

FAS 166/167 and FSP FAS 115-2



Amendments to FAS 140, FIN 46(R) and
FAS 115

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- Background
- Recent History of the Amendments
- FAS 166 – Key amendments to FAS 140
- FAS 167 – Key amendments to FIN 46(R)
- Examples
- Implementation Challenges
- Proposed Regulation AB amendment
- Other than Temporary Impairments

FASB: “Constituents have voiced concerns over the lack of transparency of the enterprises’ involvement with structures that contained significant risk”

Previous Standard Setting

- FASB had previously issued Exposure Drafts proposing amendments to FAS 140 during 2003 and 2005
- Comments to those EDs identified issues requiring significant redeliberations

Credit Crisis

Credit crisis raised questions on:

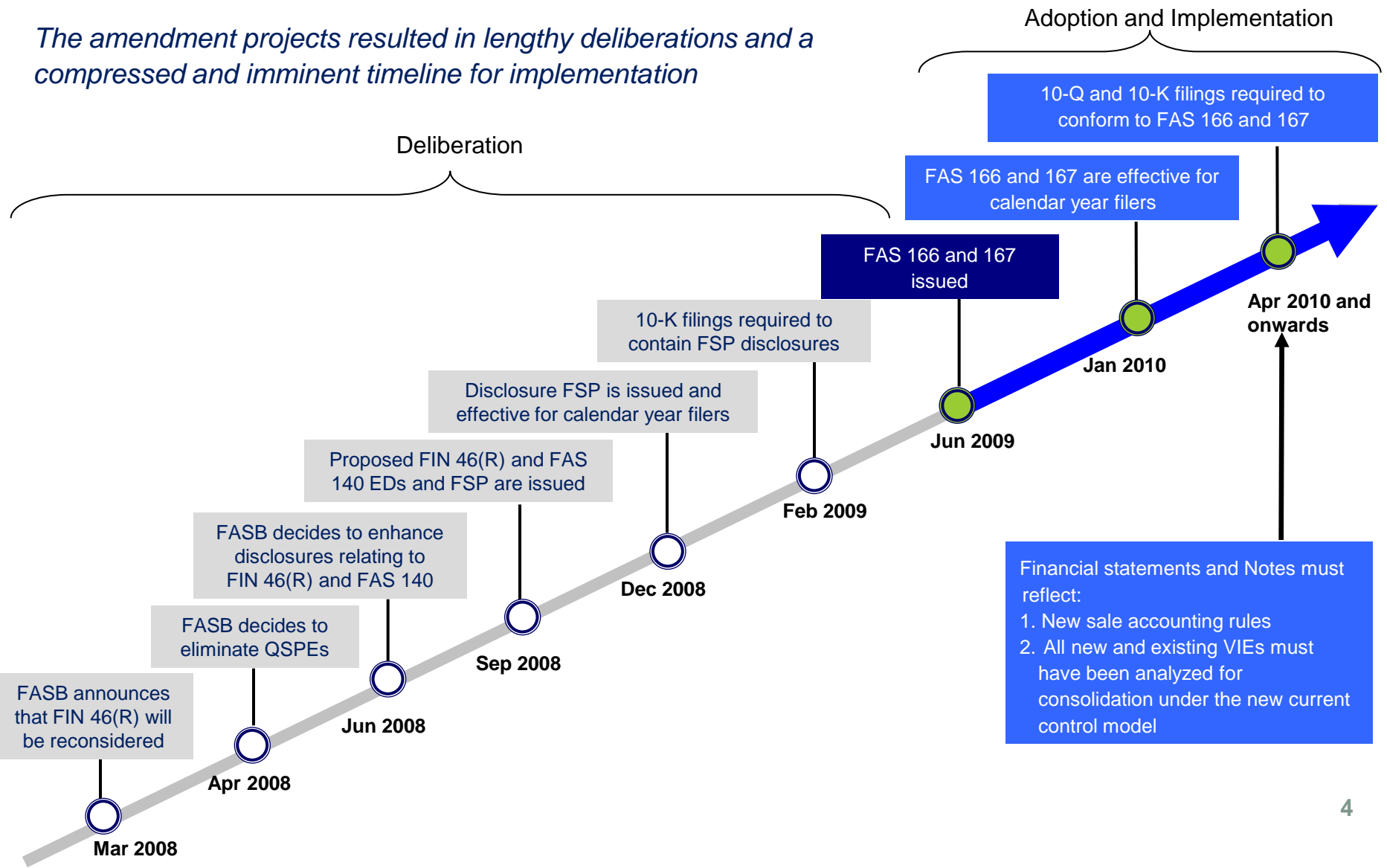
- “Q” status when payment workouts arranged
- Consolidation issues regarding troubled structured entities (CP conduits, SIVs, etc.)

