CHRISTOPHER COX
CHAIRMAN

HEADQUARTERS
100 F STREET, NE
WASHINGTON, DC 20549

REGIONAL OFFICES
ATLANTA, BOSTON, CHICAGO,
DENVER, FORT WORTH,
LOS ANGELES, MIAMI, NEW YORK,
PHILADELPHIA, SALT LAKE CITY,
SAN FRANCISCO

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

July 24,2007

The Honorable Barney Frank
Chairman
Committee on Financial Services
U.S. House of Representatives
2129 Rayburn House Office Building
Washington, DC 20515

Dear Chairman Frank:

Thank you for your recent letter inquiring about the potential impact of the accounting standard that guides securitizations (FAS 140) on mortgagors' ability to make loan modifications to forbear foreclosure. I am pleased to have the opportunity to respond, as this is an issue which the SEC staff has been actively following and considering.

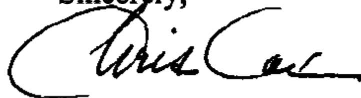
As you indicate in your letter, many securitization trusts hold subprime residential mortgage loans that are troubled or may be nearing default. One approach the servicers of such trusts may take in response to anticipated residential mortgage loan defaults is to modify the terms of the mortgage loans in the trusts when default is "reasonably foreseeable," rather than when a default or delinquency has already occurred. Examples of such modifications could include: reducing interest rates, extending loan maturity, or granting other concessions to debtors. In your letter, you noted that loan modifications are generally permitted by the trust agreements when used appropriately to maximize the value to bondholders, and asked for our views on the accounting consequences to the sponsoring companies of modifying mortgage loans held in certain securitization trusts.

At the request of the Commission's staff, on June 22,2007, the Financial Accounting Standards Board (FASB) hosted an educational forum to discuss the relevant accounting issues associated with the potential activities that servicers may take in response to anticipated residential mortgage loan defaults. In addition to SEC and FASB staff, other individuals represented at the forum included investors, preparers, auditors, servicers, and banking regulators. A central question that was discussed was whether the ability to modify a loan when default is "reasonably foreseeable" would preclude off-balance sheet treatment under FAS 140.

As described more fully in the enclosed memo prepared by the SEC's Office of the Chief Accountant, the Commission's professional staff believes that, consistent with general agreement in practice, such loan modifications would <u>not</u> result in a requirement for entities to account for those securitized assets on their balance sheets. In this case, modifications undertaken when loan default is reasonably foreseeable should be consistent with the nature of modification activities that would have been permitted if a default had occurred.

I hope this information is helpful to you. Rest assured that the Commission's staff will remain in close contact with the FASB and federal banking regulators to monitor the situation closely. Please feel free to call me at (202) 551-2126 or to have your staff call Jonathan Burks, Director of our Office of Legislative and Intergovernmental Affairs, at (202) 551-2016 if you would like to discuss this matter further.

Sincerely,



Christopher Cox
Chairman

MEMORANDUM

July 18,2007

TO: Chairman Cox

FROM: Conrad W. Hewitt
Chief Accountant

RE: Accounting for Loan Modifications

This memorandum responds to the June 15,2007 letter from Chairman Barney Frank and other members of the U.S. House of Representatives' Committee on Financial Services, which asks for our views on the following question:

Does FAS 140 clearly address whether a loan held in a trust can be modified when default is reasonably foreseeable or only once a delinquency or default has already occurred? If not, can it be clarified in a way that will benefit both borrowers and investors?

Financial Accounting Standards Board (FASB) Statement No. 140, ***Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*** (FAS 140) does not limit the ability of trust servicers to modify the terms of mortgages. This ability is determined by the contractual provisions set forth in the governing documents for the securitization trust and by any applicable laws. FAS 140 is sometimes cited as being a potential impediment to loan modifications, because FAS 140 is the accounting standard that sets forth the requirements for when securitized assets are to be recorded on balance sheet versus off balance sheet. For many financial institutions, it is important for them to receive off-balance-sheet treatment for securitized assets because of regulatory capital requirements.

FAS 140 is a detailed accounting standard with many specific requirements, and its application can be a complicated process. However, a basic underlying principle in FAS 140 is that transferred assets should only be recorded off balance sheet when the entity that transferred those assets (known as a transferor) has given up control, including decision-making ability, over those assets.

In the treatment of securitized residential mortgage loans, the issue in practice is whether an entity's having or exercising the ability to modify the terms of a securitized mortgage loan is an activity that demonstrates that the entity has not given up control over the loan, thereby precluding off-balance sheet accounting for that loan. FAS 140 does not directly address the impact on off-balance sheet treatment for modifications to the terms of a loan when default is reasonably foreseeable (but prior to delinquency or actual default).

