



June 21, 2004

Office of the Comptroller of the Currency
Public Information Room, Mailstop 1-5
250 E Street, S.W.
Washington, DC 20219
Attention: 1557-0081

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the
Federal Reserve System
20th and C St, N.W.
Washington, DC 20551

Steven F. Hanft
Clearance Officer, Legal Division
Federal Deposit Insurance Corporation
55017th St, N.W.
Room MB-3046
Washington, DC 20429

Office of Thrift Supervision
Information Collection Comments
Chief Counsel's Office
1700 G St, N.W.
Washington, DC 20552
Attention: 1550-0023

Re: "Consolidated Reports of Condition and Income" 7100-0036 (Board)
"Consolidated Reports of Condition and Income" 3064-0052" (FDIC)

Dear Ladies and Gentlemen:

The Mortgage Bankers Association (MBA) appreciates the opportunity to comment on the Notice jointly published by the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Federal Reserve Board and the Office of Thrift Supervision (the agencies) in the April 29, 2004 Federal Register. The Notice proposes that certain delinquent loans that are collateral for Ginnie Mae securities (Ginnie Mae loans) and foreclosed Ginnie Mae loans (foreclosed real estate) be classified as "past due" and "real estate owned," respectively, for regulatory reporting purposes. As explained in this letter, MBA believes these changes will misrepresent the risks of these assets and be misleading to readers of the Consolidated Reports of Condition and Income (Call Report) and Thrift Financial Report (TFR).

The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 400,000 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 prospects through

increased affordability; and to extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters excellence and technical know-how among real estate finance professionals through a wide range of educational programs and technical publications. Its membership of approximately 2,700 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web site: www.mortgagebankers.org.

I. MBA Position

MBA believes assets and liabilities should be presented in the Call Report and TFR (the Reports) in a manner that conveys information that is most relevant to the needs of analysts and others in rendering decisions about financial institutions' safety and soundness. Consistent with this view, MBA believes Ginnie Mae loans¹ and foreclosed real estate,² which are wholly insured or partially guaranteed by the U.S. Government, should be separately presented from other defaulted loans and foreclosed real estate, which are subject to partial or no reimbursement by private entities. We believe the combined presentation of these different sets of assets would obscure their different risk profiles to the detriment of readers of the Reports and financial institutions.

For this reason, we believe the agencies should amend their proposal to require institutions to exclude Ginnie Mae loans from the bodies of Call Report Schedule RC-N and TFR Schedule PD³ and to include them *only* in memoranda items. We recommend also that foreclosed real estate that is acquired on behalf of HUD and the VA be reported within "Other Assets" on the balance sheet. Finally, we recommend that the agencies amend Schedules RC-N and PD, as well as Schedule RC-C,⁴ to require separate reporting of "loans and leases held for sale" and "loans and leases held for investment."

As explained on the following pages, we believe our recommended presentations would provide readers with information that is more relevant to their needs. The exclusion of Ginnie Mae loans from "past due" and foreclosed real estate from "real estate owned" balances would ensure that performance ratios and other analytical measures based on the balances more accurately indicate institutions' potential exposure to losses. We also believe the separation of "loans and leases held for sale" and "loans and leases held for investment" would provide for a clearer presentation of these assets, which are accounted for differently.

¹ Ginnie Mae loans include loans insured or guaranteed by the U.S. Government through the Federal Housing Administration, Farmers Home Administration, or Veterans Administration. However, because MBA members securitize primarily FHA and VA loans, our comments are confined to them.

² Because defaulted multifamily FHA loans are conveyed to HUD prior to foreclosure, the term "foreclosed real estate" refers only to foreclosed FHA and VA single family residential loans.

³ Schedule RC-N is entitled "Past Due and Nonaccrual Loans, Leases, and Other Assets" and Schedule PD is entitled "Consolidated Past Due and Nonaccrual."

⁴ Schedule RC-C is entitled "Loans and Lease Financing Receivables."

