

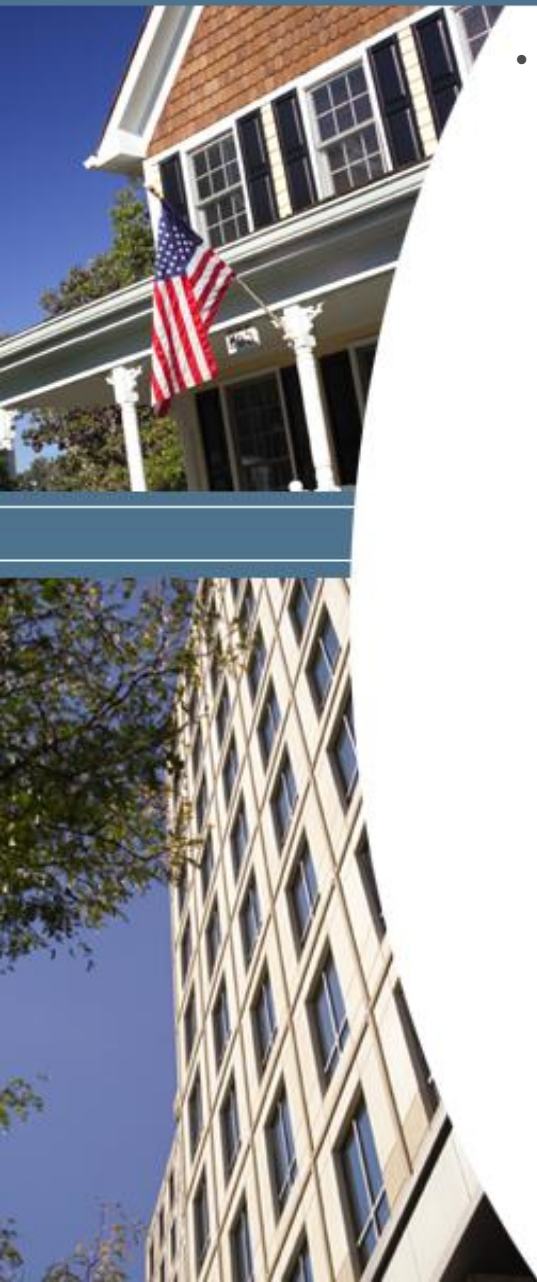


Accounting for Mortgage Securitizations

FAS 140, FIN 46(R), and Related Developments

December 11, 2008

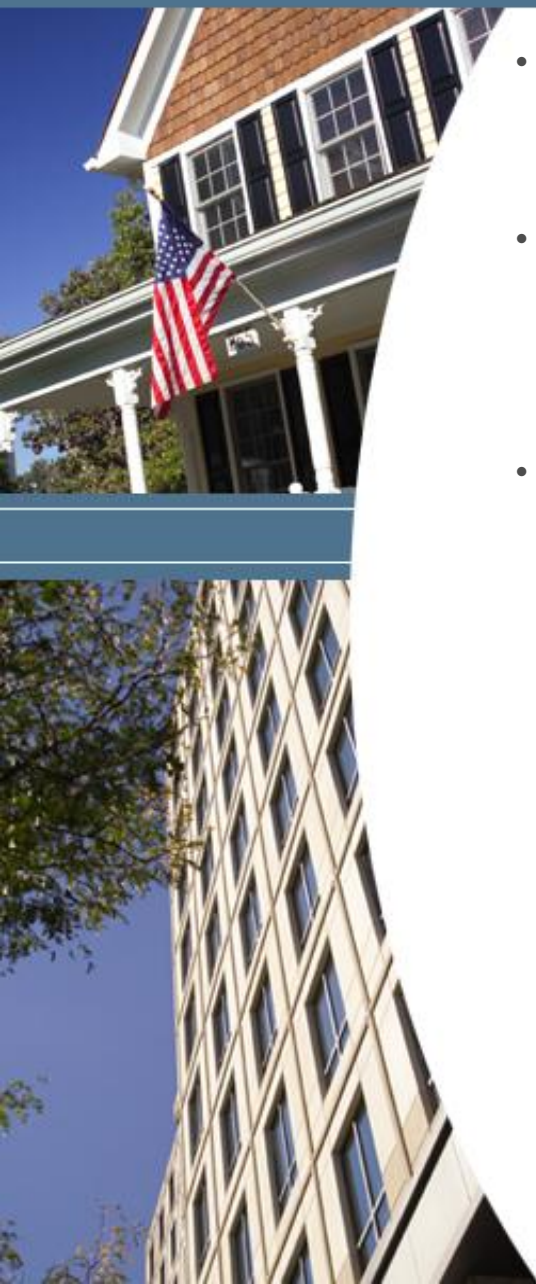
Mortgage Bankers Association
Accounting, Tax and Financial Analysis Conference 2008
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Las Vegas, Nevada

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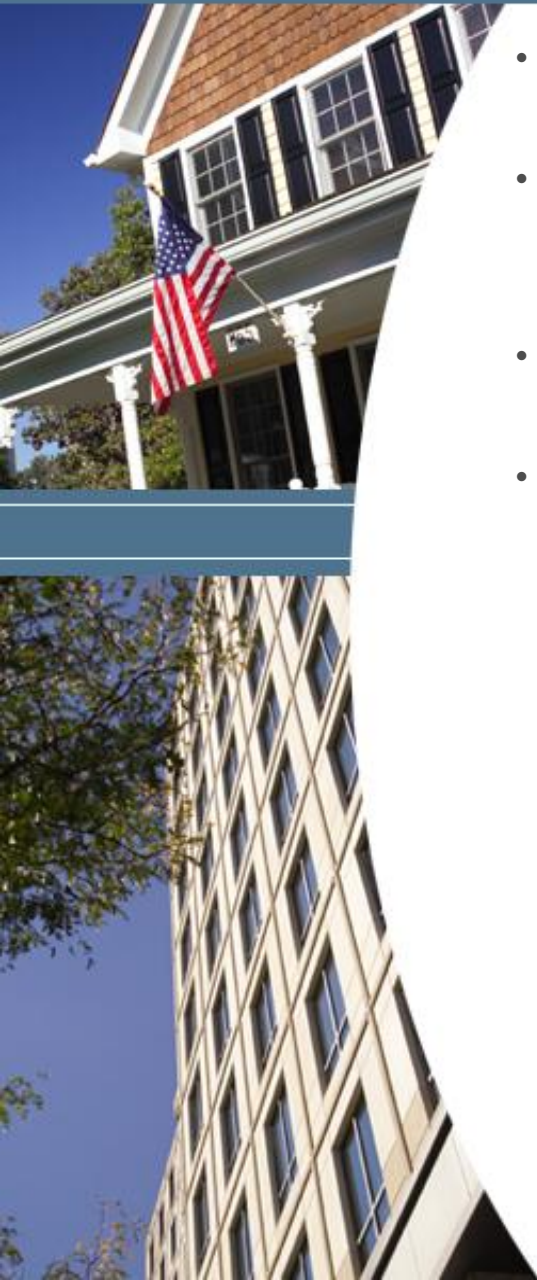


