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Audit and Enterprise Risk Services

Deloitte & Touche LLP

Turmoil in the Credit Markets: The Importance of Comprehensive and Informative Disclosures

Financial Reporting Alert 08-4

January 18, 2008

Introduction

This *Financial Reporting Alert* underscores the importance of providing comprehensive and informative disclosures about (1) the effects of the current credit environment on financial statements and (2) the potential exposures associated with this environment.

In addition, this alert highlights the need for disclosures about many of the concerns expressed by the FASB, SEC, and PCAOB regarding the challenges organizations face in this environment.

This alert discusses:

- Examples of business activities that most likely will be affected by the current credit environment.
- Remarks made by an SEC commissioner and an SEC staff member at the 2007 AICPA National Conference on Current SEC and PCAOB Developments regarding accounting and disclosure considerations in the current credit environment.
- Existing disclosures required by U.S. GAAP and the SEC that focus on an organization's exposure to credit risk and uncertainties.

Although this alert highlights a number of items preparers and auditors should consider, it is neither a comprehensive checklist nor a complete analysis. Each organization, in consultation with its professional advisers, should consider its own facts and circumstances and monitor ongoing developments to determine the adequacy and comprehensiveness of its disclosures.

Editor's Note: The effects of the credit environment are not isolated to financial institutions. All entities, regardless of industry, should consider providing comprehensive and informative disclosures about their exposures to the credit environment.

The alert includes the following three appendixes, which (1) highlight the SEC staff's areas

of focus as organizations prepare their year-end notes to the financial statements and MD&A disclosures and (2) include a compilation of recently issued disclosures regarding the credit environment:

- [Appendix A: Recent SEC Comments That Are Relevant to the Current Credit Environment \(see attached\)](#) — This appendix provides recent comments registrants have received from the SEC's Division of Corporation Finance regarding their disclosures about the impact of the credit environment in their SEC filings. Appendix A also highlights certain disclosure considerations that the SEC staff emphasized at the 2007 AICPA National Conference on Current SEC and PCAOB Developments.
- [Appendix B: Excerpts From Recent Registrant Disclosures \(see attached\)](#) — This appendix includes excerpts from notes to the financial statements and MD&A disclosures (addressing the impact of the credit environment) that registrants have provided in recent annual and quarterly SEC filings. Because of the timing of this alert, most of the disclosure excerpts in Appendix B are from registrants' Forms 10-Q rather than from their annual filings. It is reasonable to expect that registrants' Form 10-K disclosures will be more extensive.
- [Appendix C: Sample SEC Letter Emphasizing Disclosures About Off-Balance-Sheet-Entities \(see attached\)](#) — This appendix provides a sample letter sent by the SEC staff to various registrants. The letter provides disclosures that registrants may want to consider in their Forms 10-K regarding their involvement with off-balance-sheet entities.

Examples of Business Activities Affected by the Current Credit Environment

The well-publicized effects of the continuing turbulence in the credit markets now extend beyond significant declines in the values of financial assets backed by subprime mortgage loans. As more asset classes and business activities are affected by the credit crunch, financial statement users expect organizations to provide comprehensive and informative disclosures that accurately and fairly portray their exposures to the risks associated with the current credit environment. The following are some business activities organizations should consider when evaluating the adequacy of their disclosures about the current credit environment.

Investing Activities

- Investing in financial instruments (including asset-backed securities and other structured investment products backed by subprime mortgage loans or other collateral with exposure to current credit conditions).
- Investing in loans (including subprime mortgage loans).
- Investing in auction rate securities.
- Valuations of financial instruments, especially illiquid securities with little or no price transparency.

Lending and Related Activities

- Originating loans (including subprime mortgage loans) and commitments to originate loans.
- Securitizing financial assets.
- Servicing financial assets.

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- Issuing financial products.

Sponsoring Off-Balance-Sheet Entities (Including Asset-Backed Commercial Paper (ABCP) Conduits and Collateralized Debt Obligations (CDOs))

Issuing Short-Term Financing

- Issuing commercial paper (including auction rate securities and other short-term liquidity facilities).
- Liquidity and capital resources.