Regulatory Pressure

- Pressure from the SEC, Congress, Treasury Department and investors
- SEC originally mandated changes become effective no later than January 1, 2009

Recent History of the Amendments

The amendment projects resulted in lengthy deliberations and a compressed and imminent timeline for implementation



FAS 166 – Key Amendments to FAS 140

Topic	Previous Accounting	Revised Standard	Impact
QSPE	Allows for the derecognition of financial assets transferred to QSPEs	Eliminates the QSPE concept; All SPEs must be analyzed for consolidation under FAS 167	High
Derecognition Criteria	“Look-through” concept is available for “QSPE” only; all other transfer would need to meet requirements under paragraph 9 of FAS 140	Introduce the “ look-through ” concepts to all securitization SPEs to determine if investors are constrained	High
Initial Measurement of Retained Interest	Requires a beneficial interest in a transferred financial asset that is retained by the transferor to be initially recognized on the basis of a relative fair value allocation of previous carrying amounts	A retained beneficial interest in a transferred financial asset should be initially recognized at fair value	High
Derecognition of a Portion of a Transferred Asset	Does not provide prescriptive guidance	Eligible if transferred portion qualifies as a participating interest	Moderate
Contemporaneous Arrangements	Does not explicitly require consideration of arrangements made in connection with a transfer	Arrangements made contemporaneously or in contemplation with a transfer must be analyzed	Moderate

