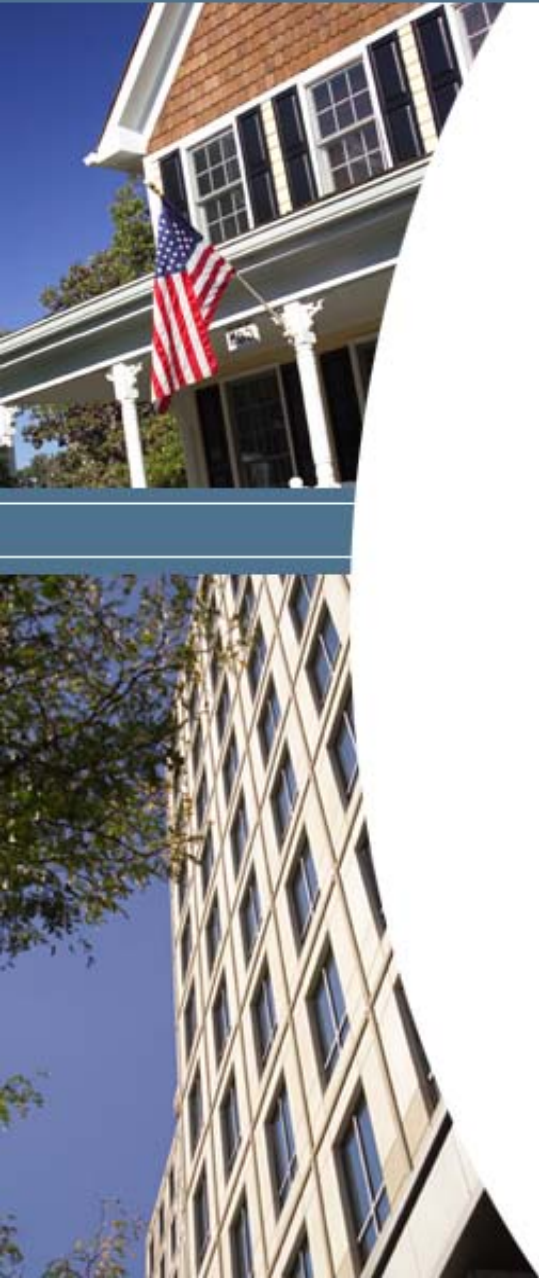




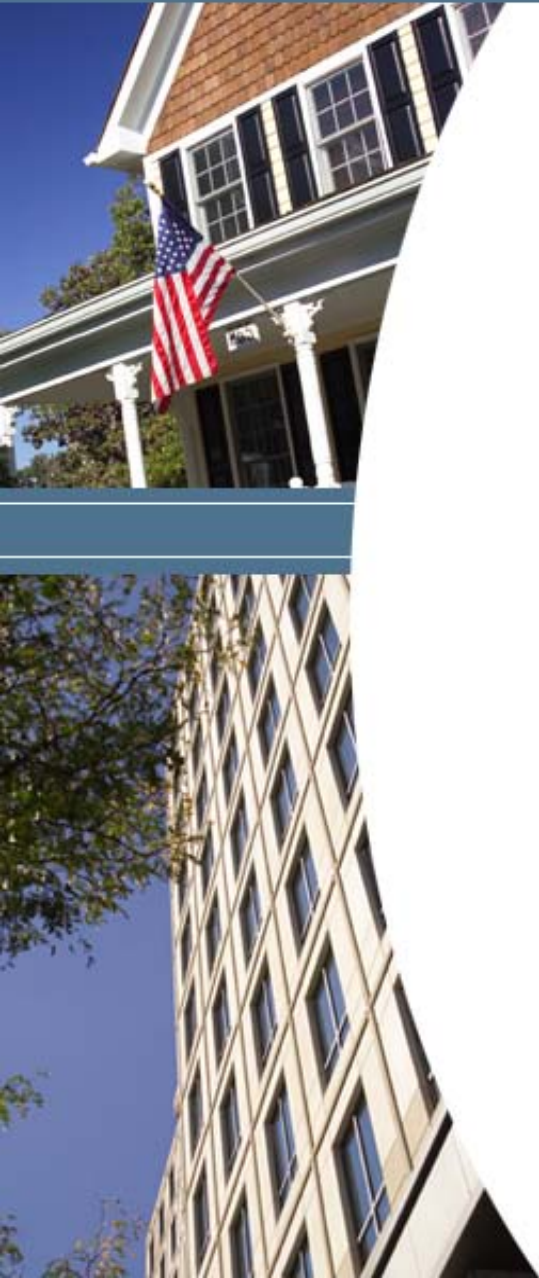
MBA Accounting, Tax and Financial Analysis Conference
SFAS 166/SFAS 167 Implementation



- » Transfer of a participating interest must be carefully evaluated for sale accounting
 - Excess interest as part of the servicing fee is not a participating interest as long the transfer is of an entire financial asset