If an organization engages in any of the business activities listed above, it should consider expanding its disclosures about the various effects of the credit environment. These disclosures should focus on the extent of subprime exposure, including the impact of illiquid market conditions on determining fair value and related estimates.

2007 AICPA National Conference on Current SEC and PCAOB Developments

A major theme at the 2007 AICPA National Conference on Current SEC and PCAOB Developments (see Deloitte & Touche LLP's [December 20, 2007, Heads Up](#)) was the need for registrants to provide transparent disclosures in their notes to the financial statements and MD&A about the potential for credit losses as well as about their exposures to the current credit environment.

Overview

In her keynote speech, SEC Commissioner Kathleen Casey indicated that the staff is issuing comments to registrants regarding their disclosures about recent subprime developments. Ms. Casey emphasized that disclosures must adequately address the impact of subprime loans, commercial paper markets, and other market conditions.

In her discussion of appropriate MD&A disclosures related to current credit markets, Stephanie L. Hunsaker, associate chief accountant in the SEC's Division of Corporation Finance, noted aspects of the current credit environment in which entities are experiencing increasing loan loss allowances, write-downs and impairments of securities, credit downgrades, dividend reductions, and liquidation of CDOs or structured investment vehicles (SIVs). Ms. Hunsaker observed that registrants should provide investors with information about their:

- Subprime exposure.
- Off-balance-sheet risks.
- Structures that may need to be consolidated in the future.
- Exposure to investments without readily determinable values.

Disclosures Regarding Fair Value Measurements

Ms. Hunsaker indicated that the SEC staff believes many registrants do not provide sufficient insight into how fair value is determined, especially when fair value measurements rely on unobservable data. She remarked that the SEC staff believes registrants should consider the following disclosures when fair value measurements rely on unobservable inputs:

- The valuation models used to determine fair value.

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- The significant inputs into those models.
 - The assumptions that could have the greatest impact on the valuations.
 - Whether, how, and why those assumptions have changed from prior periods.

Ms. Hunsaker also noted that registrants that have early adopted FASB Statement No. 157, *Fair Value Measurements*, should consider enhancing their disclosures about fair value measurements that, because of a lack of observable market inputs, have been reclassified from Level 2 to Level 3 measurements. She indicated that registrants should disclose the amounts and types of instruments being reclassified and the nature of the inputs that are no longer observable.

Off-Balance-Sheet Entities (e.g., Conduits and SIVs)

Ms. Hunsaker emphasized the need for registrants to consider whether the MD&A included in their quarterly and annual filings appropriately reflects their involvement with off-balance-sheet entities and SIVs. She stressed that entities should provide detailed disclosures about the nature and level of the support provided to off-balance-sheet entities, including:

- The type of involvement.
- The nature of the off-balance-sheet entity and its exposure to credit losses.
- The sponsor's maximum potential exposure to losses as a result of the credit or other support.¹

FASB Interpretation No. 46(R), *Consolidation of Variable Interest Entities*

Ms. Hunsaker reminded registrants about the requirement for a variable interest holder to disclose its maximum exposure to loss associated with its interest in a variable interest entity. She indicated that, on the basis of the SEC staff's review of filings, it has been difficult to determine what is included in an entity's maximum exposure to loss and which agreements were considered in making that determination. The SEC staff suggests expanding this disclosure to:

- Identify what the maximum loss amount includes, such as unfunded liquidity commitments and other contractual guarantees.
- Quantify the maximum exposure for each component.
- Describe what events would need to occur for the maximum loss amount to be incurred.

Accelerated Efforts to Mitigate Subprime Crisis — Refinancing Subprime Loans

In early January 2008, SEC Chief Accountant Conrad Hewitt issued a [letter](#) addressing the accounting implications under FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, of the American Securitization Forum's [Streamlined Foreclosure and Loss Avoidance Framework](#) (ASF Framework). The ASF, in coordination 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. 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 "will not object to continued status as a QSPE [qualifying special-purpose

entity] if Segment 2 subprime ARM [adjustable-rate mortgage] loans are modified pursuant to the specific screening criteria in the ASF Framework.”

