



FAS 140 Implications of Restructurings of Certain Securitized Residential Mortgage Loans

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Issues Raised by Loan Modifications, Include:

Tax Issues	Accounting Issues	Legal Issues
REMIC Considerations	FAS 140/QSPE Considerations	PSA Considerations



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◆ Background:

- If lenders want to treat transfers of their loans in securitization transactions as sales, the vehicles to which the loans are transferred *must be QSPEs* under FAS 140 unless:
 - (1) the transferor does not have **any** continuing involvement in the transferred loans, or
 - (2) the SPE has the ability to pledge or exchange the transferred assets and there are no constraints on that ability that provide more than a trivial benefit to the transferor.

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◆ Background

- If a QSPE ceases to be qualifying because it no longer meets the qualifying conditions in FAS 140, a transferor of the loans to the QSPE would be required to record a 'repurchase' of any remaining previously transferred loans to the QSPE and recognize any liabilities assumed.
- The effect would be an expansion of the transferor's balance sheet to include loans to which they no longer have legal title and liabilities they are not legally obligated to pay, with negative financial statement and regulatory capital implications for the company.

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◆ What is a QSPE?

- A trust or other level vehicle that passively holds assets on behalf of the beneficial owners of the assets. The activities of the trust must be significantly limited, entirely specified in the legal documents and subject to change in very limited circumstances.

Note: Related FAS 140 guidance states that a QSPE can undertake restructurings or workouts of loans. A QSPE may not, however, engage in “new lending.”



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MBA formed a FAS 140 working group earlier this year to address accounting questions raised by the QSPE guidance.

The working group's findings are described as follows....



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- ◆ Question 1:
 - Would modifications of loans be *troubled debt restructurings* (TDRs) and therefore permitted ‘restructures’ or ‘workouts’ of loans which are permitted activities of a QSPE?



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- ◆ MBA Response to Question 1:
 - Yes, the modifications would be TDRs provided:
 - ◆ **Key Point:** The borrower confirms they will be unable to make their mortgage payments and they provide evidence to support their assertion.
 - Modifications cannot be undertaken wholesale, without evidence that borrowers are in default or in reasonably foreseeable default.



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- ◆ Question 2:

- If they *are* TDRs, would the activities involved in restructuring the loans, including contacting borrowers to assess probability of default and to initiate conversations regarding restructuring of their loans, be considered ‘significantly limited’ and ‘entirely specified in legal documents?’

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◆ MBA Response to Question 2:

- Yes, discretion is 'significantly limited' if the restructuring is limited to loans that are in default or for which default is reasonably foreseeable pursuant to the legal documents.
 - ◆ **Key Point:** If not defined more narrowly in the legal documents, 'default' means the borrower has missed one or more mortgage payments. "Reasonably foreseeable default" means there has been **actual contact** with the borrower, an assessment of ability to continue to pay, and a reasonable basis for concluding that the borrower will be unable to continue to make their mortgage payment in the foreseeable future



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- ◆ Question 3:
 - If they *are* TDRs, would the decisions involved in restructuring the loans, including contacting borrowers to assess probability of default and to initiate conversations regarding restructuring of their loans, be considered “decisions inherent in servicing?”

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- ◆ MBA Answer to Question 3:
 - MBA reasoned that because loan restructurings that are TDRs are permitted activities of a QSPE, and because TDRs involve decision-making (e.g. to lower the rate on a loan rather than extend the term of the loan), then the decision-making involved in the loan restructurings must be decisions inherent in servicing the loans.
 - ◆ **Key Point:** The decisions involved in restructuring loans in default or reasonably foreseeable default should be substantively the same.



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- ◆ FASB met June 15 and concurred with MBA's positions. FASB made the following additional point:
 - Modifications must benefit the structure as a whole.
 - **SEC Chairman Cox released letter to Barney Frank in July with attached memo by SEC Chief Accountant which cites MBA's paper.**



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- ◆ Accounting Issues Resolved
- ◆ Legal/Servicing Issues Remain
- ◆ Questions?