Proposed FSP FAS 140-e and FIN 46(R)-e

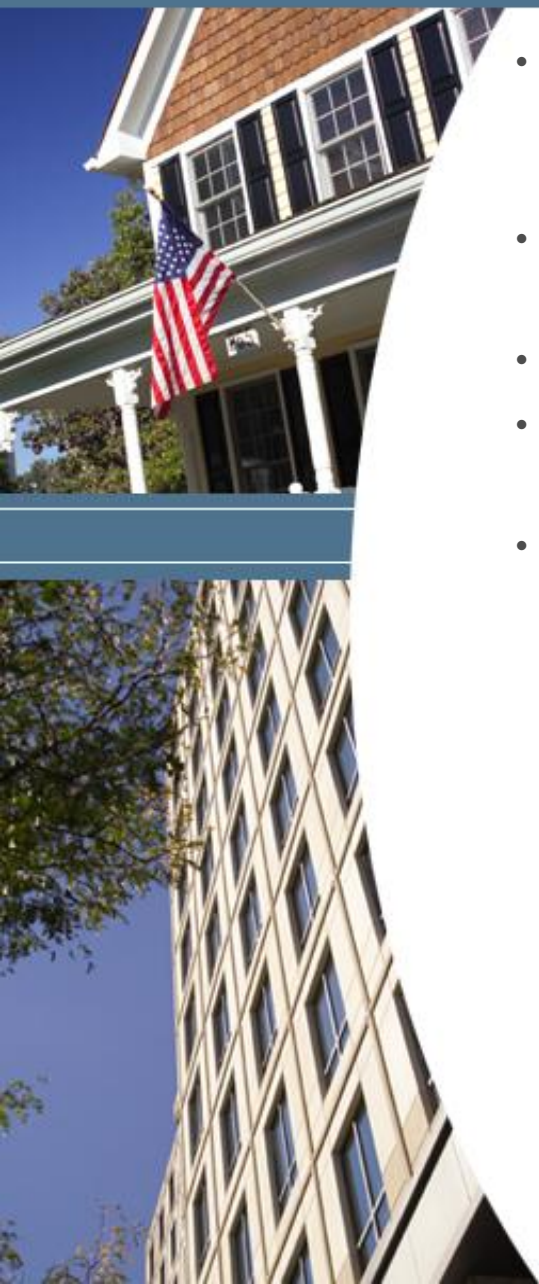
“Disclosures about Transfers of
Financial Assets and Interests in
Variable Interest Entities”



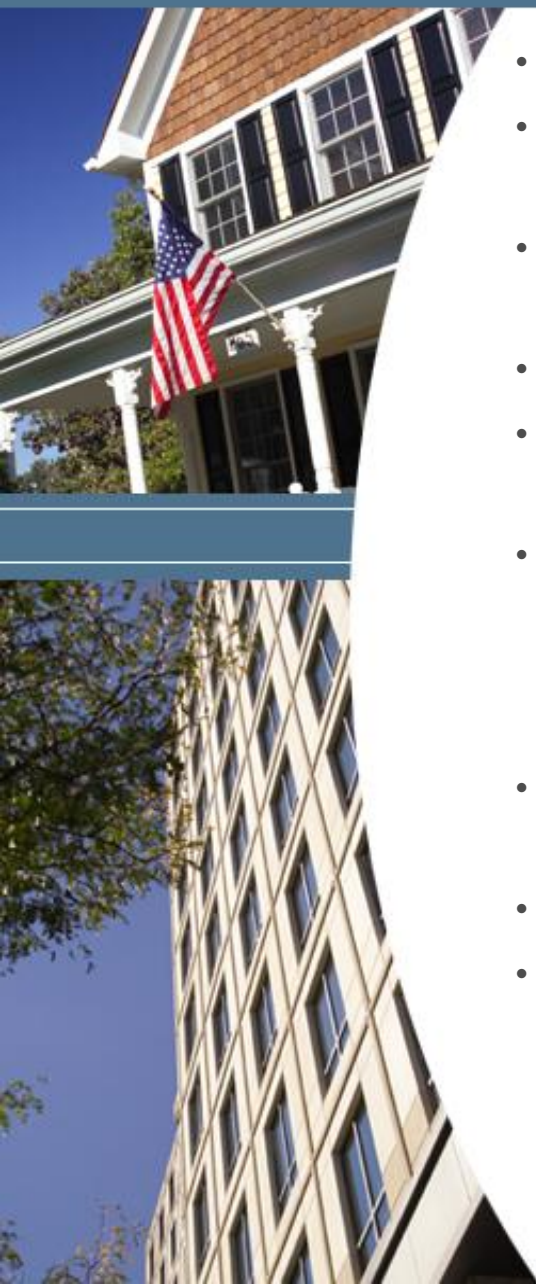
- Financial statement transparency by various entities that transfer financial assets and / or entities that have interests in variable interest entities (VIEs)
- Due to deferral of effective dates for the proposed amendments to FAS 140 and FIN 46(R) – currently expected in fiscal years beginning after November 15, 2009 – FASB decided to issue a proposed FSP that would require similar disclosures but with an earlier effective date
- FSP is expected to be effective for reporting periods ending after December 15, 2008 (e.g., December 31, 2008 – for calendar year companies). Earlier application is encouraged:
 - » Exposure draft issued on September 15, 2008
 - » Comment period ended on October 15, 2008; more than 30 comments letters submitted
 - » November 12, 2008 FASB redeliberation session
 - » Only public companies included in scope
 - » Issuance of the final FSP is expected shortly



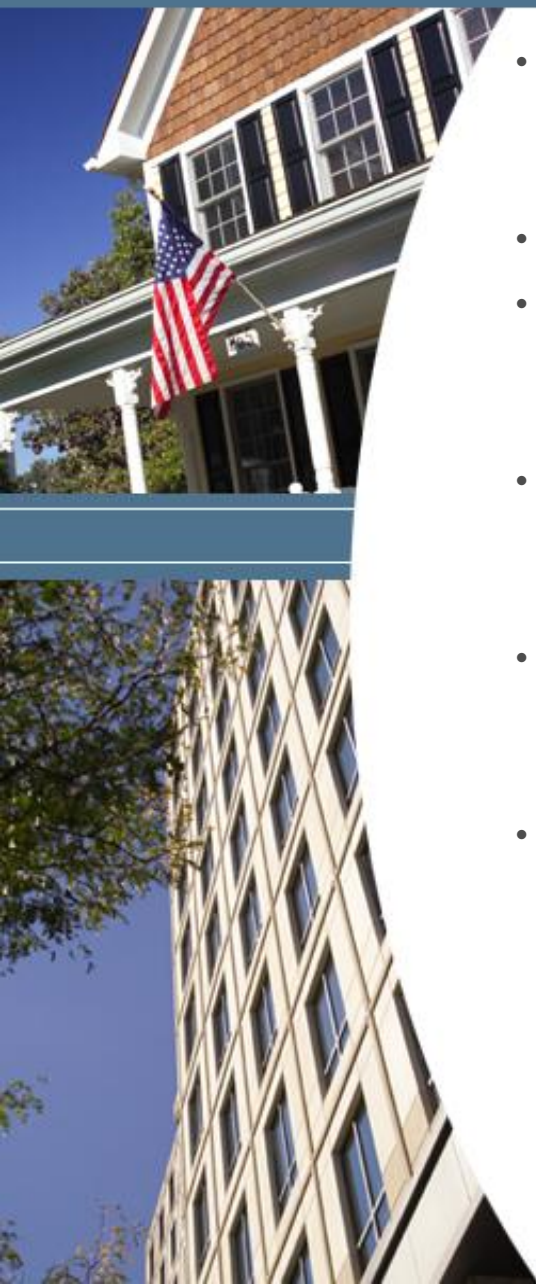
- Both disclosure principles and detailed disclosure requirements are retained
- Consideration of “implicit” arrangements: consideration of all available evidence for FAS 140, and definition of “implicit variable interests” in FSP FIN 46(R)-5
- Liquidity guarantees and other commitments provided by third parties: encouraged vs. required
- FASB decided not to provide specific examples but include reference to April 2008 Senior Supervisors Group Report titled *Leading-Practice Disclosures for Selected Exposures*



