

# United States Senate

WASHINGTON, DC 20510

August 23, 2007

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Chairman and Senior Partner  
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Dear Sirs:

The anticipated increase in delinquencies and foreclosures among subprime borrowers is not only causing a crisis of confidence in the mortgage markets, but risks causing additional damage to the housing market and to the economy as a whole. One of the most promising solutions to the anticipated foreclosure crisis is the voluntary modification by lenders of existing unsustainable subprime loans. However, some have said, despite explicit recent guidance by the SEC and FASB to the contrary, that FAS 140 may present an obstacle to such loan modifications. My hope is that you will assist this country's mortgage crisis by ensuring that your clients are aware of the recent SEC and FASB guidance on FAS 140, and by otherwise encouraging them to modify subprime loans at risk of default.

The damage that will be caused by the subprime crisis will be devastating, in the absence of strong and effective solutions. Earlier this week, we learned that national foreclosure filings are 93 percent higher than they were this time last year. If increased foreclosures are allowed to proceed unchecked, the ultimate harm could extend well beyond the families that will lose their homes. Regional housing markets in several states are experiencing high ownership vacancy rates and large inventories of new homes for sale. In these markets, increased foreclosures will put additional downward pressure on housing prices, and this additional pressure could contribute to severe price declines and foreclosures.

I have also learned that an estimated 40 percent of current at-risk subprime borrowers would qualify for refinancing into sustainable prime mortgages. The ability to transition these borrowers into prime loans will be essential to our efforts to prevent further damage to the nation's housing markets. As you may know, yesterday I wrote to many of the key lenders, servicers, and investors in subprime mortgage securities—many of whom are your auditing clients—and asked that they work with at-risk borrowers to modify their

loans and transition them into more sustainable mortgages. I believe this is a key step towards stabilizing this nation's housing markets.

There was some concern expressed earlier this year that FAS 140 might pose an obstacle to such loan modifications. Specifically, some people claimed that 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 requirements.

This issue was firmly addressed in FASB's June 22, 2007 educational forum, out of which a general consensus emerged that when default was reasonably foreseeable, loan modifications would not preclude continued off-balance sheet treatment under FAS 140. This conclusion was supported by SEC Chairman Chris Cox's July 24, 2007 letter to House Financial Services Committee Chairman Barney Frank, in which Cox unequivocally stated the SEC's position that "consistent with general agreement in practice, such loan modifications [where default was reasonably foreseeable] would not result in a requirement for entities to account for those securitized assets on their balance sheets."

While the SEC's and FASB's positions on FAS 140 as it applies to loan modifications should now be clear, I am concerned that many of the investors holding securitized mortgage assets are continuing to cite FAS 140 as a reason to avoid loan modifications and refinancings. To that end, I would like to know what steps you are taking to ensure that your clients are aware of this guidance. I am hopeful that you will make it a priority to inform your clients of the recent pronouncements by FASB and the SEC on FAS 140, 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. The auditing firms of this country have played a critical role in keeping our economy strong, and I am confident you will continue to do so.

Sincerely,

  
Charles E. Schumer  
United States Senator

Cc: Cynthia Fornelli  
Executive Director  
The Center for Audit Quality