billions of dollars of assets coming back on the books of financial institutions as a result of the proposed revisions to FIN 46(R), and would eliminate the need to re-write debt agreements and capital rules directly impacted by leverage ratios.

The enterprise will parenthetically disclose the “linked” amounts on the face of the balance sheet in addition to providing additional details in the notes.

***Measurement of linked assets and liabilities:***

*Principle:* MBA believes the net assets of the VIE should be required to be presented at fair value in accordance with applicable accounting literature for the following reasons:

- Because the proposed criterion to qualify for linked presentation includes that the liabilities of the VIE can't be paid from the general credit of the primary beneficiary and the assets are not owned by the primary beneficiary, the result of fair valuing all of the assets and liabilities will generally be consistent with the fair value of the continuing involvement with the transferred assets. MBA observes that many of the retained interests in these types of securitizations are currently carried at fair value under applicable accounting literature.
- Accounting for these assets and liabilities that qualify for linked presentation at carrying value may be misleading and create unnecessary operational complexities. For example, many situations will exist where the carrying value of the underlying assets (due to allowance for loan loss, impairment, etc.) will be less than the carrying value of the liabilities. MBA believes showing a “net interest in VIEs” as a net liability is inappropriate when the primary beneficiary will never be obligated to make a payment to the VIE (see the first criterion of the proposed linked presentation framework). In fact, the proposed framework (along with fair value measurement of the linked assets and liabilities) ensures that a net liability can never exist.

MBA appreciates the opportunity to share these principles and guidelines for linked presentation of VIE's with the Board. Any questions about our 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).

Most sincerely,



John A. Courson  
President and Chief Executive Officer