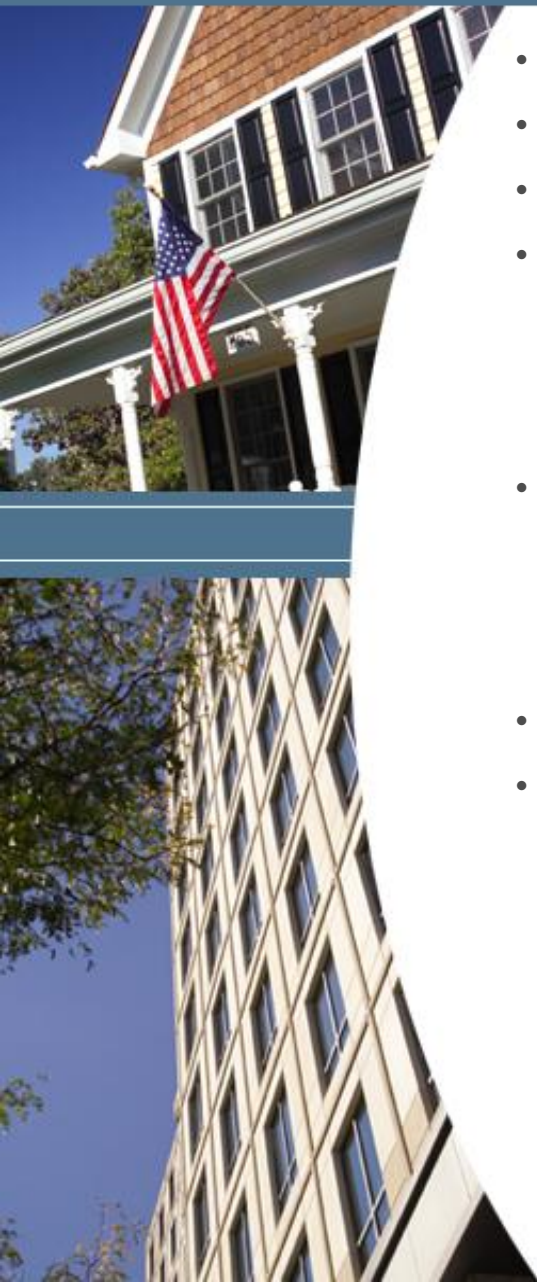
- Transferor's continuing involvement with financial assets transferred to a special purpose entity (SPE), including transfers that are accounted for as sales and transfers that are accounted for as secured borrowings
- How a transfer of financial assets affects an entity's financial position, financial performance, and cash flows
- Nature of any restrictions on assets reported in the entity's balance sheet
- Nature, purpose, size, and activities of an SPE utilized in transfer of financial assets, including how SPE is financed
- Calculation of the initial gain or loss recognized as a result of a transfer of financial assets to an SPE that has been accounted for as a sale



- Scope of disclosures required of transferors with continuing involvement
- Exclusion of certain derivatives from the definition of continuing involvement
- Fair value disclosures: eliminated duplicative disclosure requirements (already required by FAS 157, *Fair Value Measurements*)
- Model validation techniques for servicing will not be required
- Sensitivity analyses: required only for interests that continue to be held by a transferor and for servicing assets / liabilities
- Disclosures of secured borrowings: carrying amounts and classification of assets and associated liabilities recognized in the transferor's balance sheet, and qualitative information about the relationships between those assets and associated liabilities
- Transfers to an SPE: entities whose activities primarily relate to securitization or other form of asset-backed financing
- Gain on sale disclosure
- Disclosures for a transferor if there is no continuing involvement



- The nature of, and changes in, the risks associated with the entity's involvement with the VIEs and how the entity's involvement with the VIE affects its financial position, financial performance, and cash flows
- Nature, purpose, size and activities of VIEs
- Methodology for applying FIN 46(R); judgments and assumptions made by entity in determining whether the entity must consolidate or disclose information about its involvement in the VIEs
- Terms of arrangements that could require company to provide financial support to VIE and whether company provided support to VIE it was not contractually required to provide (explicit vs. implicit support)
- Fair values and carrying amounts and classification of assets and liabilities related to variable interests recognized, including nature of any restrictions on ability to use assets (disclosures instead of linked presentation)
- Maximum exposure to loss resulting from involvements with VIEs

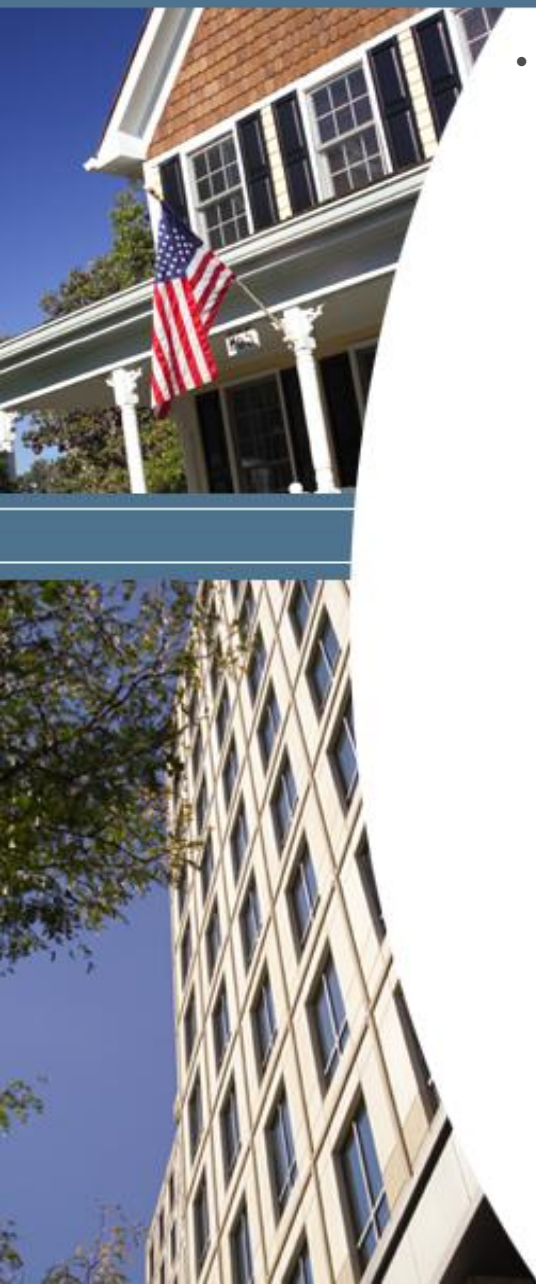


- Level of disclosures for consolidated VIEs
- Sponsors: FASB decided not to define the term “sponsor”
- Methodology for determining the primary beneficiary (PB)
- Proposed requirement to disclose whether different assumptions or judgments could have been reasonably made that would result in a different FIN 46(R) consolidation conclusion was eliminated in FASB redeliberations
- Exposure to loss: instead of estimated exposure to loss in the original draft FASB decided to require entities provide tabular, side-by-side comparison of the entity’s maximum exposure to loss with the liability recognized in the financial statements
- Scope exception for PBs that also hold a majority voting interest
- Significance to the VIE or reporting enterprise