At the request of the Commission's staff, on June 22,2007 the Financial Accounting Standards Board ("FASB") hosted an educational forum to discuss the relevant accounting issues associated with the potential activities that servicers may take in response to anticipated residential mortgage loan defaults. Included in the forum were thirty participants and observers including individuals representing investors, preparers, auditors, servicers, and banking regulators. One objective of this forum was to gather information from a wide range of experts on the possible accounting consequences for entities tbat are seeking to modify securitized residential mortgage loans in order to determine whether additional clarifying guidance in practice is necessary. The issue of whether the ability to modify a loan when default is reasonably foreseeable would preclude off-balance sheet treatment was one of the central issues discussed at this education session. Further, during that discussion a representative of the Mortgage Bankers Association (MBA) provided an overview of its position paper (referred to in this letter as the "MBA white paper") on the relevant accounting issues.[1] This MBA white paper was also discussed at a FDIC Forum on May 29,2007, which Commission staff attended.

There was general agreement among participants at the FASB educational forum that, subject to certain constraints, the ability to restructure mortgages when default is reasonably foreseeable is an activity that is not inconsistent with the notion of continued off-balance sheet accounting treatment. Further, there was general agreement by participants that the decision-making ability (or discretion) that is required in working out a loan where default is reasonably foreseeable[2] is similar to the discretion required when a loan becomes delinquent or default has occurred. When a loan is delinquent or when default has occurred, FAS 140 implementation guidance provides that a servicer may have discretion in restructuring or working out a loan, subject to certain limitations, without calling into question off-balance sheet treatment for the loan.

Currently, the Commission's staff does not believe that additional interpretive guidance is necessary in order to clarify the application of FAS 140 to the contemplated types of securitized mortgage loan work-out activities. Rather, after considering the information gathered at the FASB educational forum and information we have received from other sources, there appears to be general agreement in practice regarding the application of FAS 140 to these fact patterns. Specifically, there appears to be a consensus in practice, and it is our view, that entering into loan restructuring or modification activities (consistent with the nature of activities permitted when a default has occurred) when default is reasonably foreseeable does not preclude continued off-balance sheet treatment under FAS 140.

---

[1] The MBA white paper is available on the MBA's web site at http://www.mortgagebankers.org/NewsandMedia/PressCenter/55315.htm

[2] Participants indicated that default is reasonably foreseeable when there has b [illegible] ct with the borrower, an assessment of the borrower's ability to pay has been made and there is a reasonable basis to conclude that the borrower will be unable to continue to make its mortgage payments in the foreseeable future.

Further Background on Guidance in FAS 140

FAS 140 deals with the accounting for transfers of financial assets, which include mortgage loans. FAS 140 sets forth a model for determining when an entity that transfers financial assets (known as a transferor) has surrendered control over those assets, allowing for the assets to be treated as sold and removed from the transferor's balance sheet.

FAS 140 also provides accounting guidance for securitizations of financial assets through the use of structures known as "qualifying special-purpose entities," or QSPEs. A transferor can achieve sale accounting (and off-balance sheet treatment) for financial assets transferred to a QSPE as long as certain conditions are met to demonstrate that the transferor has surrendered control over those assets. FAS 140 achieves this, in part, by setting forth certain permitted activities of a QSPE, which are described further below.

Conditions for Sale Accounting

For atransfer to receive sale accounting treatment, which allows the transferring company to remove the assets from its balance sheet and recognize a gain or loss on the sale, the transfer must meet certain conditions. These conditions are that the transferring company must isolate the assets from itself, the purchaser must be able to transfer the assets or interests in the assets it has purchased without restriction, and the company can no longer have the ability to effectively control the assets that have been transferred.

Permitted Activities of a OSPE

Many mortgage loans are securitized using QSPE structures. The FASB intended for QSPEs to be entities that would not be actively managed and instead would be on "auto pilot." Under FAS 140, to be a QSPE, an entity must meet the following criteria, among others:

- The entity must have a significantly limited range of permitted activities;
- The activities must be entirely specified in the legal documents that establish the entity; and
- The activities can be changed only with the approval of a majority of the investors in the entity.

These criteria are in keeping with the principle that assets that are transferred into a QSPE cannot be controlled by anyone, permitting off-balance sheet treatment of the assets. QSPEs are intended to hold passive assets, and there are certain limited activities in which a QSPE can engage, which include servicing the passive assets it holds and distributing the proceeds from collection of the assets to the investors. A QSPE cannot sell or otherwise dispose of financial assets it holds, such as mortgage loans, except under limited conditions and can only temporarily hold nonfinancial assets, such as a house obtained by foreclosure on a mortgage, obtained in connection with the collection of financial assets it holds.

As discussed above, QSPEs can only hold passive financial assets, and as such, they are not permitted to hold assets that require making decisions other than those required in servicing of the financial assets. Typically a servicer will be engaged to service the assets held in trust for investors. Servicing activities include collecting principal and interest payments on the loans, monitoring delinquent loans, executing foreclosure if necessary, disposing of foreclosed assets, transfemng collected fund to investors and other similar actions.