Appendix A of that letter provides guidance on what disclosures the Office of the Chief Accountant and the Division of Corporation Finance believe registrants that have transferred subprime ARM loans to QSPEs should consider in future SEC filings (for a detailed listing of each disclosure, see [Appendix A](#) of this *Financial Reporting Alert*).

With respect to disclosures in the notes to the financial statements, Appendix A of the letter indicates that “to meet the disclosure requirements of APB Opinion No. 22, *Disclosure of Accounting Policies*, the SEC staff generally expects that a registrant’s disclosure of its accounting policies would need to include a discussion of the permitted activities of off-balance-sheet QSPEs, including the ability of the servicer to modify subprime mortgages when default is ‘reasonably foreseeable,’ and the adoption of the specific screening criteria in Segment 2 of the ASF Framework for purposes of determining the subprime ARM loans that are ‘reasonably foreseeable’ of default.”

Existing Disclosure Requirements

U.S. GAAP and SEC literature include numerous disclosure requirements regarding fair value, credit risk, uncertainties, contingencies, and impairments. The following guidance contains disclosure requirements preparers should consider when making disclosures about the effects of the current credit environment in the notes to the financial statements and MD&A.

- FASB Statement No. 157, *Fair Value Measurements* (also see the Center of Audit Quality white paper, *Fair Value Measurements in Illiquid (or Less Liquid) Markets*, since Statement 157 is not effective for many entities as of December 31, 2007).
- FASB Statement No. 156, *Accounting for Servicing of Financial Assets* — an amendment of FASB Statement No. 140.
- FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* — a replacement of FASB Statement No. 125.
- FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*.
- FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*.
- FASB Statement No. 107, *Disclosures About Fair Value of Financial Instruments*.
- FASB Interpretation No. 46(R), *Consolidation of Variable Interest Entities* — an interpretation of ARB No. 51.
- FASB Interpretation No. 45, *Guarantor’s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others* — an interpretation of FASB Statements No. 5, 57, and 107 and rescission of FASB Interpretation No. 34.
- FASB Staff Position No. FAS 115/124-1, “The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments.”
- FASB Staff Position No. SOP 96-1-1, “Terms of Loan Products That May Give Rise to a Concentration of Credit Risk.”
- AICPA Statement of Position 01-6, *Accounting by Certain Entities (Including*

Entities With Trade Receivables) That Lend to or Finance the Activities of Others.

- AICPA Statement of Position 94-6, *Disclosure of Certain Significant Risks and Uncertainties*.
- SEC Regulation S-K, Item 303, "Management's Discussion and Analysis of Financial Condition and Results of Operations."

The above guidance was not developed in the context of the current severe credit environment. Thus, entities should carefully consider the extent of their disclosures to determine that the objectives of the disclosure requirements are satisfied.

1 In a related development, in December 2007, the Division of Corporation Finance sent letters to chief financial officers of certain public companies. This letter provides disclosures that registrants may want to consider regarding their involvement with off-balance-sheet entities. A sample letter is included as [Appendix C](#) (see attached) of this *Financial Reporting Alert*.

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Appendix A — Recent SEC Comments That Are Relevant to the Current Credit Environment

As discussed in the body of this *Financial Reporting Alert*, a current focus of the SEC's Division of Corporation Finance is disclosures about the impact of the current credit environment on registrants' financial position and results of operations. Many comments made at the 2007 AICPA National Conference on Current SEC and PCAOB Developments, as well as comments received by registrants in conjunction with SEC's review of quarterly and annual filings, relate to registrants':

- Involvement with subprime mortgage loans.
- Determination of fair value for specific asset classes (especially when internal valuation models and methods are used).
- Involvement with off-balance-sheet conduits, structured investment vehicles, and other securitization trusts.
- Determination of asset impairment.

The following table lists some examples of these comments. Although not all-inclusive, the list includes information the SEC staff believes relevant to understanding the types of registrants' exposure to the current credit environment.