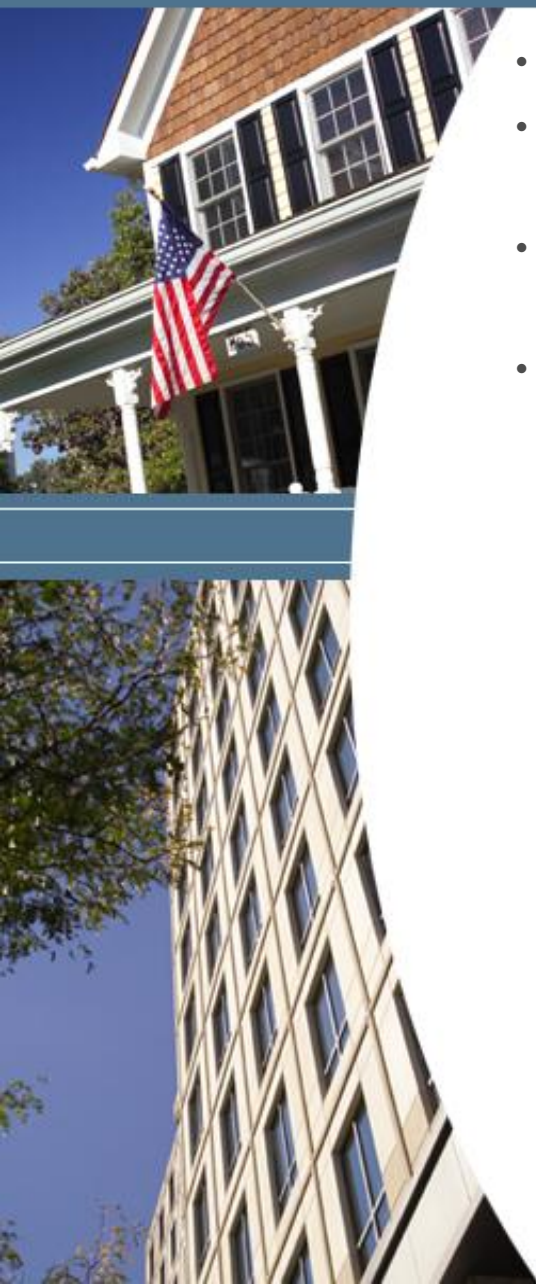


Proposed FAS 140 Amendments

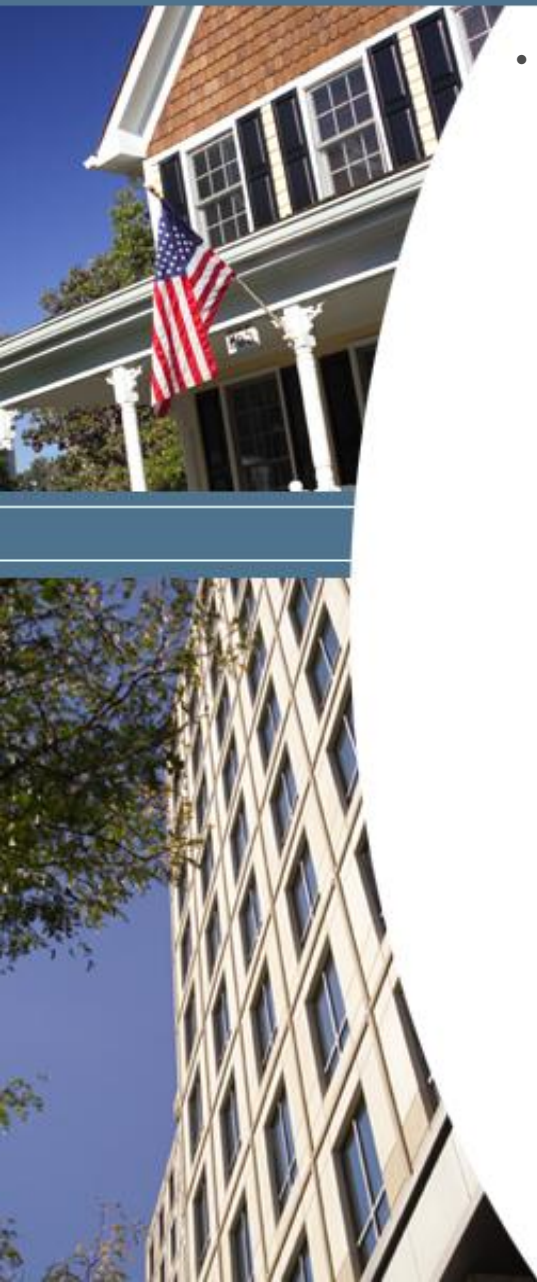
“Accounting for Transfers of
Financial Assets”



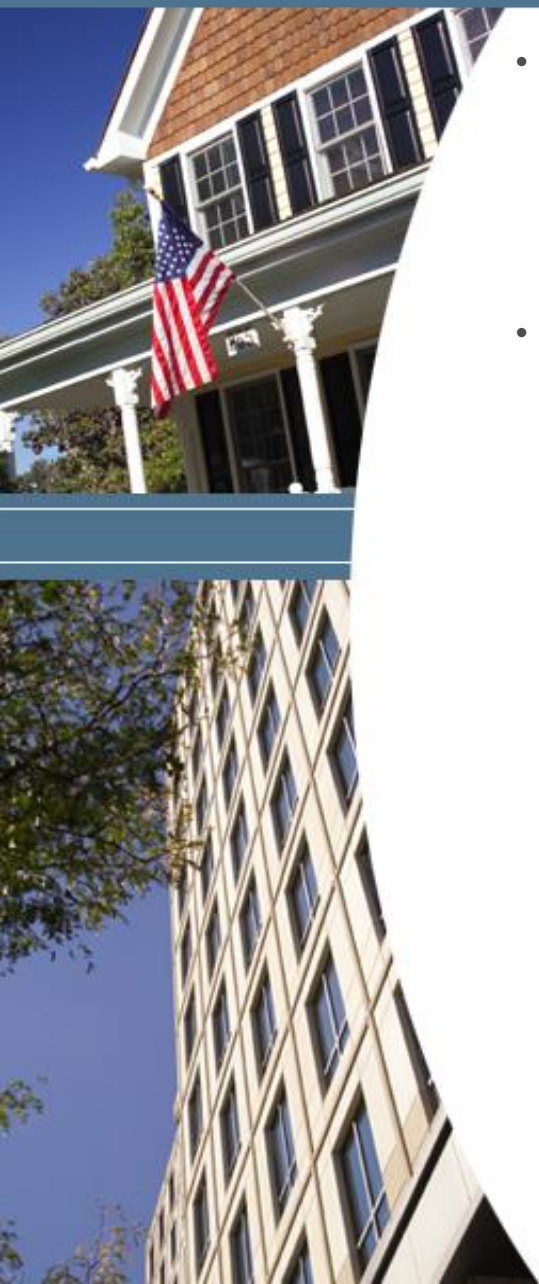
- Under existing guidance in FAS 140, sale recognition is achieved if all of the following conditions are met:
 - » The transferred assets have been isolated from the transferor (seller)
 - » Each transferee (or if the transferee is a QSPE, each of the investors in the beneficial interests issued by a QSPE) has the right to pledge or exchange the assets received and no condition constrains the transferee from taking advantage of its right to pledge or exchange and provides more than a trivial benefit to the transferor
 - » The transferor (seller) does not maintain effective control over the transferred assets through (a) an agreement that entitles and obligates the transferor (seller) to repurchase or redeem them before maturity or (b) the ability to cause the holder (investor) to return specific assets



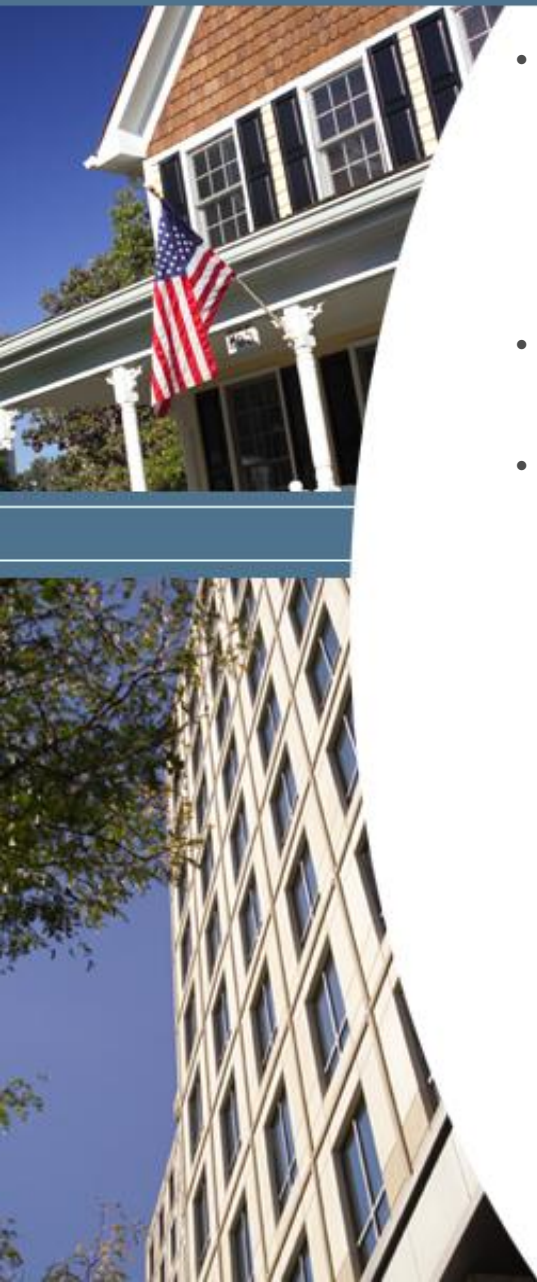
- Detailed guidance in FAS 140 and FASB Q&A regarding QSPEs
- QSPEs are passive entities that have significant limitations on the types of assets they can hold and the ability to manage those assets
- The transferor of assets to QSPEs can achieve sale accounting for the assets transferred into the QSPE
- Neither the transferor nor investors consolidate a QSPE