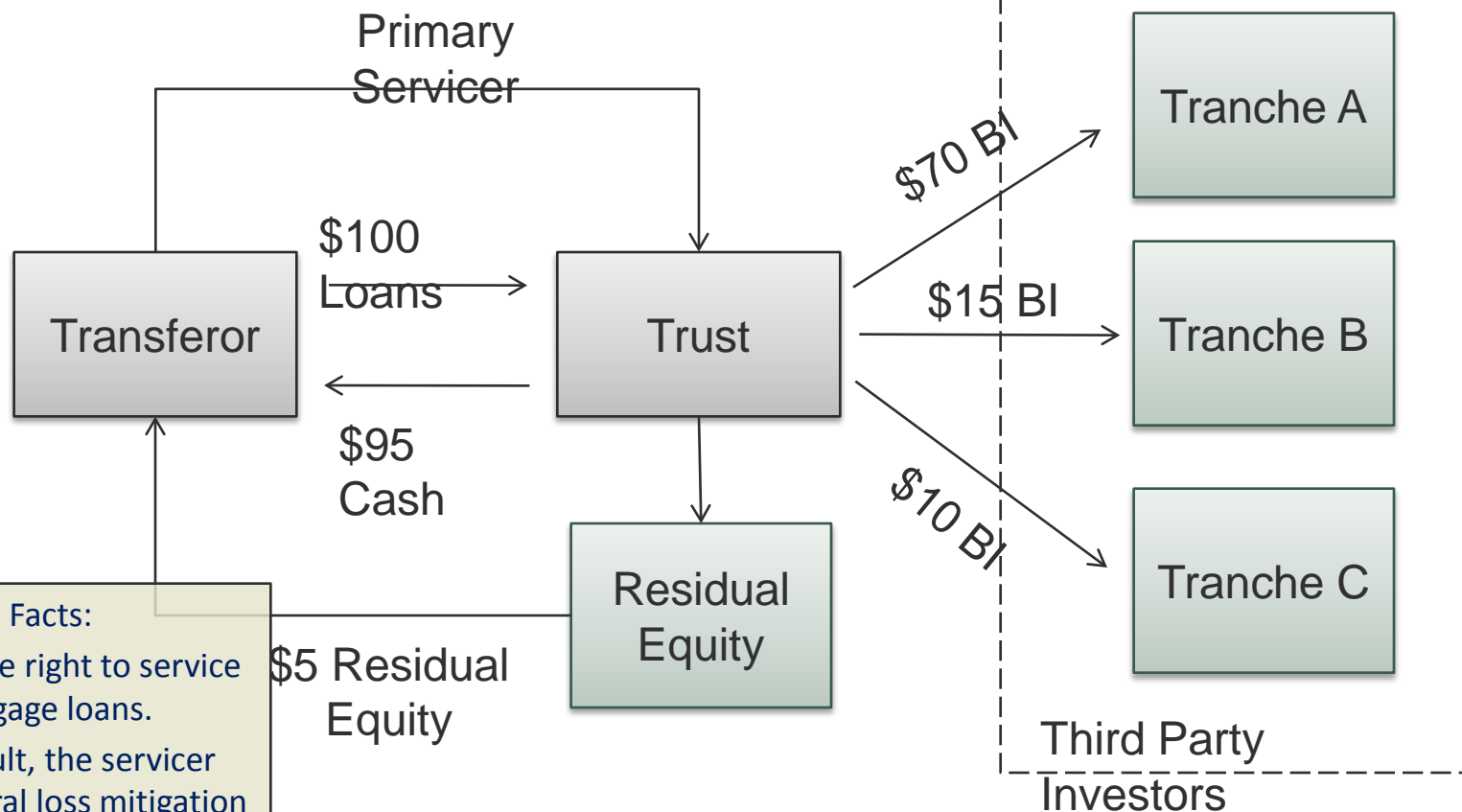
- » Measurement of interests retained by the transferor depends on whether those interests are from the sale of an entire financial asset or a participating interest

- » Guaranteed mortgage securitizations for which the seller receives 100 percent the beneficial interests no longer qualify for a scope exception



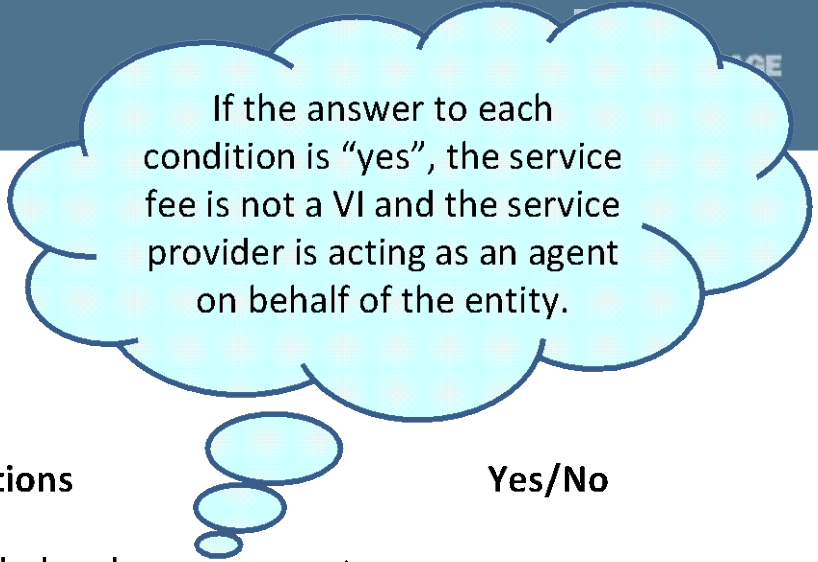
- » Although quantitative risks and rewards no longer determine who is the primary beneficiary, a quantitative analysis may be needed to determine whether or not an entity is a VIE and whether a fee is a variable interest
- » Identifying the party who has the power to direct activities that most significantly impact the VIE's economic performance requires a judgmental assessment of significance
- » Requires an evaluation of all fees as they are generally variable interests unless scoped out per B22
- » The first time consolidation of many SPEs will impact financial ratios, loan covenants and regulatory capital

Example 1 – Private Label RMBS



Additional Facts:

- Transferor retains the right to service the transferred mortgage loans.
- In the event of default, the servicer chooses among several loss mitigation alternatives included in the PSA.