Business Activity	Source of Comment	
Investing Activities	Registrant Comment Letters	AICPA Conference
<ul style="list-style-type: none"> • A detailed description of the registrant's involvement with subprime mortgage lenders. 	√	
<ul style="list-style-type: none"> • A detailed quantification and description of any loans to, commitments in, or investments in subprime lenders. 	√	
<ul style="list-style-type: none"> • A detailed quantification of a registrant's exposure to securitized subprime mortgage loans, including: <ul style="list-style-type: none"> ○ The principal amount and the nature of any retained securitized interests backed by subprime mortgage loans. ○ The categories, ratings, and weighted-average life of subprime assets held. ○ The amounts of write-offs or impairments related to retained interest in subprime mortgage loans. ○ The current delinquencies in retained securitized subprime mortgage loans. 	√	√

<ul style="list-style-type: none"> • A detailed description of the registrant's measurement of fair value, including: <ul style="list-style-type: none"> ○ The valuation methods and models used to measure fair value. ○ The significant inputs to models used. ○ The assumptions that could have the greatest impact on valuations. ○ The significant unobservable inputs, if any, used to measure fair value and the significance of the input to the fair value measurement. ○ The assumptions, if any, used in valuations that changed from prior periods, including a description of how and why the assumptions changed. 	√	√
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Business Activity	Source of Comment	
Lending and Related Activities	Registrant Comment Letters	AICPA Conference
<ul style="list-style-type: none"> • A detailed description of the registrant's exposures to subprime mortgage loans, including: <ul style="list-style-type: none"> ○ The registrant's origination and underwriting policies. ○ The registrant's definition of subprime mortgage loans (e.g., LTV, interest rate). ○ The registrant's allowance for loan losses recognized in the balance sheet (including how the allowance was determined). ○ The registrant's most recent provision for loan losses recognized in the income statement. 	√	
<ul style="list-style-type: none"> • A detailed quantification of the registrant's exposures to the following: <ul style="list-style-type: none"> ○ Subprime mortgage loan purchase commitments. ○ Subprime mortgage loan securitizations. ○ Subprime mortgage loan delinquencies. ○ Subprime mortgage loans that are nonperforming. ○ Subprime mortgage loans that are on 	√	

nonaccrual status.		
<ul style="list-style-type: none"> • A detailed quantification of revenues from involvement or origination of subprime loans. Break out such revenues on the basis of fees, interest earned, servicing rights, and other sources. 	√	
<ul style="list-style-type: none"> • A detailed description and quantification of any and all repurchase commitments the registrant has associated with subprime mortgage loans. 	√	
<ul style="list-style-type: none"> • A detailed description of the forms of funding and weighted-average life of funding 	√	
<ul style="list-style-type: none"> • A detailed description of any difficulties experienced in issuing commercial paper or other forms of financing during the period. 	√	
<ul style="list-style-type: none"> • A detailed description of the maximum loss amounts associated with unfunded liquidity commitments and other contractual guarantees, including what events would need to occur to incur the maximum loss amounts. 	√	
<ul style="list-style-type: none"> • A detailed description of the impact of modifying subprime mortgage loans in accordance with the ASF Framework or transferring subprime mortgage loans to a QSPE, including the following: <ul style="list-style-type: none"> ○ A general description of the ASF Framework and the criteria used by the registrant to define a subprime mortgage loan. ○ A statement that the adoption of the ASF Framework did not affect the QSPE status of trusts that hold subprime mortgage loans. ○ The total dollar amount of assets held by QSPEs that hold subprime mortgage loans. ○ The total dollar amount of subprime mortgage loans that fall within each of the categories of the ASF Framework. ○ A description of the nature of loss mitigation activities for subprime mortgage loans that fall within each of the categories of the ASF Framework. 	(a) ¹	

¹ These disclosure considerations were provided in a letter sent by the SEC Chief Accountant to the CAQ and the Financial Executive International's Committee on Corporate Reporting. The letter concerns the accounting implication to mortgage servicers that modify subprime mortgage loans on the basis of the ASF Framework.