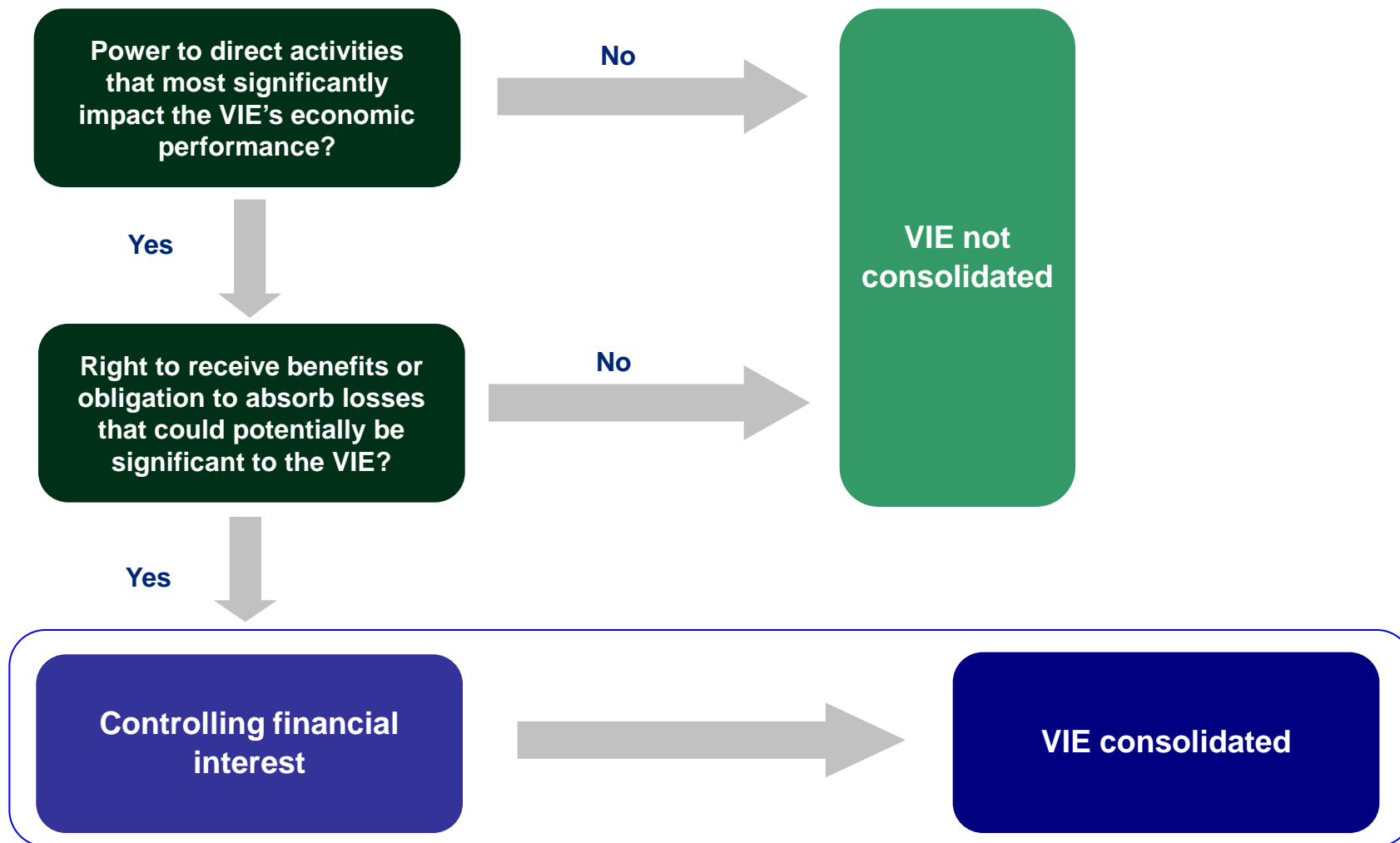
FAS 167 – Key Amendments to FIN 46(R)

Topic	Previous Accounting	Revised Standard	Impact
Primary Beneficiary Determination	Requires the enterprise that is entitled to the majority of the risk and rewards of a SPE to consolidate	Shifts to current control model. An enterprise must consolidate if it has both (1) power and (2) receives benefits or absorbs losses that are potentially significant to the VIE	High
Kickout rights	Kick-out rights may overcome the presumption of “control” when it is exercisable by a simple majority of non-related parties.	Ability of a group of investors to remove a VI holder that currently has power to direct matters that most significantly impact the activities of VIE should be ignored in PB determination unless the rights are held by a single enterprise .	High
Reconsideration	Requires reconsideration of (1) whether an invested entity is a VIE and (2) whether the enterprise should consolidate upon the occurrence of triggering events	Requires ongoing reconsideration for determining whether an enterprise is the primary beneficiary of an entity	High