Is the Servicing Fee a Variable Interest?

Para Ref.	Variable Interest Conditions	Yes/No
B22(a)	Is the fee compensation for services provided and commensurate with the level of effort required?	Yes
B22(b)	Are substantially all the fees at or above the same level of seniority as other operating liabilities?	Yes
B22(c)	Does the decision maker hold no other interests in the VIE that absorb more than an insignificant amount of the entity's expected losses?	Yes
B22(d)	Does the service arrangement include only terms, conditions, or amounts that are customary and negotiated at arm's length?	Yes
B22(e)	Is the total amount of anticipated fees insignificant relative to the total amount of the entity's anticipated economic performance?	Yes
B22(f)	Is the anticipated fees expected to absorb an insignificant amount of the variability associated with the entity's anticipated economic performance?	Yes

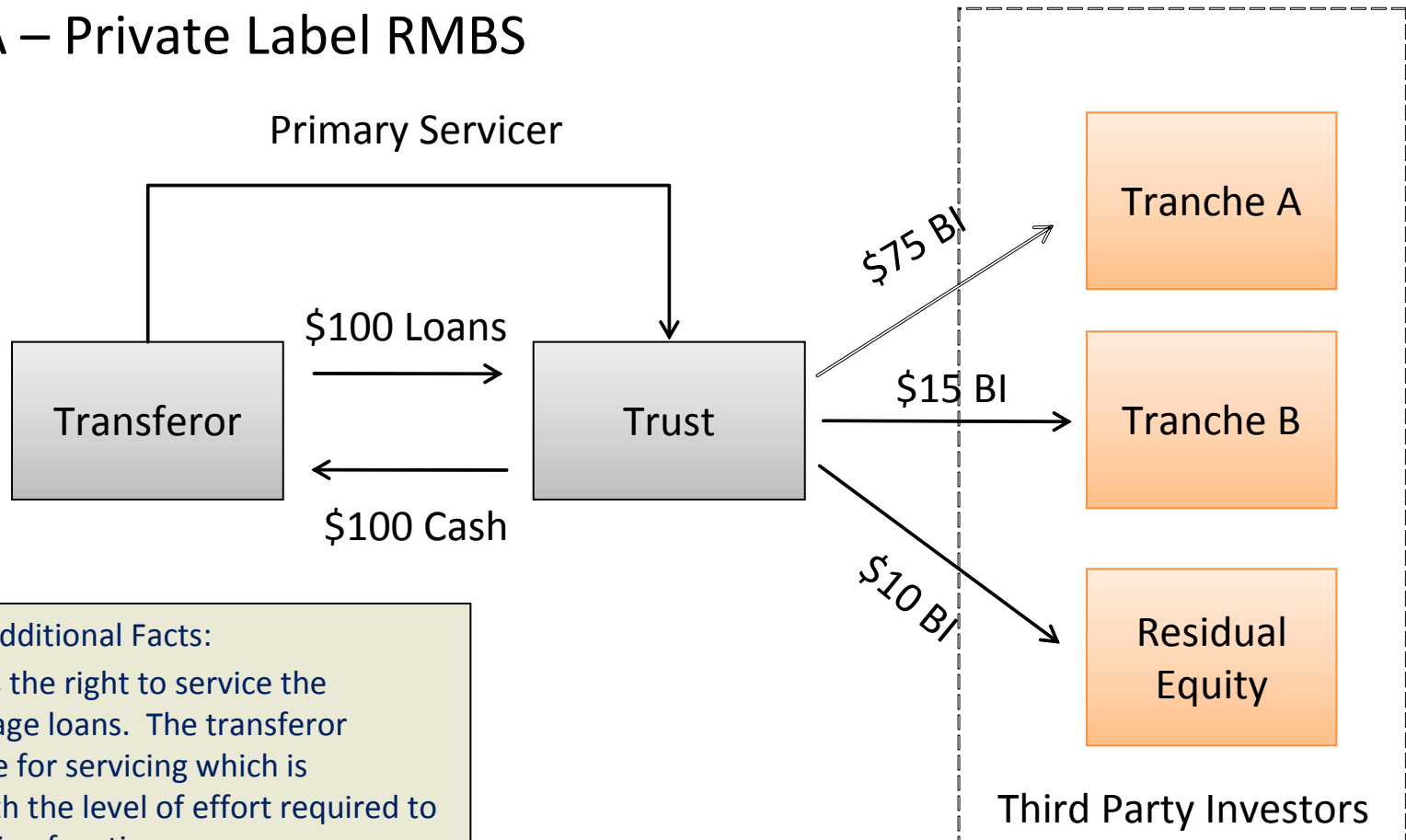
Example 1 – Private Label RMBS

Power to direct activities that most significantly impact the VIE's economic performance?

Right to receive benefits or obligation to absorb losses that could potentially be significant to the VIE?