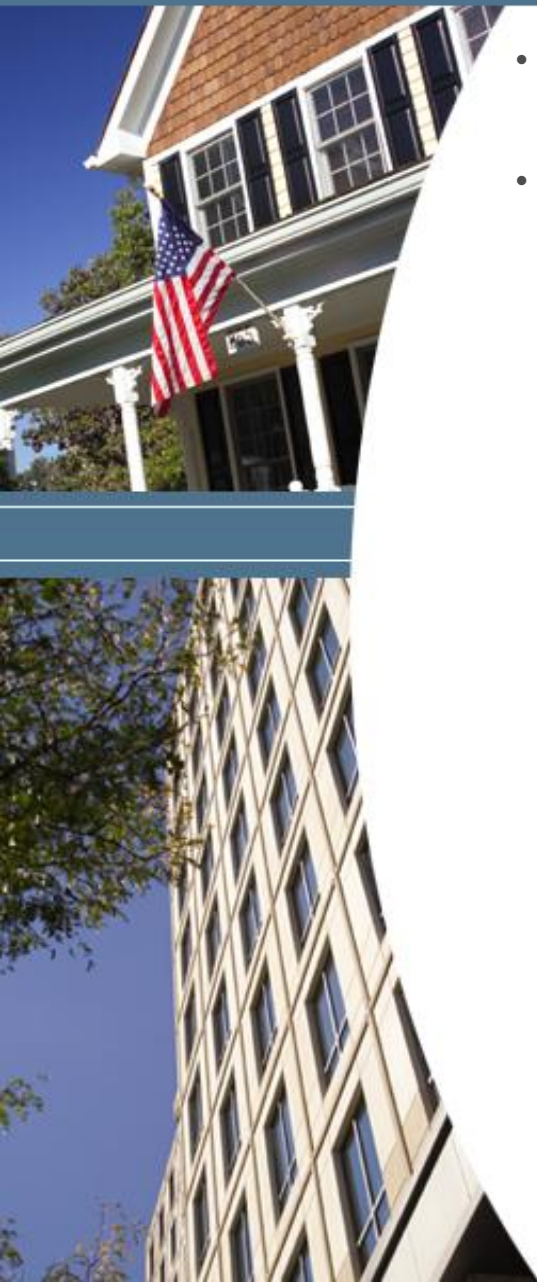


- There can be a sale only of:
 - » An entire financial asset or
 - » A “participating interest” (see next slide) in an individual financial asset

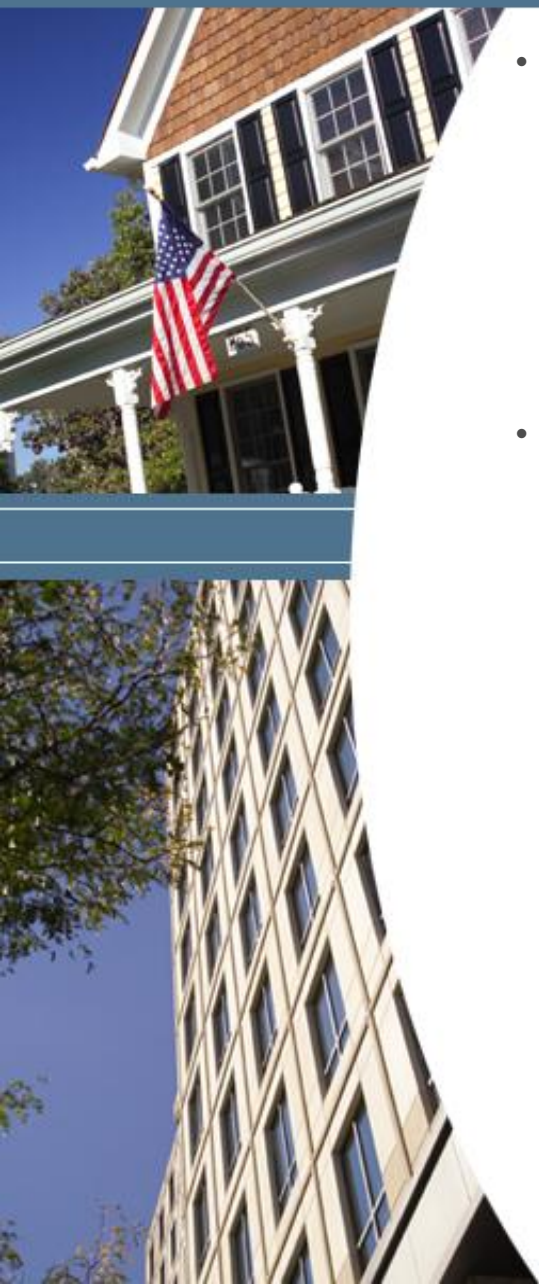


- May not be an interest in:
 - » An equity instrument
 - » A derivative financial instrument
 - » A hybrid financial instrument with an embedded derivative that is not “clearly and closely related” to the “host”
- Must have:
 - » Proportionate cash flow division
 - » Same priority by each participating interest holder
 - » No subordination: no participating interest holder is subordinated to another
 - » No transferor or participating interest holder:
 - Recourse other than standard reps and warranties
 - Right to pledge or exchange the entire financial asset

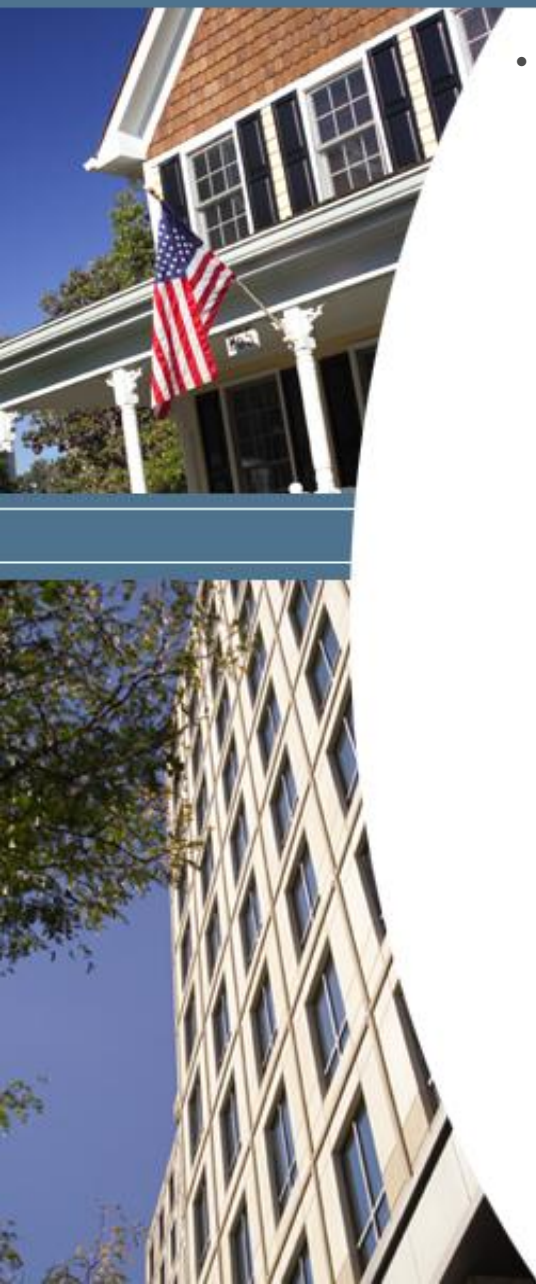
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- Transferred assets must be beyond the reach of the transferor and consolidated affiliates (other than bankruptcy remote entities) and their creditors, even in bankruptcy, requiring “would”:
 - » True sale opinion
 - » Substantive non-consolidation opinion
 - Must consider all arrangements made in connection with the transfer (new provision)
 - “Continuing involvement” defined (see next slide) (new provision):
 - » Legal opinions generally required if any continuing involvement (generally accepted auditing standards)