II. Basis for MBA's Position

A. Relevancy in Reporting -

MBA believes the overarching objective in making decisions about the presentation of regulatory financial data must be the degree to which a particular form of presentation is most relevant to readers in rendering judgments about financial institutions' safety and soundness. In this regard, we believe a selected form of presentation is not *the best* form of presentation if a reader must consistently look beyond the presented information to other sources to gain a full and accurate understanding of its relevance to an institution's financial condition and performance. We feel strongly this would be the case if Ginnie Mae loans and related foreclosed real estate were reported as "past due" and "real estate owned" because analysts would have to look beyond regulatory reports to obtain a proper understanding of the balances in these line items.

Consequently, while we agree that any reporting changes should "... ensure consistent accounting and reporting for these loans and foreclosed real estate,"⁵ we believe the agencies' foremost objective in proposing reporting changes should be to ensure they will provide users with information that best meets their needs. Indeed, because a focus on consistency without regard to relevancy would produce information that would be the same across financial institutions but of potentially limited use to readers, the first question to be addressed in making reporting changes must be: "Which type of presentation would be most helpful to readers in understanding institutions' financial strengths and weaknesses?" The Notice, however, is silent with respect to the comparative advantages and disadvantages to users of the agencies' proposed presentations of Ginnie Mae loans and foreclosed real estate.

The authoritative accounting literature emphasizes the importance of relevancy and consistency in reporting but ranks relevance (and reliability) as the more important quality in making accounting information useful. FASB Statement of Concepts No. 2, *Qualitative Characteristics of Accounting Information*, includes the following:

"Relevance and reliability are the two primary qualities that make accounting information useful for decision making. Subject to constraints imposed by cost and materiality, increased relevance and increased reliability are the characteristics that make information a more desirable commodity – that is, one useful in making decisions. If either of those qualities is missing, the information will not be useful. Though, ideally, the choice of an accounting alternative should produce information that is both more reliable and more relevant, it may be necessary to sacrifice some of one quality for a gain in another.

⁵ See Federal Register Vol. 69, No. 83, page 23504.

To be relevant, information must be timely and it must have predictive value or feedback value or both. To be reliable, information must have representational faithfulness and it must be verifiable and neutral. ***Comparability, which includes consistency, is a secondary quality*** that interacts with relevance and reliability to contribute to the usefulness of information. Two constraints are included in the hierarchy, both primarily quantitative in character. Information can be useful and yet be too costly to justify providing it. To be useful and worth providing, the benefits of information should exceed its cost. All of the qualities of information shown are subject to a materiality threshold, and that is also shown as a constraint." [*Primary Decision-Specific Qualities, Summary of Principal Conclusions*] Bolding added.

We call the agencies' attention also to the guidance in FASB Statement of Financial Accounting Concepts No. 5, *Recognition and Measurement in Financial Statements of Business Enterprises*:

"Classification in financial statements facilitates analysis by grouping items with essentially similar characteristics and separating items with essentially different characteristics. Analysis aimed at objectives such as predicting amounts, timing, and uncertainty of future cash flows requires financial information segregated into reasonably homogeneous groups. For example, components of financial statements that consist of items that have similar characteristics in one or more respects, such as continuity or recurrence, stability, **risk**, and reliability, are likely to have more predictive value than if their characteristics are dissimilar." [par. 20] Bolding added.

We believe this guidance supports our view that similar items with substantially dissimilar risks should be classified separately in regulatory reports; particularly if understanding the risk profiles of the items is integral to readers' needs. Further, we believe the low risk of loss on Ginnie Mae loans and foreclosed real estate is sufficiently relevant to users' needs, and reliable in terms of measurement, to justify their separate presentation for regulatory reporting purposes.