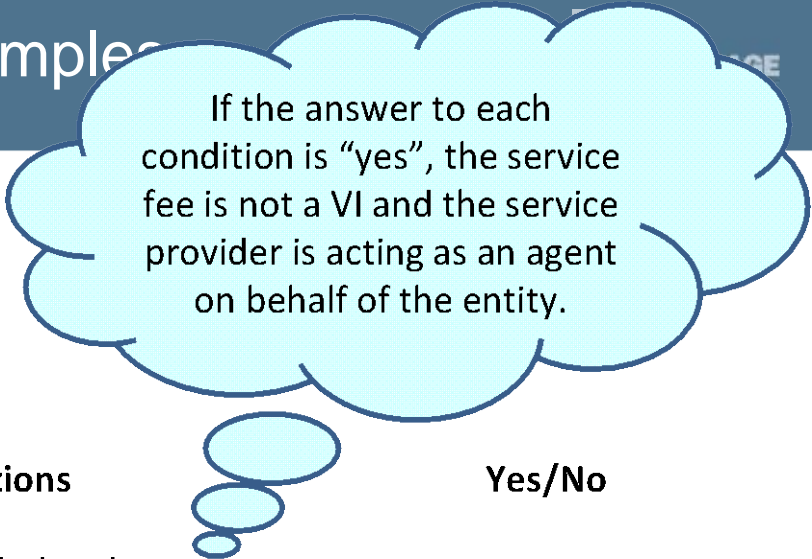
Interest Holder	Power Over Significant Activities?	Significant Benefits &/or Losses?
Class A		✓
Class B		✓
Class C		✓
Residual/ Servicer	✓	✓

Example 1A – Private Label RMBS



Additional Facts:

- Transferor retains the right to service the transferred mortgage loans. The transferor receives a 25bp fee for servicing which is commensurate with the level of effort required to perform the servicing function.
- In the event of default, the servicer chooses among several loss mitigation alternatives included in the PSA.



Is the Servicing Fee a Variable Interest?

Para Ref.	Variable Interest Conditions	Yes/No
B22(a)	Is the fee compensation for services provided and commensurate with the level of effort required?	Yes
B22(b)	Are substantially all the fees at or above the same level of seniority as other operating liabilities?	Yes
B22(c)	Does the decision maker hold no other interests in the VIE that absorb more than an insignificant amount of the entity's expected losses?	Yes
B22(d)	Does the service arrangement include only terms, conditions, or amounts that are customary and negotiated at arm's length?	Yes
B22(e)	Is the total amount of anticipated fees insignificant relative to the total amount of the entity's anticipated economic performance?	Yes
B22(f)	Is the anticipated fees expected to absorb an insignificant amount of the variability associated with the entity's anticipated economic performance?	Yes

Example 1A – Private Label RMBS

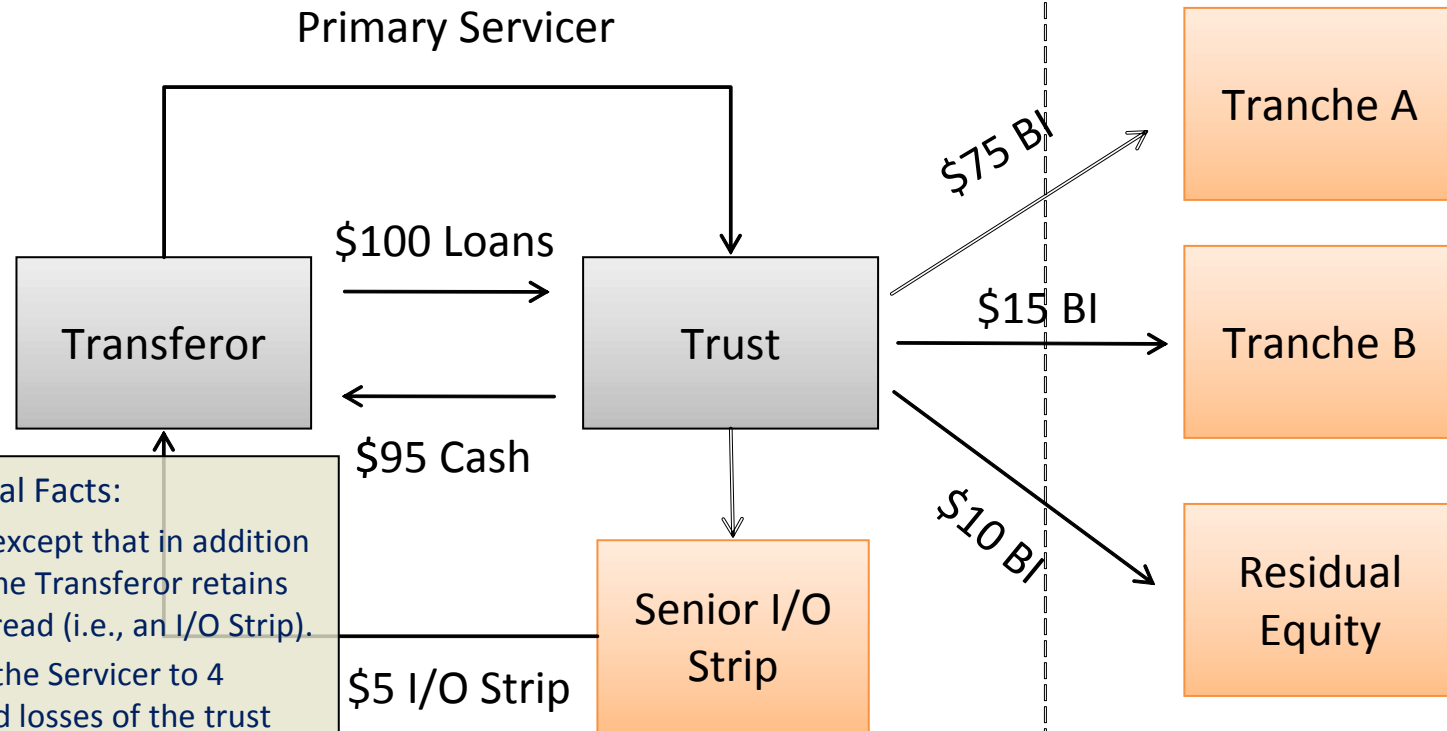
Power to direct activities that most significantly impact the VIE's economic performance?