<ul style="list-style-type: none"> ○ The total dollar amount of other assets owned by QSPEs that hold subprime mortgage loans and a description of the change in the amount of those assets for the quarterly and year-to-date periods. ○ The total principal amount of beneficial interests issued by QSPEs that hold subprime mortgage loans as of the date of the latest balance sheet and the impact that loss mitigation efforts have had on the fair value of the registrant's retained interests and other forms of financial support provided. 		
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Business Activity	Source of Comment	
Sponsoring Off-Balance-Sheet Entities (Including ABCP conduits and CDOs)	Registrant Comment Letters	AICPA Conference
<ul style="list-style-type: none"> • A detailed description of all involvements with special-purpose entities and variable interest entities. 	√	√
<ul style="list-style-type: none"> • A detailed description of the types of scenarios in which a registrant would have to consolidate the off-balance-sheet entity and the likelihood of such an event. 	√	√
<ul style="list-style-type: none"> • A detailed description of whether the registrant purchased commercial paper or other securities issued by off-balance-sheet entities managed by the entity, and whether those purchases were required by any agreement. 		√
<ul style="list-style-type: none"> • A detailed description of all obligations under any existing liquidity facilities or written put options. 		√
<ul style="list-style-type: none"> • A detailed description of the maximum limit of losses to be borne by first-loss note holders. 		√
<ul style="list-style-type: none"> • A detailed quantification of the registrant's subprime exposure related to such entities, regardless of whether they are consolidated. 		√
<ul style="list-style-type: none"> • A detailed description of whether the registrant provided any other type of support, or expects to do so in the future. 		√
<ul style="list-style-type: none"> • A detailed description of the potential impact on debt covenants, capital ratios, credit ratings, and collateral requirements or 		√

dividends, should the consolidation of an off-balance-sheet be required or significant losses incurred.		
<ul style="list-style-type: none"> A detailed description of the frequency with which the registrant reconsiders whether it is the primary beneficiary of an entity, and the typical events that would require reconsideration. 	√	√

Other Comments	Source of Comment	
Future Exposures	Registrant Comment Letters	AICPA Conference
<ul style="list-style-type: none"> A detailed description of whether a registrant believes its financial conditions, results of operations, or liquidity will be adversely affected by its involvement with subprime lending, including: <ul style="list-style-type: none"> If an adverse impact is considered remote, support for that conclusion. If an adverse impact is not considered remote, a detailed description of potential disclosures considered. 	√	

Appendix B — Excerpts From Recent Registrant Disclosures

The disclosures in this appendix are excerpts from the notes to the financial statements and MD&A sections of various registrants' quarterly and annual SEC filings. Because a registrant will most likely have disclosed, in its financial statements or elsewhere in its filing, other information about the business activity, readers should not assume that the extracts below represent a complete presentation of all pertinent information disclosed by the registrant.

The disclosures below are not necessarily consistent with U.S. GAAP or SEC requirements. Rather, they are examples of how some registrants have disclosed the effects of the current credit environments on their financial position, results of operations, or both. In addition, registrants issued many of the excerpts below before the SEC provided the observations and recommendations contained in this *Financial Reporting Alert*. Entities have the responsibility and obligation to consult with their advisers to determine what disclosures to make in registration statements and periodic and other filings.

Contents

Investing Activities

- Investing in Financial Instruments (Including ABS and Other Structured Products Backed by Subprime Mortgage Loans or Other Collateral With Exposure to Current Credit Conditions)

- Investing in Loans (Including Subprime Mortgage Loans)

- Investing in Auction Rate Securities

- Valuation of Financial Instruments, Especially Illiquid Securities With Little or No Price Transparency

Lending and Related Activities

- Originating Loans (Including Subprime Mortgage Loans) and Commitments to Originate Loans

- Securitizing Financial Assets

- Servicing Financial Assets

- Issuing Financial Products

Sponsoring Off-Balance-Sheet Entities (Including ABCP Conduits and CDOs)

Issuing Short-Term Financing

- Issuing Commercial Paper (Including ARS and Other Short-Term Liquidity Facilities)
- Liquidity and Capital Resources

Investing Activities

Investing in Financial Instruments (Including ABS and Other Structured Investment Products Backed by Subprime Mortgage Loans and other Collateral With Exposure to Current Credit Conditions)

Merrill Lynch & Co. Inc. 3rd Quarter 10-Q

Our U.S. sub-prime residential mortgage net exposure (excluding Merrill Lynch's Bank sub-prime residential mortgage portfolio held for investment purposes which is described *in Sub-prime Mortgage-Related Securities in Merrill Lynch Bank Investment Portfolio*) consists of the following:

- Sub-prime whole loans : We purchase pools of whole loans from third-party mortgage originators. In addition, First Franklin originates mortgage loans through its retail and wholesale channels. Prior to their sale or securitization, whole loans are predominantly reported on the balance sheet in Loans, notes and mortgages and are accounted for as held for sale.