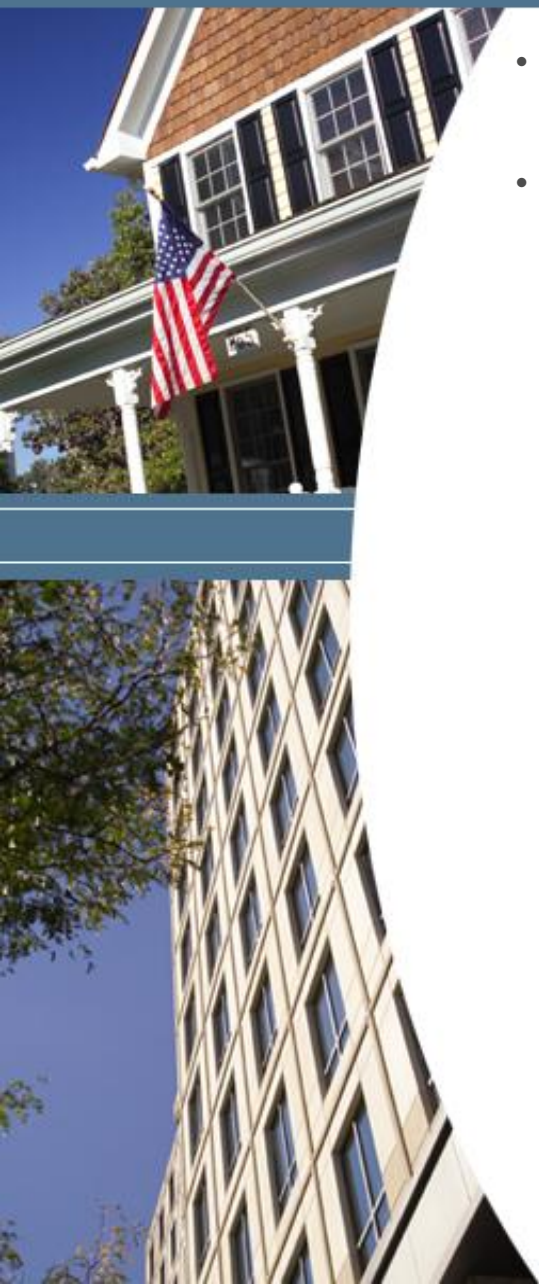
- Involvement of any kind with transferred assets other than standard representations and warranties on delivery requirements
- Examples:
 - » Servicing
 - » Recourse or guarantee
 - » Agreement to repurchase or redeem
 - » Derivatives
 - » Pledge of collateral
 - » Participation in future cash flow
 - » Retained subordinated interests
 - » Restrictions on transferor held interests



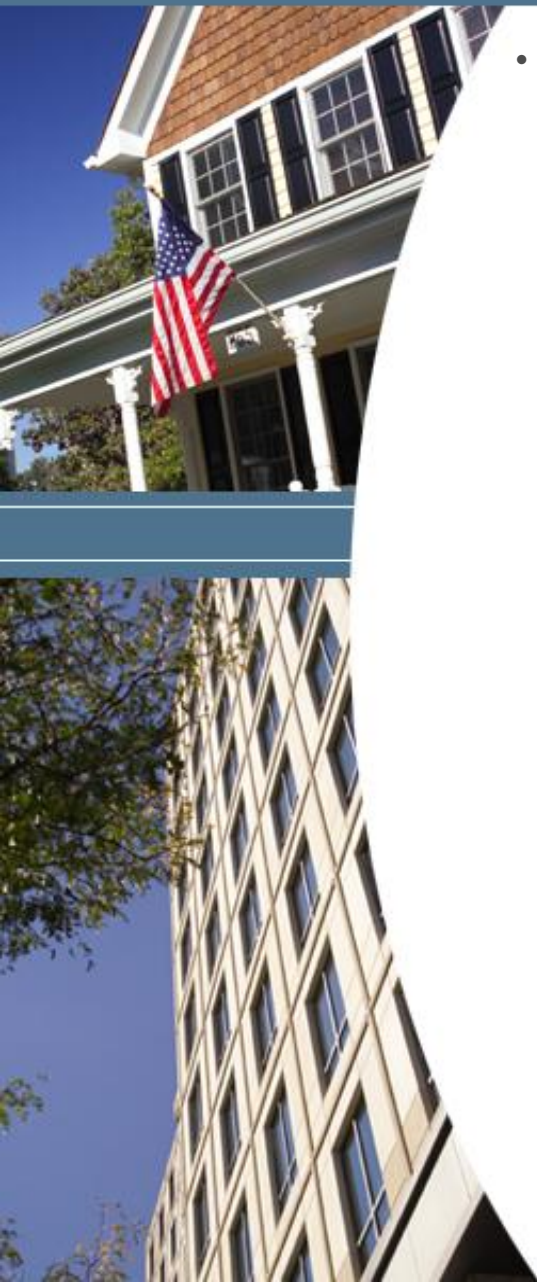
- QSPE concept eliminated due to several FASB concerns regarding whether conditions required for a QSPE were met in practice:
 - » QSPEs are able to make decisions about future refinancing
 - » Certain QSPEs hold assets that are not truly passive in nature and level of discretion and activity by servicers of those entities may be more than originally envisioned (e.g., commercial mortgages)
 - » Questions were raised regarding loan modifications in QSPEs
- All other criteria: modified and moved to Par. 9(c)



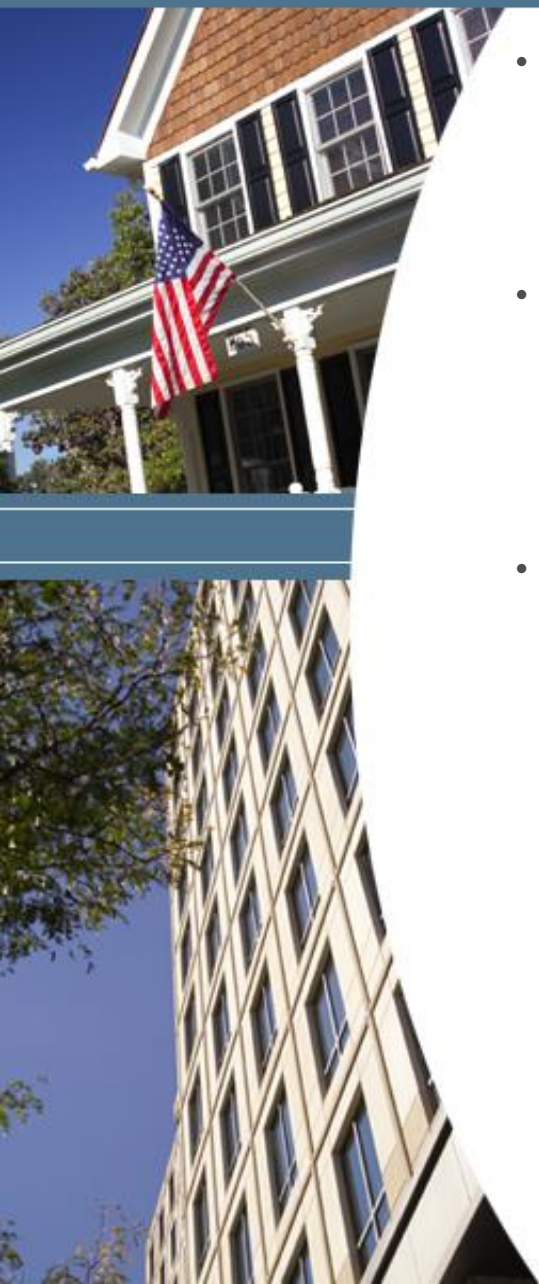
- Transferor and consolidated affiliates cannot control assets by being:
 - » Entitled and obligated to repurchase “readily obtainable” asset before maturity
 - » Entitled to repurchase “non-readily obtainable” assets, other than upon “cleanup call” exercise
 - » Able to constrain transferee from pledging or exchanging assets with no transferee benefit (new provision). In other words, constraints may be permissible if they exist primarily to provide the buyer of the assets with a benefit