Effective Date

Effective for fiscal years beginning after November 15, 2009

Consolidation Decision Process



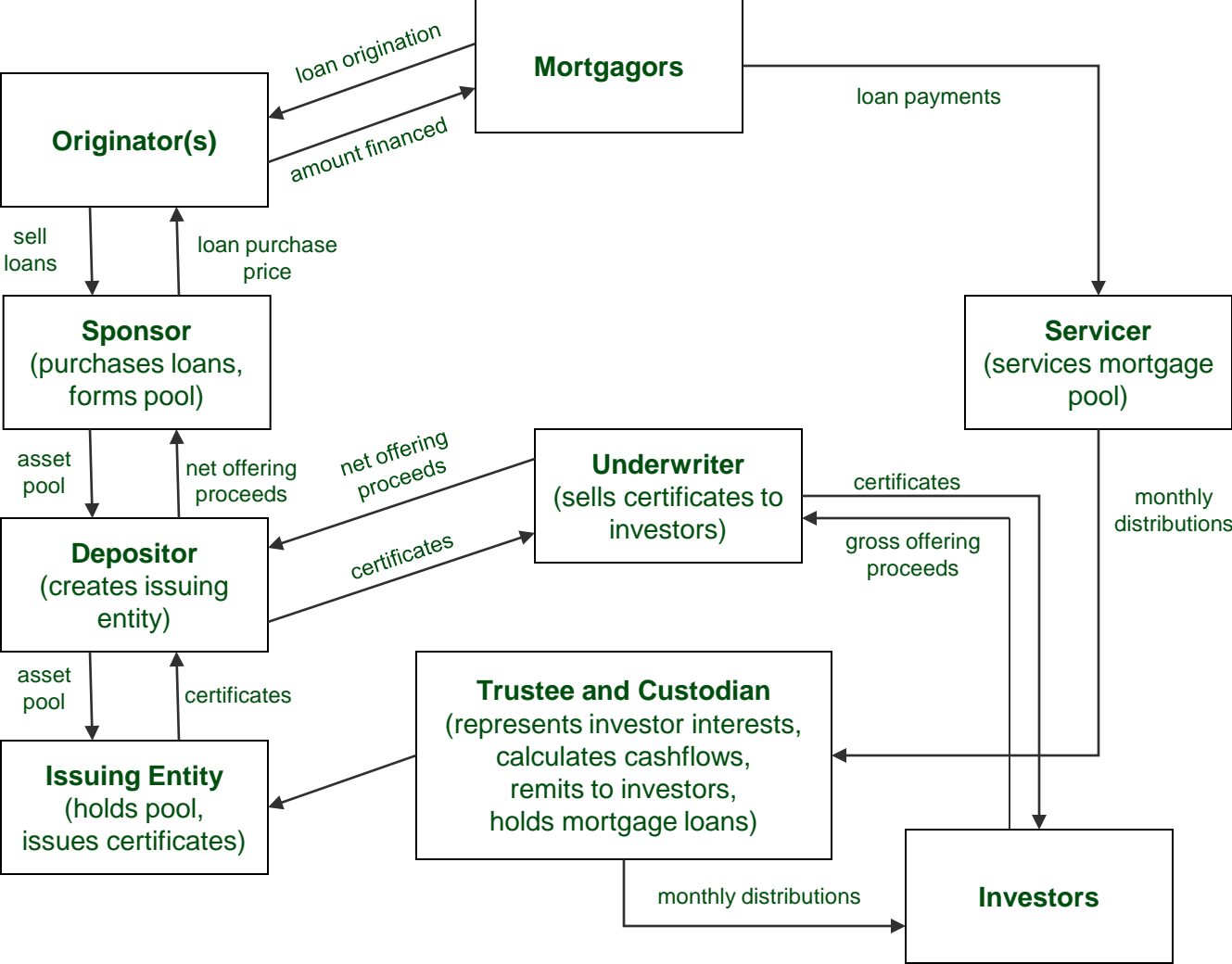
Consolidation Considerations – Decision Process (Cont.) – Illustrative Analysis

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		✓
Guarantor/ Master Servicer		✓
Residual/ Special Servicer	✓	✓