Right to receive benefits or obligation to absorb losses that could potentially be significant to the VIE?

Interest Holder	Power Over Significant Activities?	Significant Benefits & Losses?
Class A		✓
Class B		✓
Class C		✓
Servicer		

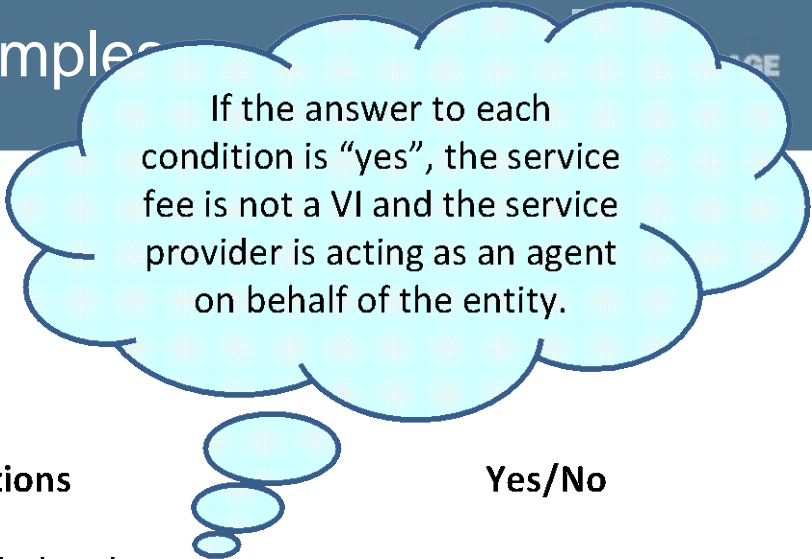
Based on B22, the servicer does not have a variable interest. To be a primary beneficiary, an enterprise must first have a variable interest in the VIE.

Example 1B – Private Label RMBS



Additional Facts:

- Same as Example 1A, except that in addition to the servicing right, the Transferor retains the excess servicing spread (i.e., an I/O Strip).
- The I/O Strip exposes the Servicer to 4 percent of the expected losses of the trust and 3 percent of the total anticipated performance of the trust.
- The I/O strip also exposes the servicer to 6 percent of the variability of the Trust's anticipated economic performance.



Is the Servicing Fee a Variable Interest?

Para Ref.	Variable Interest Conditions	Yes/No
B22(a)	Is the fee compensation for services provided and commensurate with the level of effort required?	Yes
B22(b)	Are substantially all the fees at or above the same level of seniority as other operating liabilities?	Yes
B22(c)	Does the decision maker hold no other interests in the VIE that absorb more than an insignificant amount of the entity's expected losses?	Yes
B22(d)	Does the service arrangement include only terms, conditions, or amounts that are customary and negotiated at arm's length?	Yes
B22(e)	Is the total amount of anticipated fees insignificant relative to the total amount of the entity's anticipated economic performance?	Yes
B22(f)	Is the anticipated fees expected to absorb an insignificant amount of the variability associated with the entity's anticipated economic performance?	Yes

Example 1B – Private Label RMBS

Power to direct activities that most significantly impact the VIE's economic performance?

Right to receive benefits or obligation to absorb losses that could potentially be significant to the VIE?

Interest Holder	Power Over Significant Activities?	Significant Benefits & Losses?
Class A		✓
Class B		✓
Class C		✓
Servicer		✓

Based on B22, the servicer is an agent of the trust. Therefore, it does not have power to act on its own behalf.