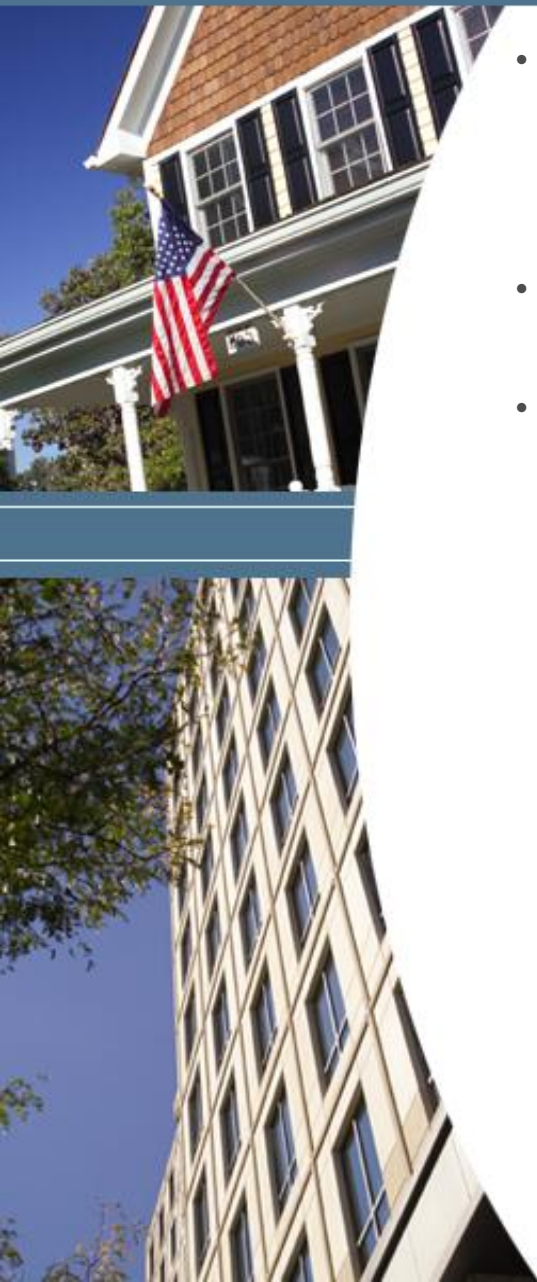
- Beneficial interests are currently measured at allocated carrying amounts upon recognition of sale
- Under the new proposed guidance – if a seller receives a beneficial interest (a pass-through ownership interest in the transferred assets), it should be considered proceeds of sale and initially measured at fair value if the sale meets the following criteria:
 - » Sale of an entire financial asset
 - » Sale is to an entity that is not consolidated by the seller
 - » Qualifies for sale accounting



- If a transfer of participating interests satisfies the conditions to be accounted for as a sale, the seller should:
 - » Allocate previous carrying amount between participating interests sold and participating interest that continues to be held based on their relative fair values at date of transfer
 - » Derecognize participating interests sold
 - » Recognize at fair value any assets obtained or liabilities incurred from sale (including servicing assets/liabilities)
 - » Recognize in earnings gain/loss on sale
 - » Report any participating interest that continues to be held as the difference between previous carrying amount and amount derecognized



- A guaranteed mortgage securitization (GMS) is a securitization of mortgage loans that includes a substantive third-party guarantee. In some GMSs, the seller receives 100% of beneficial interests in the QSPE. Therefore, the transaction does not meet requirements for sale accounting
- Under current guidance there are two exceptions for GMSs that do not qualify as sales in accordance with FAS 140:
 - » Seller can reclassify interests received as securities
 - » If securities are classified as AFS or trading, the seller is required to recognize a servicing asset/liability
- FASB decided to remove both of the above exceptions in the FAS 140 proposed exposure draft

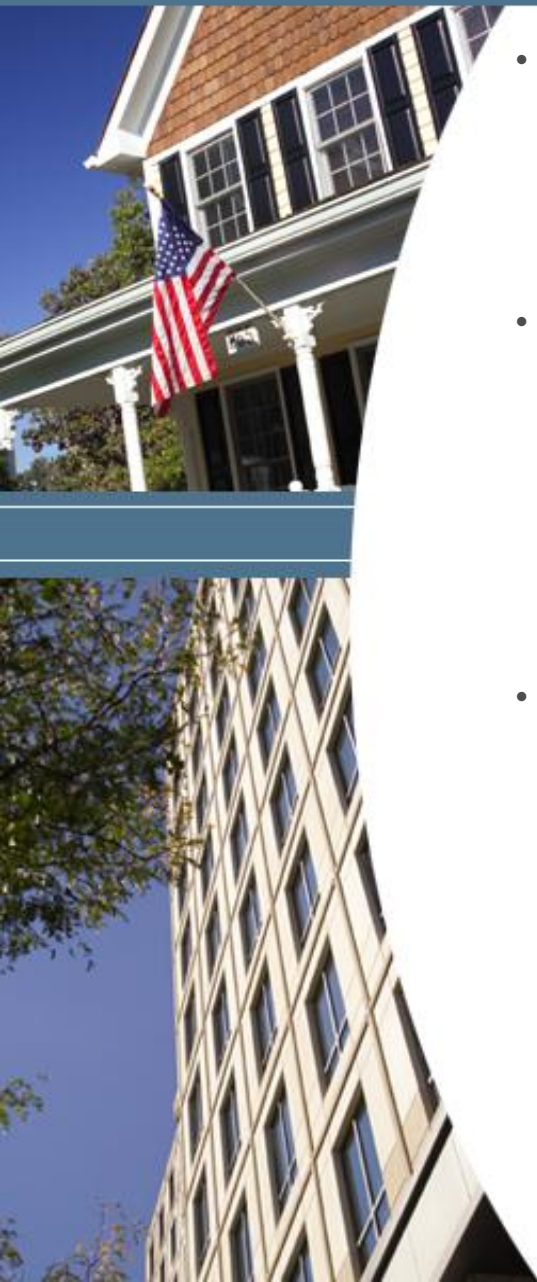


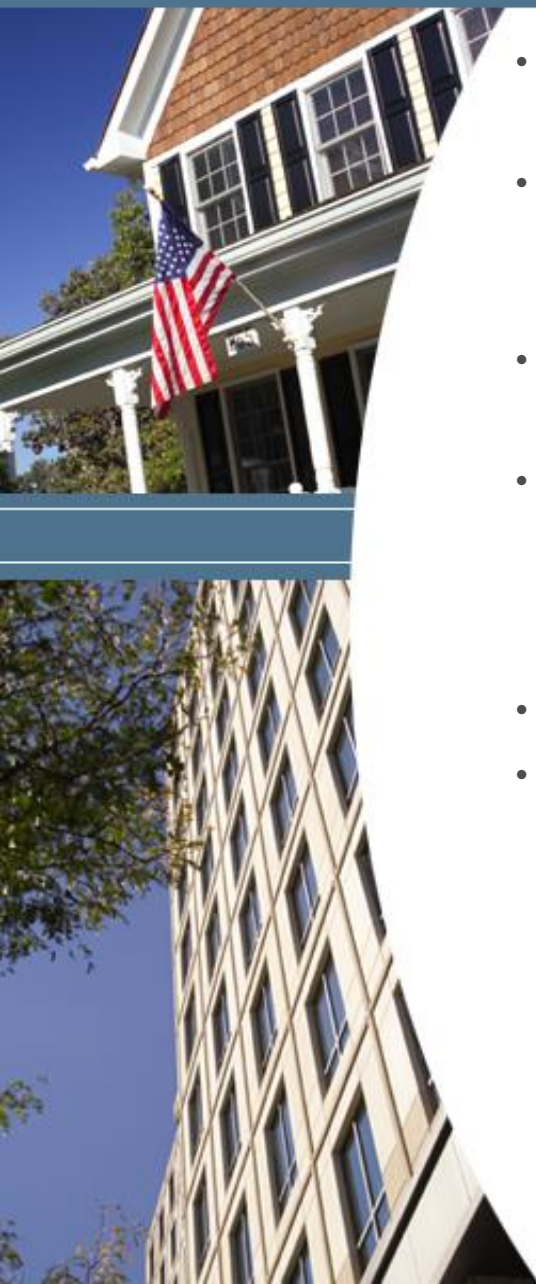
- The amendments to FAS 140 will be effective for fiscal years beginning after November 15, 2009 along with amendments to FIN 46(R)
 - » Prospective application
 - » Early application is prohibited
- Exposure draft was issued on September 15, 2008
 - » Comments were due November 14, 2008: 48 comment letters
- Most of the same disclosures will be required as those proposed in the FSP on disclosures (discussed earlier)



