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# SEC Issues Letter Clarifying Accounting Ramifications of Accelerated Efforts to Mitigate Subprime Crisis

## Financial Reporting Alert 08-1

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This week, SEC Chief Accountant Conrad Hewitt issued a [letter](#) addressing the Statement 140<sup>1</sup> accounting implications of the American Securitization Forum's [Streamlined Foreclosure and Loss Avoidance Framework](#)<sup>2</sup> (ASF Framework). The ASF, coordinating with the Department of the Treasury, developed the Framework to encourage mortgage loan servicers to refinance or modify classes of adjustable-rate subprime mortgage loans with certain risk characteristics that make them susceptible to default. However, a potential hurdle has been whether the modifications of mortgage loans violate qualifying special-purpose entity (QSPE) status under Statement 140 (see Deloitte & Touche LLP's [August 29, 2007, Heads Up](#) for further background).

The SEC's letter, addressed to both the Financial Executive International's Committee on Corporate Reporting and the Center for Audit Quality's Professional Practice Executive Committee, indicates that the Office of the Chief Accountant (OCA) "will not object to continued status as a QSPE if Segment 2 subprime ARM loans are modified pursuant to the specific screening criteria in the ASF Framework." The letter also states that the "OCA believes that it would be reasonable to conclude that Segment 2 subprime ARM loans are 'reasonably foreseeable' of default in absence of a modification based upon a qualitative consideration of the expectation of defaults."<sup>3</sup> Appendix A to the letter sets forth disclosures that the SEC staff generally expects will be included in registrants' Management's Discussion and Analysis and notes to the financial statements.

The ASF Framework was designed to "fast-track into loan modifications only those borrowers who have demonstrated the ability to pay their starter rates, are unable to refinance, and are unable to afford their reset rates."

The letter notes that, as staff guidance, it has not been approved by the Commission and its application should not be extended by analogy or relied upon for any mortgage modification not occurring pursuant to the screening criteria of Segment 2 of the ASF Framework.

The OCA believes that the letter is an interim step and has requested that the FASB "immediately address the issues that have arisen in the application of the QSPE guidance in Statement 140." The letter also notes that the OCA has requested that the FASB complete its project such that any amendments to Statement 140 would be effective no later than years beginning after December 31, 2008.

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1 FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*.

2 "Streamlined Foreclosure and Loss Avoidance Framework for Securitized Subprime Adjustable Rate Mortgage Loans."

3 The letter describes limitations on the availability of representative quantitative data for these types of loans.

[back to top](#)

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