1. Proposed Presentation of Ginnie Mae Loans -

Our members that currently report their Ginnie Mae loans as "past due," note that the combined reporting of these loans with other defaulted loans in Schedules RC-N and PD fosters misunderstandings among analysts and others who often are not aware that the Schedules include defaulted loans whose unpaid principal balances are wholly insured or partially guaranteed by the U.S. Government. This is true because many analysts rely, as an initial point of reference, on information that is downloaded from regulatory reports into "canned" programs that calculate performance ratios and other safety and soundness indicators. For example, the ratios of past due balances of loans wholly or partially guaranteed by the U.S. Government are not presented separately

from other past due loans in the "Uniform Bank Performance Report" published by the Federal Financial Institutions Examination Council (FFIEC).

In these situations, our members must spend considerable time explaining the distinctions between Ginnie Mae and other defaulted loans to help analysts fully understand their institutions' financial conditions, which often involves justifying the relationship between an institution's reported loan loss reserves and "past due" loan balances. Once the matter is clarified, analysts revise their findings or analyses to correct for the inclusion of Ginnie Mae loans in their data. This situation would be exacerbated if the balances of the Schedules RC-N and PD were carried forward, without adjustment for Ginnie Mae loans, to other publicly available regulatory reports, including regulatory reports and reports filed with the Securities & Exchange Commission.

2. Proposed Presentation of Foreclosed Real Estate⁶ -

The agencies also argue that because institutions often hold foreclosed real estate, for conveyance to HUD or the VA, for extended periods of time, the presentation of such properties as "real estate owned" is appropriate. By contrast, we believe the amount of time a property is held is less relevant to an accurate portrayal of the safety and soundness of an institution than the risk of loss associated with a property. Stated differently, if analysts were given the choice between knowing the amount of time an institution might hold a property versus the institution's risk of loss relative to the property, we would venture to say that the vast majority of them would select the latter knowledge.

The Notice indicates also that the agencies are not swayed by the argument that institutions generally regard their interests in foreclosed real estate as essentially those of agents holding assets in trust for the U.S. Government. The agencies note that institutions often hold foreclosed real estate in their own names for extended periods of time until conveyance of the property to HUD (in the case of FHA loans) or to the VA (in the case of VA loans). We submit that this is a case of putting "*form over substance*" as industry practice clearly reveals that the vast majority of these properties are managed and held at the behest of the Government.

Additionally, in some circumstances and depending upon applicable state law, an institution may not hold title to a property at any point between foreclosure of the loan and conveyance of the property to HUD or the VA, regardless of how long the property is held. In fact, if certain conditions are met, HUD encourages "direct conveyances" of properties by mortgagees, without taking title in their own name first.⁷ In these cases, the Notice could be interpreted to mean institutions must distinguish between foreclosed

⁶ Defaulted multifamily FHA loans are transferred to HUD prior to foreclosure. HUD handles loan foreclosure and sales of the related real estate. Consequently, our comments here relate to foreclosed FHA and VA loans on single-family residential loans.

⁷ See 24 CFR 203.358.

real estate that they have title to and those that they do not have title to for the purpose of determining which real estate should be reported as "real estate owned" for regulatory reporting purposes. This would be a costly undertaking, especially if it required the continual examination by institutions of applicable state laws to determine the legal ownership of individual properties.

We understand also that some regulators may not fully appreciate our concerns because they consider REO an innocuous label for property that is held by an institution. In fact, however, REO generally is viewed unfavorably by analysts and others because it is not an income producing asset and it can decline in value (as a result of downturns in the real estate market). By contrast, foreclosed FHA and VA loans are receivables from the U.S. Government which are not subject to declines in value and, in the case of foreclosed FHA loans, are "performing" in the sense that they earn interest through the date they are conveyed to HUD.

We believe these distinctions would be lost to many readers if foreclosed real estate were reported as REO. More specifically, we believe analysts would draw incorrect conclusions regarding institutions' financial conditions and performance if these distinctly different assets were required to be reported as one. In those circumstances, financial institutions would have to educate users as to the composition of their REO balances with the likely result that the balances would be adjusted to exclude their foreclosed FHA and VA loans.

