

FAS 140: QSPE Status of Certain Securitizations

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Background

- Earlier this year, questions were raised by the auditing community regarding whether certain commercial mortgage backed securitization (CMBS) structures met all the criteria to be considered QSPEs under Statement No. 140
- The following provisions were questioned:
 - Waiver of “Due on Sale” provisions
 - Collateral Substitution
 - Length of Time before REO is sold

1

Description of Provisions

- Waiver of “Due on Sale” Provisions
 - If an underlying property is sold, normally the loan would become due and payable on sale. This requirement may be waived by the servicer of the assets and the new borrower substituted for the existing borrower
- Collateral substitution
 - In certain multi-property loans, a borrower may elect to substitute one property for another, as long as certain conditions are met regarding the similarity of the underlying property
 - Servicer must approve such substitution
- REO
 - Tax REMIC rules permit a servicer to hold a property that is acquired via foreclosure for no longer than three years

2

Issue/Status

- Concern arose as to whether these provisions provide a servicer with too much discretion, or constitute new lending (not permissible for a QSPE)
- Big 4 and Industry Association (CMSA) met with FASB to discuss; no decisions reached
- Standard setters may elect to issue guidance on this issue – forum and outcome both uncertain

3

Classification of Auction Rate Securities

4

Cash Equivalents – FAS 95 definition

- Cash Equivalents are generally short-term, highly liquid investments that are both:
 - Readily convertible to known amounts of cash
 - So near their maturity that they present insignificant risk of changes in value because of changes in interest rates
- Typically, only investments with original maturities of 3-months or less qualify under this definition
 - US Treasuries, Fed Funds, etc.

5

Auction Rate Securities - Overview

- Also referred to as Auction Rate Notes, Market Auction Preferred Stock and Money Market Preferred Stock.
- Auction rate securities usually have a long-term stated maturity but their interest or dividend rate is reset periodically (e.g., 7, 28 or 35 days) through a Dutch Auction conducted by a broker-dealer or other financial institution.
- The holder of the security does not have the right to put the security back to the issuer.
- Although these securities trade and price similar to other cash equivalents, they do not qualify as cash equivalents.
 - Long-term stated maturity does not meet strict criteria of FAS 95

6

Resolution

- SEC's Division of Corporate Finance confirmed guidance
 - As a result, more than ½ of corporate investors reclassified and many had to restate
- Bond Market Association approached FASB to reconsider this decision
- In October, the FASB met and decided not to add to its agenda at this time

7