Securitizable whole loans are valued on an "as-if" securitized basis based on estimated performance of the underlying mortgage pool collateral, rating agency credit structure assumptions and market pricing for similar securitizations. Key characteristics include underlying borrower credit quality and collateral performance, mortgage terms and conditions, assumptions on prepayments, delinquencies and defaults. Non-securitizable loans are valued using a combination of discounted liquidation value and re-performing value.

- Residuals : We retain certain mortgage residuals, which represent the subordinated classes and equity/first-loss tranche from our residential mortgage-backed securitization activity. Residuals have been retained from the securitizations of third-party whole loans we have purchased as well as from our First Franklin loan originations.

Residuals are valued by modeling the present value of projected cash flows that will accrue to the residual holder, based on actual and projected performance of the mortgages underlying a particular securitization. Key determinants include estimates for borrower prepayments, delinquencies, defaults and loss severities. Modeled performance and loan level loss projections are adjusted monthly as actual borrower performance information is released from trustees and loan servicers.

- Residential mortgage-backed securities ("RMBS") : We retain and purchase securities from the securitizations of loans, including sub-prime residential mortgages. Valuation of RMBS securities is based on observable prices and securitization cash flow model analysis.
- Warehouse lending : Warehouse loans represent collateralized revolving loan facilities to originators of financial assets, such as sub-prime residential mortgages. These mortgages typically serve as collateral for the facility. Loans are generally carried at amortized cost with an allowance for loan losses established for credit losses estimated to exist in the portfolio unless deemed to be permanently impaired. In the case of an impairment, the loan receivable value is adjusted to reflect the valuation of the whole loan collateral underlying the facility if the value is less than amortized cost

Echelon Corporation 3rd Quarter 10-Q

As of September 30, 2007, our investment portfolio contained three asset backed commercial paper instruments issued by Structured Investment Vehicles ("SIVs") with a par value of \$4.5 million each, or \$13.5 million in total. In general, a SIV is an investment company that generates investment returns through yield curve arbitrage by purchasing high grade medium and long-term fixed income instruments and funding those purchases by issuing low cost, short-term senior debt instruments such as asset-backed commercial paper and asset-backed medium term notes. These investments are considered illiquid based upon the fact that there were no open market bids for these investments as of September 30, 2007, or through November 9, 2007, the date of this filing. As such, the fair value of these investments was estimated to approximate the amortized cost, or \$13.4 million in total, by a third party pricing firm that supplies pricing estimates to our investment manager. One of these investments was repaid in full by the issuer on its maturity date of October 3, 2007. The two remaining investments mature on November 13, 2007 and January 18, 2008, and are rated A-1+ by Standard and Poor's and P1 by Moody's. In addition, we have reviewed the respective issuer's liquidity for the two remaining investments as well as the quality of the underlying collateral to further support each issuer's ability to repay the respective investments at maturity. It is our intent to hold these investments to maturity. As a result, we have not recorded an impairment charge or similar write-down of the reported values. However, if these securities were to begin trading below these values in the future, or the issuer were to default on its repayment obligations, we may be required to record losses on these investments, which would in turn negatively impact our results of operations and our financial condition.