Residential Mortgage-Backed Securities

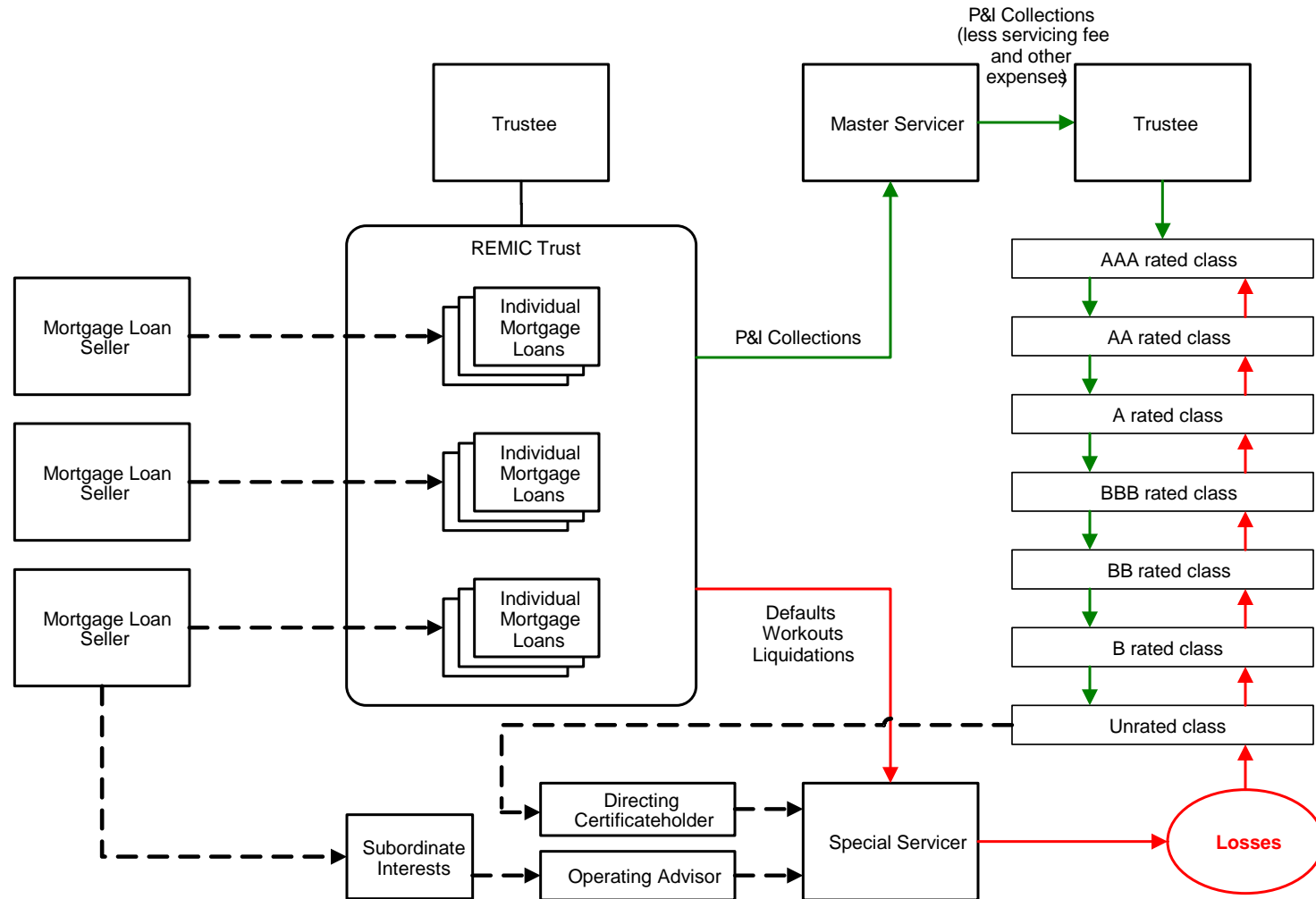


Power to direct activities that most significantly impact the VIE's economic performance?

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

- **What roles does the originator play besides origination?**
 - Impact if originator is servicer
 - Impact if originator holds bottom classes
 - Impact if originator holds bottom classes and is servicer
- **What roles does the underwriter play besides structuring and underwriting?**
 - Impact if underwriter affiliate buys/retains bond classes
 - Impact if underwriter services or provides trustee services?
- **What roles does the trustee play besides custodian?**
 - Impact if trustee affiliate owns/retains some bonds at closing and/or later in life of deal

Commercial Mortgage-Backed Securities



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?

- **What happens if one of the mortgage loan sellers is also the special servicer and retains/buys the subordinate bonds?**
- **What happens if one of the mortgage loan sellers is the master servicer and holds no bonds? Or holds some bonds but not the most subordinate?**
- **What happens if the special servicer is not a mortgage loan seller but buys the subordinate bonds?**
- **What happens if the special servicer is a mortgage loan seller but does not hold the subordinate bonds? What if the holder of the subordinate bonds is a Fund managed by an affiliate of the special servicer?**

