American Bankers Association
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October 8, 2013

Russell G. Golden
Chairman
Financial Accounting Standards Board
401 Merritt 7
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Via email: director@fasb.org

File Reference: EITF-12Gr *Measuring the Financial Liabilities of a Collateralized Financing Entity*

Dear Chairman Golden:

The American Bankers Association[1] (ABA) appreciates the opportunity to comment on the exposure draft *Measuring the Financial Liabilities of a Collateralized Financing Entity* (ED). The ED defines a collateralized financing entity (CFE) as an entity that holds financial assets (though may temporarily hold nonfinancial assets, such as real estate, as a result of default of the debtor on the underlying financial assets), issues beneficial interests in those financial assets, and has no more than nominal equity. All of the beneficial interests that have recourse to the related financial assets of the CFE financing entity are classified as financial liabilities.

Under the ED, a reporting entity that is the primary beneficiary of a CFE (and, thus, consolidates the assets and the liabilities of the CFE) is allowed to measure the financial liabilities of the CFE using a calculation that is effectively an allocation of the derived value of the financial assets, thereby ensuring there is no gain or loss upon consolidation. Thereafter, changes in that derived value of the assets that are attributable to interests held by the reporting entity (in other words, the specific interests that are not held by third parties) are recorded within the reporting entity's income statement. The ED also prohibits entities from electing to measure the value of the financial liabilities of the CFE under the fair value option.

In the interest of resolving current diversity in practice, we support the main point to the framework in the ED, which is to recognize in net income only those changes in value (which is either fair value or very close to it) relating to a reporting entity's net economic risk. Differences in the fair value of the assets and the liabilities of the CFE can be recognized in several ways, and we believe this guidance will reduce diversity in practice and banking institutions and auditors will experience operational efficiencies because of the clarity provided.

In accordance with Accounting Standards Codification Topic 810, many assets and liabilities related to CFEs are consolidated onto the financial statements of banking institutions. Many believe this issue is

[1] The American Bankers Association represents banks of all sizes and charters and is the voice for the nation's $14 trillion banking industry and its two million employees.

normally related to CFEs associated with residential mortgage loans used as collateral to the CFE, though it affects CFEs related to other asset-backed securities, such as collateralized loan obligations (CLOs). While we believe that the impact of this ED may be reduced by a final standard resulting from the exposure draft *Principal Verses Agent Analysis*, we support the immediate attention to the issues addressed in the ED. With this in mind, we also urge FASB to consider how any final standard may require revision, based on final approval of certain provisions in the exposure draft *Recognition and Measurement of Financial Assets and Financial Liabilities*. We do not support an operationally intensive change that will later require reengineering.

Because of the diversity just mentioned in the underlying assets backing different CFEs, we disagree with the notion that financial liabilities of the CFE must be based on an allocation of the derived values of the financial assets. We believe that in many cases, the fair values of the financial liabilities can be the most appropriate starting point for the proposed formula. As the assets and the liabilities of a CFE are inextricably linked, the reporting entity should begin with the instruments that have the most observable inputs to the fair value estimate. In certain cases, the fair value of the assets may be based on the observable inputs while the liabilities are thinly traded, if at all. Many CLOs fall into this category. Conversely, the assets may be estimated based purely on Level 3 (modeled) inputs, though the liabilities (the securities) have a relatively active market. This is typical of the mortgage-backed security market.

We understand that the challenge of allocating the fair value of the financial liabilities to the individual financial assets. However, we see no easier task in allocating the value of the assets to the liabilities, especially if the beneficial interests held by the entity include structured tranches. For example, as interest-only strips held as financial assets are currently accounted for on a modified basis of the present value of cash flows, we question whether the Board wishes to account for interest-only strips held as financial liabilities at amortized cost. With this in mind, we recommend that the Board accept a principle whereby the most observable prices are the basis for the measurement at consolidation.

Consistent with this recommendation, we also urge the Board to then maintain the fair value option for the related financial liabilities. As the financial liabilities of the CFE are often currently managed on the basis of their fair values, maintaining the fair value option is critical and consistent with the overall treatment proposed in the ED.

Thank you for your attention to these matters and for considering our views. Please feel free to contact me (mgullette@aba.com; 202-663-4986) if you would like to discuss our views.

Sincerely,

Michael L. Gullette