Echelon Corporation 3rd Quarter 10-Q

As of September 30, 2007, \$13.4 million in certain asset-backed commercial paper investments issued by Structured Investment Vehicles, \$8.9 million of which is recorded in short-term investments and \$4.5 million of which is recorded in cash and cash equivalents in the condensed consolidated balance sheet, were considered illiquid based upon the fact that there were no open market bids for these investments. As such, the fair value of these investments was estimated to approximate the amortized cost, or \$13.4 million in total, by a third party pricing firm that supplies pricing estimates to the Company's investment manager. One of these investments was repaid in full by the issuer on its maturity date of October 3, 2007. The two remaining investments mature on November 13, 2007 and January 18, 2008, and are rated A-1+ by Standard and Poor's and P1 by Moody's. In addition, the Company has reviewed the respective issuer's liquidity for the two remaining investments as well as the quality of the underlying collateral to further support each issuer's ability to repay the respective investments at maturity. It is the Company's intent to hold these investments to maturity. As a result, the Company has not recorded an impairment charge or similar write-down of the reported values. However, if these securities were to begin trading below these values in the future, or the issuer were to default on its repayment obligations, the Company may be required to record losses on these investments.

Luminent Mortgage Capital Inc. 3rd Quarter 10-Q

The temporary impairment of securities at December 31, 2006 resulted from the fair value of the mortgage-backed securities falling below their amortized cost basis and was solely attributable to changes in interest rates. At December 31, 2006, none of the securities held had been downgraded by a credit rating agency since their purchase and the Company had the ability and intent to hold these securities for a period of time that is sufficient to recover all unrealized losses. As such, the Company does not believe any of these securities were other-than-temporarily impaired at December 31, 2006.

The Company evaluates available-for-sale securities for other-than-temporary impairment on a quarterly basis, and more frequently when conditions warrant such evaluation. Impairment losses of \$268.9 million and \$287.6 million for the three and nine months ended September 30, 2007, respectively, were primarily due to assumption changes on certain mortgage-backed securities for increased loss expectations and increases in the discount rates used to calculate the fair value of mortgage-backed securities on our Residential Mortgage Credit portfolio. As discussed in Note 1, due to current business conditions, the Company cannot say with certainty that it has the ability to hold these securities until recovery of the impairment loss and therefore has recorded the impairment through its statement of operations.

Impairment losses for the three and nine months ended September 30, 2006 were zero and \$2.2 million, respectively, related to Spread securities that the Company did not intend to hold until their maturity.

The Company accounts for certain of the mortgage-backed securities in its Residential Mortgage Credit portfolio in accordance with the Emerging Issues Task Force, or EITF 99-20, Recognition of interest Income and Impairment on Purchased and Retained Beneficial Interests in Securitized Financial Assets. Under EITF 99-20, the Company evaluates whether there is other-than-temporary impairment by discounting projected cash flows using credit, prepayment and other assumptions compared to prior period projections. If the discounted projected cash flows have decreased due to a change in the credit, prepayment and other assumptions, then the mortgage-backed security must be written down to fair value if the fair value is below the amortized cost basis. If there have been no changes to the Company's assumptions and the change in value is solely due to interest rate changes, the Company does not recognize an impairment of a mortgage-backed security in its consolidated statements of operations. It is difficult to predict the timing or magnitude of these other-than-temporary impairments and impairment losses could be substantial.

Countrywide Financial Corporation 3rd Quarter 10-Q

The Company's Asset/Liability Committee ("ALCO") assesses securities classified as available for sale for other-than-temporary impairment on a quarterly basis. This assessment evaluates whether the Company intends and is able to recover the amortized cost of the securities when taking into account the Company's present investment objectives and liquidity requirements and whether the creditworthiness of the issuer calls the realization of contractual cash flows into question.

During the nine months ended September 30, 2007, ALCO determined that the Company no longer intends to hold certain obligations of U.S. Government-sponsored enterprises and mortgage-backed securities until the impairment can be recovered. Such securities had a carrying value of \$587.2 million and unrealized losses recorded in accumulated other comprehensive income totaling \$25.8 million at the time this determination was made. Accordingly, the Company transferred the impairment losses relating to these securities from accumulated other comprehensive income to earnings during the nine months ended September 30, 2007. No other-than-temporary impairment was recorded during the nine months ended September 30, 2006.

