



# ISSUE PAPER

**Subject:** Reporting Mortgage Loans Held for Sale at Fair Value

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**Issue:** In February 2007, the FASB released new Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities, Including an amendment of Statement No. 115* (FAS 159), which permits (but does not require) entities to choose to measure many financial instruments and certain other items at fair value that currently are not required to be measured at fair value. A primary objective of the Statement is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring their hedged instruments (e.g. loans held for sale) and hedging instruments (e.g. forward sales commitments) differently, without the need to apply complex hedging accounting rules. While MBA is very supportive of the Statement due to its potential for reducing mortgage companies' costs of complying with Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities* (FAS 133), members are concerned about the possible emergence of diversity in practice in determining the fair values of loans under FAS 159, as well as new Statement 157, *Fair Value Measurements*, which was released last year.

**Background:** Derivative instruments used to hedge loans held for sale (mandatory and best efforts forward sales, futures and options) are required to be measured at fair (or market) value under FAS 133 while the hedged loans historically have been required to be reported at the lower of their cost or market values (LOCOM). This difference in accounting treatment presents lenders with the risk that the values of their derivative instruments could decline in value without offset (in the financial statements) for an increase in the values of their hedged loans (above amortized cost). To mitigate this reported earnings risk, most mortgage companies have sought to qualify their loan production hedging activities for hedge accounting treatment under FAS 133.

In recent years, mortgage companies have expressed support for a change in the accounting rules to allow them to report their hedged loans, as well as their loan hedging instruments, at fair value. In a March 2004 letter to the Chairman of the Financial Accounting Standards Board, MBA recommended that the Board amend the accounting literature to permit loans held for sale to be reported at fair value. In January 2007, MBA sent a second letter to the FASB expressing strong support for an exposure draft of FAS 159. Many mortgage companies now are planning to adopt the guidance in FAS 159 as soon as possible, beginning January 1, 2007, for calendar year companies.

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**MBA Position:** MBA strongly supports the guidance in FAS 159 due to its potential for reducing mortgage companies' FAS 133 compliance costs.

**Status:** At the suggestion of the Office of the Chief Accountant of the Securities & Exchange Commission, MBA formed a "Loan Valuation Working Group" in January 2007 to develop consensus positions on valuing loans and loan commitments under new FASB Statements 157 and 159.

Over the course of several weeks of discussion, however, 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 the group shared its thoughts on the proper valuation of loans with knowledgeable partners at the Big 4 accounting firms, MBA discovered that – although some common themes emerged from their comments – their views were also quite diverse. Ultimately, a letter was sent to the FASB staff on April 18 describing members' alternative views of the proper approach for valuing loans held for sale and their common view of the proper approach for valuing loan commitments under the current accounting rules. The FASB staff has not responded to the letter.

MBA will continue to monitor, and respond as needed, to developments relating to Statements 157 and 159 throughout the year.

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