We think the standard for reporting foreclosed real estate should follow current industry accounting practice which reflects the different methods of disposing foreclosed real estate and REO. Currently, the balances of foreclosed privately insured single-family residential mortgage loans are reclassified upon foreclosure (if the lender submits the winning foreclosure bid) and reported at the lower of their carrying amounts or "net realizable values," defined as their market values less expected costs to sell. By contrast, most institutions reclassify Ginnie Mae loans upon foreclosure as receivables because a "net realizable value" calculation for properties that will be conveyed, rather than sold, is irrelevant.

GAAP currently provides for foreclosed loans to be classified for financial reporting purposes as "other assets" given the substantive differences between foreclosed loans and other REO. Specifically, AICPA Statement of Position 01-6, *Accounting by Certain Entities (Including Entities With Trade Receivables) That Lend to or Finance the Activities of Others*, permits foreclosed assets to be classified "...as a separate balance sheet amount or included in other assets on the balance sheet with separate disclosures in the notes to the financial statements."⁸ Consistent with this guidance, we would support an amendment of Schedule RC-F⁹ and/or Schedule SC¹⁰ to include separate line items for foreclosed real estate.

⁸ See paragraph f.

⁹ Schedule RC-F of the Call Report is entitled "Other Assets."

3. Presentation of Loans Held for Sale versus Held for Investment

We believe "loans and leases held for sale" and "loans and leases held for investment" which must be accounted for at "lower of cost or market value" or "amortized cost," respectively, should be presented separately in Schedules RC-N and PD, and Schedule RC-C. We believe their separate presentation is appropriate and relevant to users given that their reported balances are based on different measurement approaches.

Conclusion

MBA believes assets should be reported in a manner that is most relevant to the needs of analysts and others in rendering decisions about financial institutions' safety and soundness. We believe the fact that losses of principal on Ginnie Mae loans and foreclosed real estate are wholly insured or partially guaranteed by the U.S. Government is sufficiently relevant to warrant their separate reporting in the Call Report and TFR.

Again, we recommend that the agencies amend their proposal and the Reports to require Ginnie Mae loans to be excluded from the bodies of Schedules RC-N and PD and included only in memoranda line items. *At the least*, we recommend that the agencies require that Ginnie Mae loans be presented on separate line items within the Schedules. We recommend also that the agencies amend Schedules RC-N and PD, as well as RC-C, to require separate reporting of "loans and leases held for sale" and "loans and leases held for investment." Finally, we recommend foreclosed real estate be reported as "Other Assets" on the balance sheet.

Our recommended presentation approaches would:

- Provide analysts and other readers of the Call Report and TFR with information that is most relevant to their needs;
- Achieve the agencies' objective of ensuring consistency in reporting across financial institutions;
- Be consistent with the predominant industry practice of holding foreclosed real estate for conveyance to HUD and the VA, rather than for sale to third parties;
- Be consistent with GAAP;
- Level the playing field by ensuring that financial institutions are not placed at a competitive disadvantage with companies that are not subject to regulatory reporting requirements;
- Reduce the time and effort that analysts and others currently must spend (where companies currently follow the agencies' proposed presentations) with sources outside the Reports to "drill down" beyond the balances in the Reports to get a proper understanding of institutions' financial performance and conditions.

¹⁰ Schedule SC of the TFR is the "Consolidated Statement of Condition" which includes an "Other Assets" section.

For these reasons, we strongly recommend that the agencies adopt our proposed presentations.

Thank you again for the opportunity to share our comments with you. If you have questions about our position or would like more details concerning our recommendations, please contact Alison Utermohlen, staff representative to MBA's Financial Management Committee, at 202/557-2864.

Most sincerely,

A handwritten signature in black ink, appearing to read "Jonathan L. Kempner". The signature is written in a cursive style with a large initial 'J'.

Jonathan L. Kempner
President and Chief Executive Officer