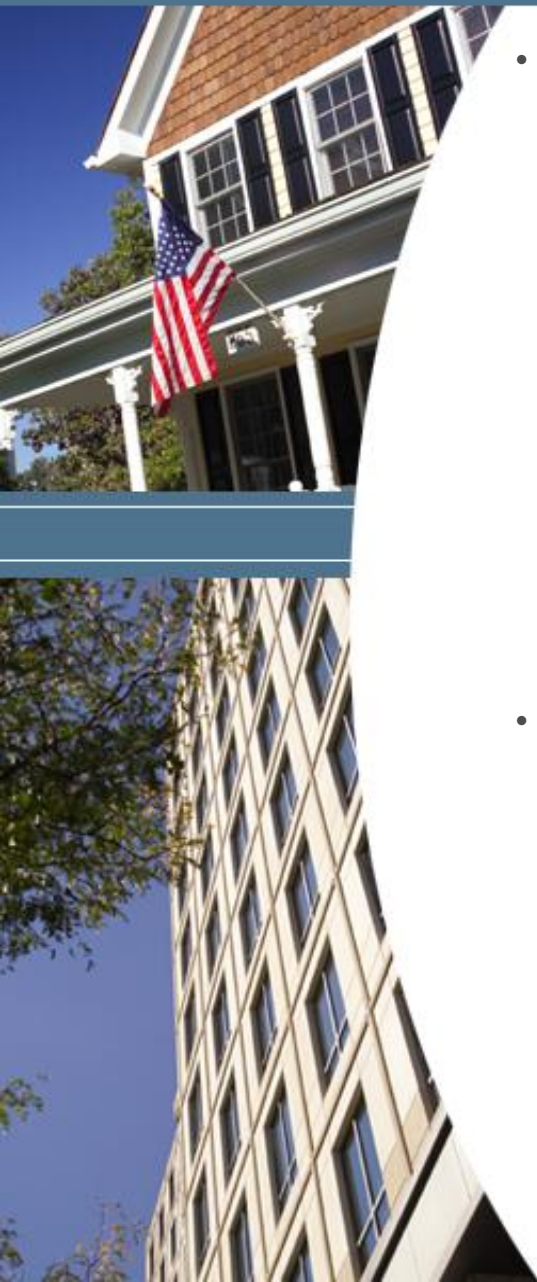
Proposed FIN 46(R) Amendments

“Consolidation of Variable Interest Entities”

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- FIN 46(R) covers variable interest entities (VIEs)
 - » VIEs are typically thinly capitalized and not controlled by voting owners
 - » Who gets to consolidate the VIE: investors or other variable interest holders
 - Under current guidance, the Primary Beneficiary (PB) is the variable interest holder that is exposed to the majority of the variability in future results of the VIE.
 - » Variability is expressed as “expected losses” and “expected residual returns”
 - » Complex quantitative analysis may be required to analyze expected losses and expected residual returns
 - If a PB exists, the PB consolidates the VIE



- No change to definition of VIEs and expected loss / expected residual return concepts remain
- New “Step 1” qualitative analysis will be the primary decision rule to identify if it has a “controlling financial interest” requiring consolidation as the PB
- Existing quantitative analysis guidance retained and used as “Step 2” only if an entity cannot determine whether it meets the Step 1 criteria
- Consolidation decisions must be reconsidered whenever facts and circumstances change:
 - » Not just for specific reconsideration events
 - » Not just at quarter / year end
- Exception for QSPEs eliminated along with FAS 140 revision
- Exception for troubled debt restructurings eliminated

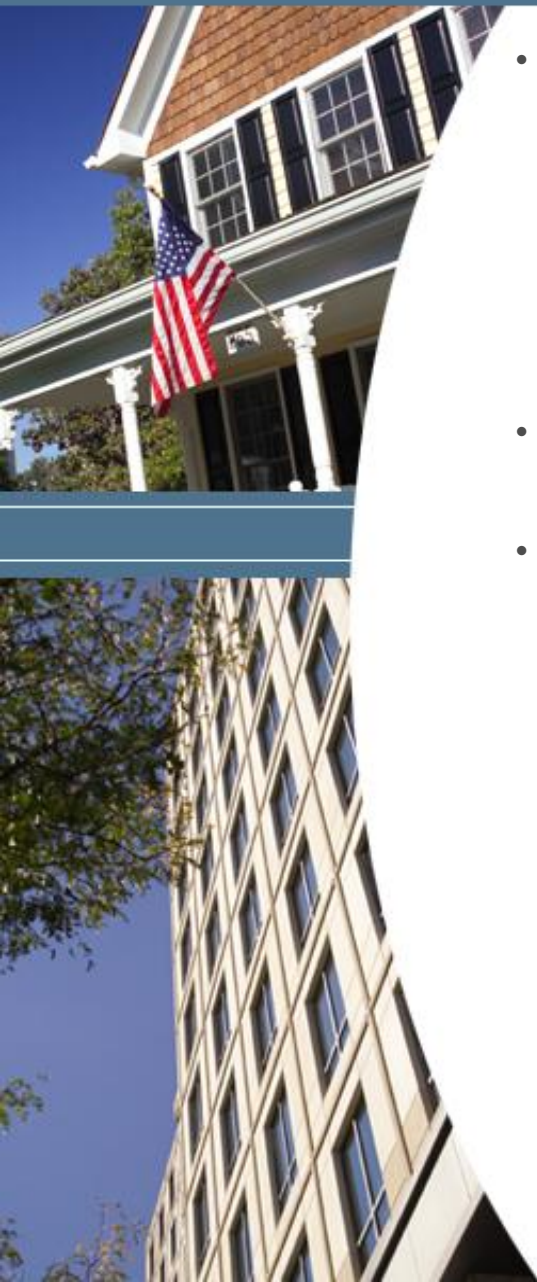


- An enterprise is a PB if it is determined qualitatively to have both:
 - » Power to direct matters that most significantly impact the activities that determine the VIE’s economic performance
 - Substantive decision-making
 - Governing financial and operating policies
 - Right to repurchase majority of transferred assets
 - Right to cause end of VIE operations
 - Kick-out rights (discussed later) are not relevant unless they are unilaterally exercisable by one party, who would then control
 - » Possibility (ignoring likelihood) of receiving benefits (not variability) or absorbing losses (not variability) that could potentially be significant to the VIE or the enterprise
 - This includes explicit and implicit responsibilities and is not based on Step 2 quantitative analysis
- No more than one enterprise should be identified as the PB

- Defined as:
 - » Decision maker removal by simple majority of voting interests held by parties other than the decision maker and its related parties
 - » Parties holding rights can exercise the rights if they choose to; no significant barriers to exercise
- Relevant for:
 - » VIE determination (par.5(b)(1))
 - » Determining if a decision-maker has a variable interest (par.B19)
 - » EITF 04-5, “*Determining Whether a General Partner, or the General Partners as a Group, Controls a Limited Partnership or Similar Entity When the Limited Partners Have Certain Rights*”



- Essentially unchanged from current FIN 46(R)
- Generally should not be required because Step 1 should be determinative
- Eight newly added examples, none of which require STEP 2



- The amendments to FIN 46(R) will be effective for fiscal years beginning after November 15, 2009 along with amendments to FAS 140
 - » No grandfather provisions for existing QSPEs or VIEs
 - » Existing FIN 46(R) paragraphs 18-21 remain unchanged; account for securitizations that come back on the balance sheet as if assets were never transferred
 - » Early application is prohibited
- Exposure draft was issued on September 15, 2008
 - » Comments were due November 14, 2008: 69 comment letters
- Most of the same disclosures will be required as those proposed in the FSP on disclosures (discussed earlier)



Questions

Andrew Mokhov, Ernst & Young LLP
(213) 977-3599