Alternative Scenarios to Example 1A and 1B

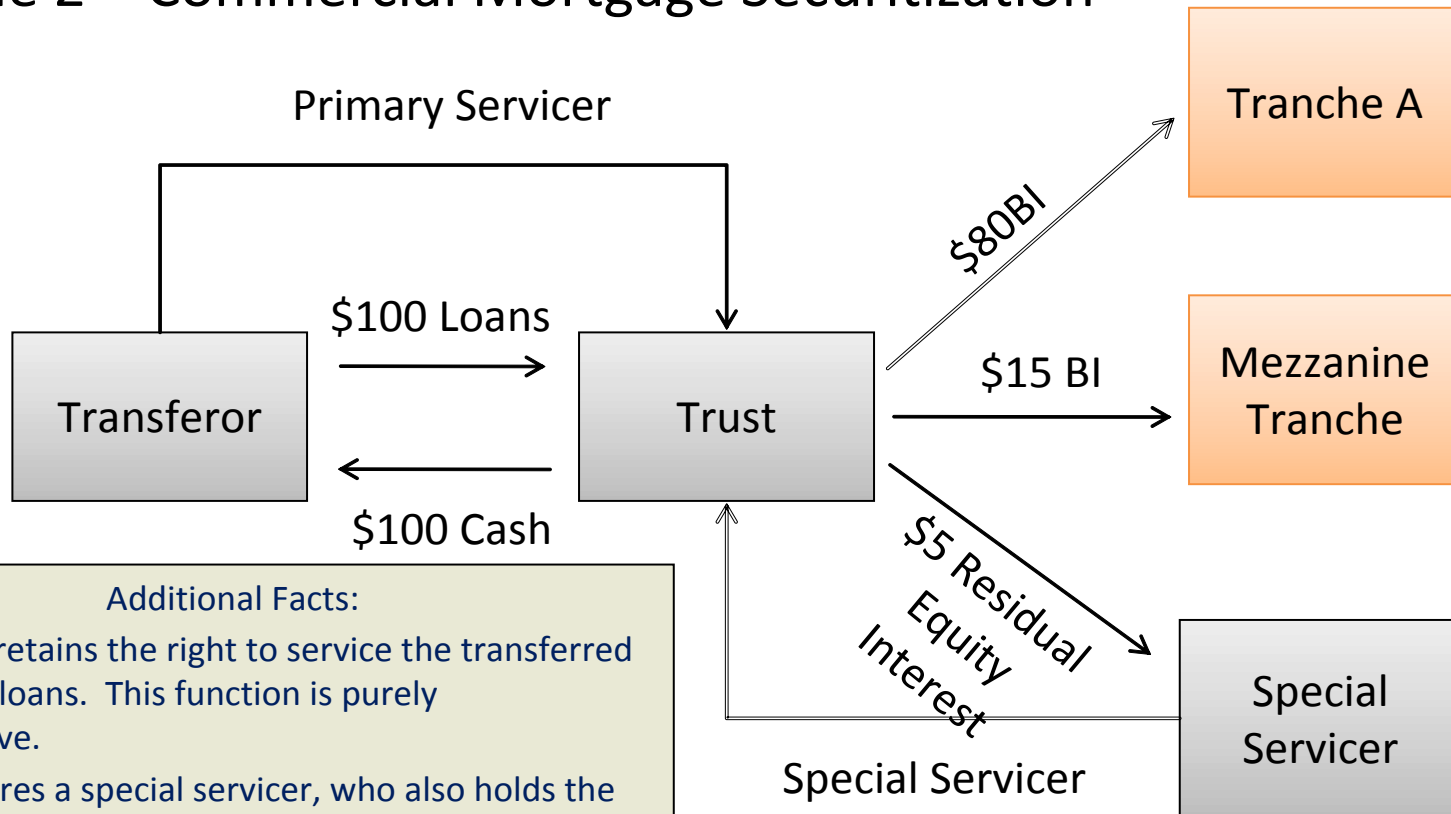
- What if the Transferor’s residual interest has a fair value of \$0 at the date of analysis because of significant prior losses?
- What if the Transferor does not have a residual interest but holds a senior interest in the Trust (e.g., excess spread in the form of an I/O strip or a senior tranche)?
- What if the Transferor does not have a residual interest but holds a default call option that allows it to purchase defaulted assets from the Trust?



Notes:

- Key to each analysis above is whether the Transferor as the servicer is acting in a fiduciary/agent capacity on behalf of the trust.
- To determine whether the Transferor is acting as a fiduciary/agent on behalf of the trust, careful consideration of the guidance in paragraph B22 is required.

Example 2 – Commercial Mortgage Securitization



Additional Facts:

- Transferor retains the right to service the transferred commercial loans. This function is purely administrative.
- The trust hires a special servicer, who also holds the residual equity interest. The special servicer assumes servicing responsibilities in the event of default.
- In default, the special servicer has significant discretion to manage the defaulted assets.