- Interpretation of “potentially significant” and “insignificant”
- Residuals with no value (“dead” residuals)
- Valuation of consolidated assets / liabilities
- Election of Fair Value Option (“FVO”)
- Challenges for banks emerging from FDIC conservatorship

Proposed Amendment issued April 2010, includes:

- Loan-level information to be filed with the SEC, at the time of the securitization and on an on-going basis
- Computer program of the contractual bond cash flows (the “waterfall”), filed with the SEC
- Shelf registration requirements include 5% risk retention of every tranche (the “vertical slice”)
- Disclosures for privately-placed ABS would be required for investors, upon request
- 90-day comment period on the proposed amendment

- What is OTTI?
- For securities classified as available-for-sale or held-to-maturity, if a decline in fair value below the amortized cost basis is other than temporary (e.g. the investor will be unable to collect all cash flows of a debt security), an other-than-temporary impairment shall be considered to have occurred.

- Evaluation based on the type of security:
 - Debt securities
 - » Bonds
 - » Redeemable preferred stocks
 - Equity securities
 - » Common stock
 - » Perpetual preferred stock
 - » Mutual funds

- Applies to debt securities that are considered beneficial interests in securitized financial assets that have contractual cash flows – either purchased or retained from a transfer
- Are not of high credit quality (i.e., below AA)
- Investor should update the estimate of cash flows to be collected over the life of the investment at each reporting date
- Changes in estimated cash flows from those previously projected results in a prospective change in the yield
- Consider if there has been an adverse change in the timing and amount of estimated cash flows from those previously projected
 - Compare PV of current estimated cash flows to PV of previous estimate (discounted using rate equal to current yield used to accrete the beneficial interest)
 - If change is adverse, an OTTI is considered to have occurred

- Is the investment impaired? (Step 1)
 - An investment is impaired if fair value is less than cost. (FAS 115)
- Is the investment other-than temporarily impaired? (Step 2)
 - Consider a number of factors in judgmentally determining if the decline is other-than-temporary (FAS 115)
 - An adverse change in the amount or timing of cash flows (EITF 99-20)
 - Intent and ability to retain the investment to allow for recovery of cost (FSP FAS 115-1)
- If other-than temporarily impaired, write down (Step 3)
 - The cost basis of the investment should be written down to fair value through earnings (FAS 115, paragraph 16)

- FSP FAS 115-2 issued on April 9, 2009
- Applies only to debt securities classified as AFS or HTM (except for certain disclosures that also apply to equities)
- Is the investment impaired? (Step 1)
 - An investment is impaired if fair value is less than cost.
- Is the investment other-than temporarily impaired? (Step 2)
 - Does the investor intend to sell (i.e., has a decision been made to sell)?
 - » If so, OTTI
 - Is it more likely than not the investor will be required to sell before recovery of its cost basis?
 - » If so, OTTI
 - Does the investor expect to recover the entire cost basis of the security?
 - » Consider a number of factors
 - » An adverse change in the amount or timing of cash flows (EITF 99-20)
 - » If investor will not recover the entire cost basis of the security, OTTI

- If other-than temporarily impaired, write down (Step 3)
 - Geography of OTTI depends on whether there is an intention to sell and whether it is more likely than not that the investor will be required to sell the security.
- If the investor intends to sell or if it is more likely than not they will be required to sell the security before recovery
 - OTTI recognized in earnings equal to difference between cost and fair value (consistent with previous guidance)
- If the investor does not intend to sell and if it is not more likely than not they will be required to sell the security before recovery, OTTI separated into
 - Amount representing the decrease in cash flows expected to be collected (i.e., credit loss)
 - Amount related to all other factors

Measurement of OTTI to be recognized in earnings (Step 3)

- Best estimate of the amount of OTTI that relates to a decrease in cash flows expected to be collected
- May measure according to FAS 114
 - Credit loss is measured as the difference between the current amortized cost of the security and the new estimate of future cash flows discounted at the security's original effective interest rate
- Securities in the scope of EITF 99-20 must use that guidance
 - Credit loss is measured as the difference between the current amortized cost of the security and the new estimate of future cash flows discounted at a rate equal to the current yield used to accrete the beneficial interest