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CAQ Alert #2007-47 – August 24, 2007

DEAR CENTER MEMBERS

Senator Schumer Urges Auditors to Advise Clients on the SEC's and FASB's Recent Guidance on Subprime Loans

On August 23, 2007, Senator [Charles Schumer](#) sent a [letter](#) to the Chief Executive Officers of the four largest accounting firms with a copy to Cindy Fornelli, Executive Director of the Center for Audit Quality (CAQ or the Center) asking for the auditing profession's assistance by urging auditors to ensure that their clients are aware of the recent FASB Statement No. 140, [Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities—a replacement of FASB Statement No. 125](#) (SFAS 140) guidance from the SEC and FASB and “to otherwise urge your clients to do their part to keep our housing markets afloat, by modifying subprime loans that are at risk of default.”

Senator Schumer stressed how serious the damage from this crisis can be and how important it is for lenders to find effective solutions. Senator Schumer stated that the number of national foreclosures is up 93 percent from last year and that in certain struggling regional housing markets, “increased foreclosures will put additional downward pressure on housing prices, which if continued, could contribute to severe price declines and disclosures.” Senator Schumer also sent [letters on August 22, 2007](#) to key lenders, servicers and investors in subprime mortgage securities asking them to work with at-risk borrowers to modify and transition their loans into more sustainable mortgages.

Senator Schumer has learned that an estimate of 40 percent of at-risk subprime loans would qualify for refinancing into sustainable prime mortgages. He stressed that transitioning these borrowers into prime loans is essential to the efforts to prevent further damage to the nation's housing market. Initially, there were hesitations to modifying these loans because of concerns that under SFAS 140, such loan modifications might require companies to cease using off-balance sheet treatment for their securitized mortgage assets, putting them at risk of violating capital and other debt covenants and requirements.

Accordingly, the issue was addressed during the FASB's June 22, 2007 educational forum where there was general agreement that when a default was reasonably foreseeable, loan modifications would not preclude continued off-balance sheet treatment under SFAS 140. In addition, as CAQ reported in [Alert 41](#), in a letter issued on July 24, 2007 by SEC Chairman Christopher Cox to Barney Frank, Chairman of the Committee on Financial Services of the U.S. House of Representatives, the SEC provided its staff position that, “consistent with general agreement in practice, such loan modifications would **not** 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.” [Congressman Frank's letter of inquiry](#) to Chairman Cox as well as [Chairman Cox's response](#) can be accessed by clicking on the respective links.

However, Senator Schumer expressed continued concern that many of the at-risk investors continue to cite SFAS 140 as a reason to avoid loan modifications and refinancings. As a result, he is trying to raise awareness of the SEC's and FASB's recent guidance on this topic by asking auditors to do their part to educate their clients.

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