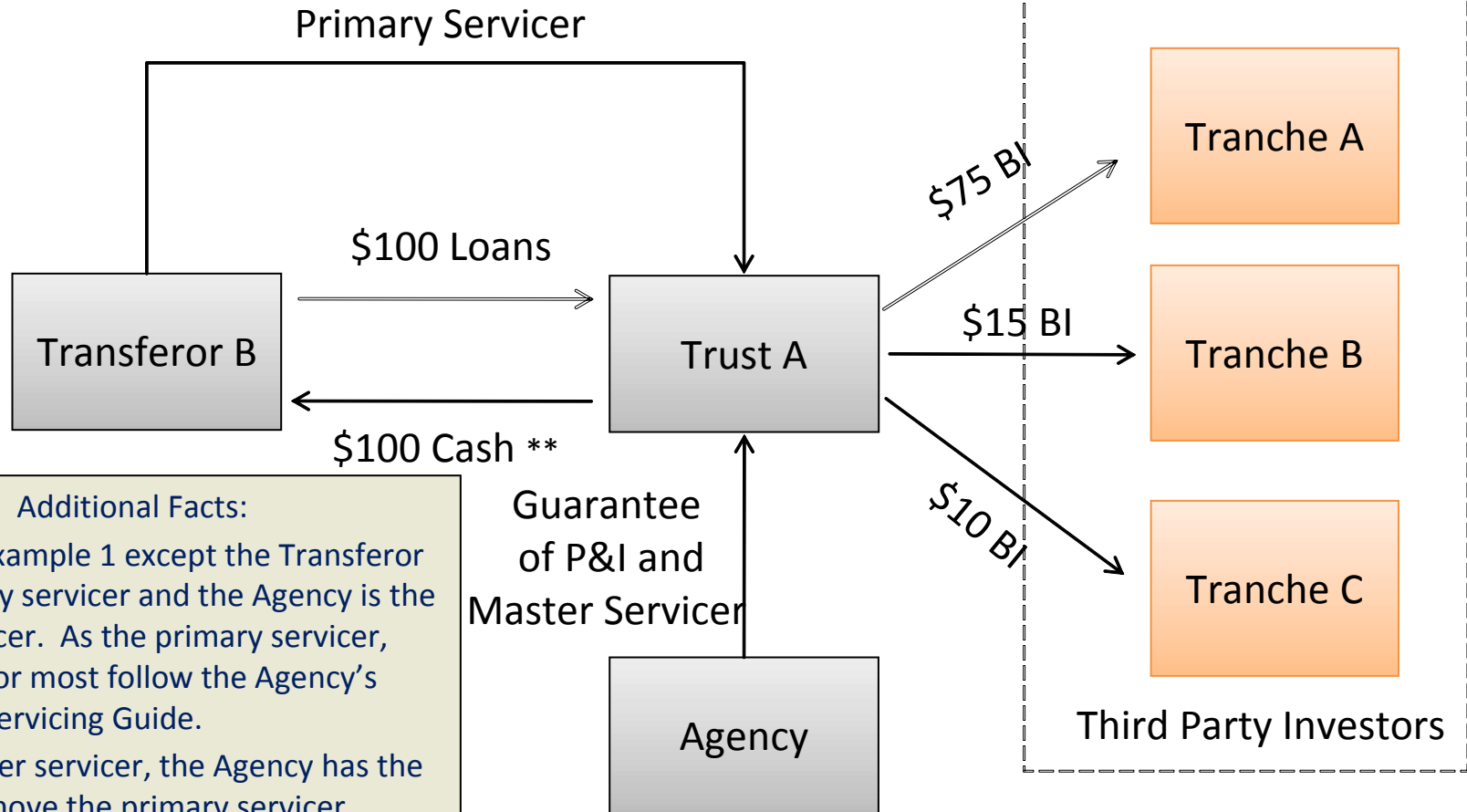
Example 2 – Commercial Mortgage Securitization

Power to direct activities that most significantly impact the VIE's economic performance?

Right to receive benefits or obligation to absorb losses that could potentially be significant to the VIE?

Interest Holder	Power Over Significant Activities?	Significant Benefits & Losses?
Tranche A		✓
Mezzanine		✓
Primary Servicer		✓
Residual/ Special Servicer	✓	✓

Example 3 – Agency RMBS:



Additional Facts:

- Similar to Example 1 except the Transferor is the primary servicer and the Agency is the master servicer. As the primary servicer, the Transferor must follow the Agency's Selling and Servicing Guide.
- As the master servicer, the Agency has the ability to remove the primary servicer without cause and determine when the purchase defaulted loans from the Trust.

** Under SFAS 166, guaranteed mortgage securitizations are no longer a scope exception

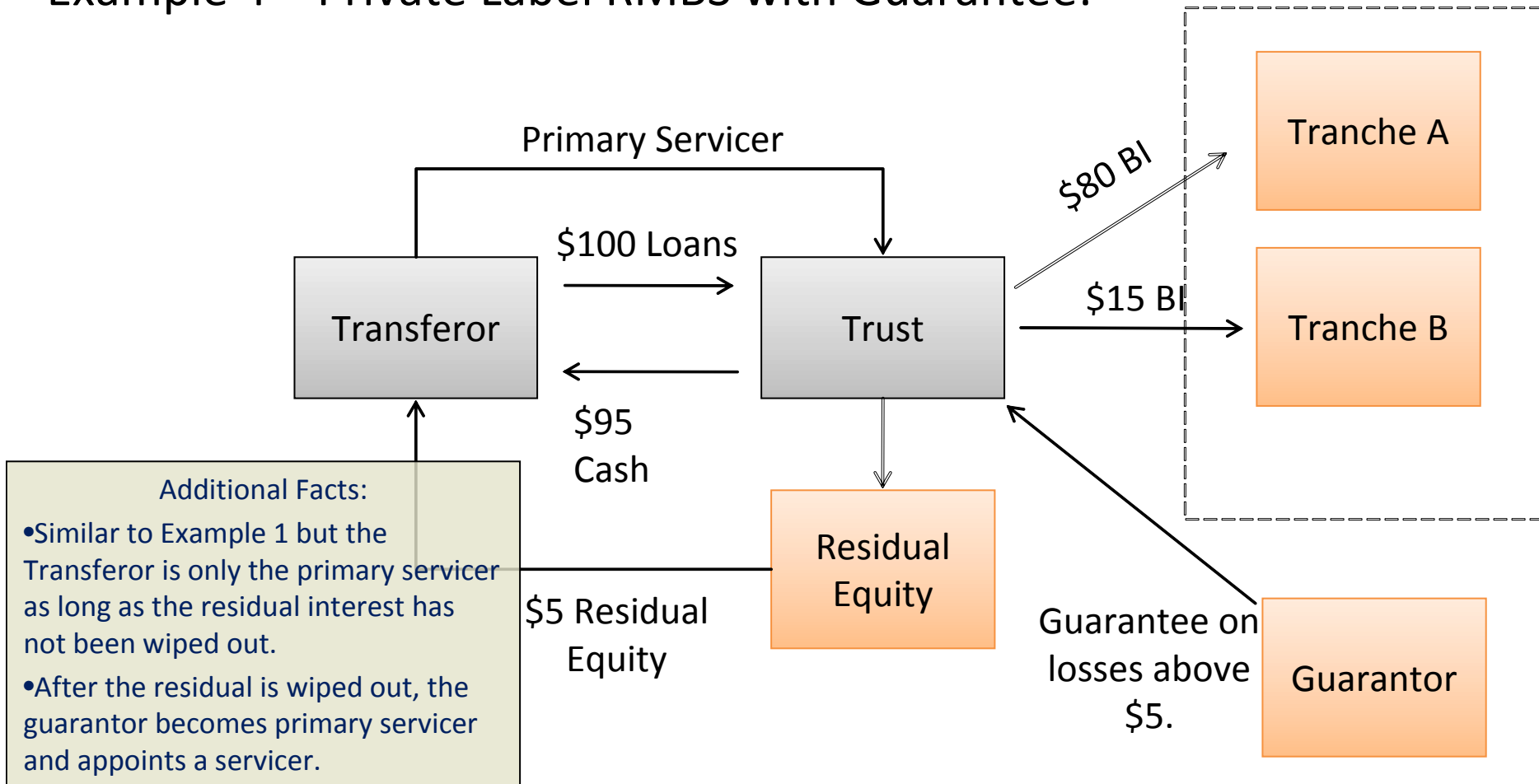
Example 3 – Agency RMBS:

Power to direct activities that most significantly impact the VIE's economic performance?

Right to receive benefits or obligation to absorb losses that could potentially be significant to the VIE?

Interest Holder	Power Over Significant Activities?	Significant Benefits & Losses?
Tranche A		✓
Tranche B		✓
Primary Servicer		✓
Master Servicer/ Guarantor	✓	✓

Example 4 – Private Label RMBS with Guarantee:



Statement 167 - Consolidation Examples

Would this conclusion be different if it is highly likely the residual will be wiped out?

Power to direct activities that most significantly impact the VIE's economic performance?

Right to receive benefits or obligation to absorb losses that could potentially be significant to the VIE?

Interest Holder	Power Over Significant Activities?	Significant Benefits & Losses?
Tranche A		✓
Tranche B		✓
Guarantor		✓
Residual/ Servicer	✓	✓

Day 1 of the Trust.

Example 4 – Private Label RMBS with Guarantee:

Power to direct activities that most significantly impact the VIE's economic performance?

Right to receive benefits or obligation to absorb losses that could potentially be significant to the VIE?

Interest Holder	Power Over Significant Activities?	Significant Benefits & Losses?
Tranche A		✓
Tranche B		✓
Guarantor	✓	✓
Residual/ Servicer		✓

Once it becomes probable that the residual will be wiped out.

SFAS 167 allows an election of a transition method . . .

Carrying Amount Method

Advantages

- Comparable reporting with similar on-balance assets
- Systems integration may be simplified

Disadvantages

- Obtaining historical information to determine carrying amounts may be expensive and/or time-consuming
- Roll-forward accounting may be complex
- May be asymmetrical with treatment of other assets and liabilities

Unpaid Principal Balance

Advantages

- Easier to implement than “carrying amount” method
- Information can be obtained from servicing reports

Disadvantages

- May be asymmetrical with treatment of other assets and liabilities
- Possible inconsistent presentation with other similar assets and liabilities

Fair Value at Adoption

Advantages

- May be easier to implement than “carrying amount” method
- Does not require ongoing fair value accounting unless the accounting model for items is fair value

Disadvantages

- May be a larger cumulative adjustment impact if fair value of assets and liabilities are significantly different
- Potential future earnings implications from the amortization of discounts/premiums recorded at adoption

Fair Value Option

Advantages

- Symmetry between assets and liabilities
- Comparable to similar on-balance sheet assets and liabilities if carried at fair value

Disadvantages

- Election is irrevocable
- May require new valuation systems and procedures to accommodate fair value reporting
- May be a significant transition impact if fair values of assets and liabilities differ significantly
- Potential income statement volatility going forward
- Similar on-balance sheet assets and liabilities may not be presented at fair value
- Additional disclosures are required

- Obtain a complete VIE population
- Collect information and other transaction documents
 - May need to contact external parties
 - The amount of data required can be significant
 - Disclosure requirements include information on nonconsolidated entities
- Develop systems and process to collect VIE numbers and to perform valuations
- Identify additional or revise SOX controls for new processes
- Consider stakeholder communication to avoid catching stakeholders off-guard
 - Consolidation of managed assets may mask core earnings, assets and liabilities
 - Performance measures (interest margin, ROA, ROE, etc.) may impact peer comparison
 - Possible impact on compensation
 - Possible impact to loan covenants

Other Possible Accounting Considerations

- Segment Reporting and Goodwill Impairment
- Hedge Accounting
- Embedded Derivative accounting
- Guarantee Accounting
- Amortization of Loans versus Debt

Ongoing Evaluation of Variable Interest Entities

- Must continue to ensure that a complete population of variable interest entities is monitored
- Information needed to monitor primary beneficiary status is qualitative and doesn't lend itself to systematic tracking
- Losses may cause something that wasn't a variable interest to become a variable interest

Questions?