Citigroup Inc. 3rd Quarter 10-Q

Citi's \$43 billion in ABS CDO super senior exposures as of September 30, 2007 is backed primarily by sub-prime RMBS collateral. These exposures include approximately \$25 billion in commercial paper principally secured by super senior tranches of high grade ABS CDOs and approximately \$18 billion of super senior tranches of ABS CDOs, consisting of approximately \$10 billion of high grade ABS CDOs, approximately \$8 billion of mezzanine ABS CDOs and approximately \$0.2 billion of ABS CDO-squared transactions.

Although the principal collateral underlying these super senior tranches is U.S. sub-prime RMBS, as noted above, these exposures represent the most senior tranches of the capital structure of the ABS CDOs. These super senior tranches are not subject to valuation based on observable market transactions. Accordingly, fair value of these super senior exposures is based on estimates about, among other things, future housing prices to predict estimated cash flows, which are then discounted to a present value. The rating agency downgrades and market developments referred to above have led to changes in the appropriate discount rates applicable to these super senior tranches, which have resulted in significant declines in the estimates of the fair value of S&B super senior exposures.

E*TRADE Financial Corporation 3rd Quarter 10-Q

The decrease in the total gain (loss) on loans and securities, net during the three months ended September 30, 2007 was due primarily to write downs in our asset-backed securities portfolio totaling \$197.6 million. These write downs were primarily confined to securities rated below "AA" in what we believe are the two highest risk categories within our asset-backed portfolio: CDOs and securities collateralized by second lien mortgages. We did not sell any of these securities during the period ended September 30, 2007; however, it is our intent to sell them in future periods in order to reduce our exposure to further deterioration in these asset classes. The write downs were due to both an anticipated deterioration in cash flows and our decision to sell these securities. In either case, the securities were required to be written down to fair market value as of September 30, 2007.

We expect conditions in the residential real estate and credit markets to remain uncertain for the foreseeable future. Due to the inherent leverage within our asset-backed securities, even a slight deterioration in the performance of the underlying loans could result in a significant deterioration in the performance of our asset-backed securities. Therefore, continued deterioration in market conditions would likely cause additional write downs in our securities portfolio, primarily in our asset-backed portfolio.

Subsequent to September 30, 2007, we observed a significant decline in the fair value of our asset-backed securities portfolio, specifically our asset-backed CDO and second-lien securities. Our total exposure to asset-backed CDO and second-lien securities at September 30, 2007 was approximately \$450 million in amortized cost.

The declines in fair value followed a series of rating agency downgrades of securities in this sector and occurred after the end of the third quarter. We believe there will likely be additional downgrades by the rating agencies of securities in this sector. Overall, approximately \$208 million of our asset-backed securities were downgraded during the month of October and through November 7, 2007, including approximately \$50 million of "AAA" rated asset-backed CDOs that were downgraded to below investment grade.

We expect these declines will result in significant write downs to these securities during the fourth quarter; however, we cannot predict the amount for the fourth quarter as the write downs will depend on future market developments, including potential additional downgrades, and the estimated fair values of these securities on December 31, 2007.

In addition to our asset-backed CDO and second lien portfolio, we hold approximately \$2.6 billion in amortized cost in other asset-backed securities, mainly securities backed by prime residential first-lien mortgages. These securities have also declined in fair value subsequent to September 30, 2007; however, the decline has not been as significant.

E*TRADE Financial Corporation 3rd Quarter 10-Q

The Company does not believe that any individual unrealized loss as of September 30, 2007 represents an other-than-temporary impairment. The majority of the unrealized losses on mortgage-backed securities are attributable to both changes in interest rates and a re-

pricing of risk in the market. Substantially all mortgage-backed securities backed by U.S. Government sponsored and Federal agencies are "AAA" rated. The Company has the intent and ability to hold the securities in an unrealized loss position at September 30, 2007 until the market value recovers or the securities mature. Municipal bonds, corporate bonds and other debt securities are evaluated by reviewing the credit-worthiness of the issuer and general market conditions.

Within our securities portfolio, the asset-backed securities portfolio has the greatest exposure to the current instability in the residential real estate and credit markets. Based on its evaluation, the Company recorded other-than-temporary impairment charges for its asset-backed securities of \$159.8 million⁽¹⁾ and \$162.7 million for the three and nine months ended September 30, 2007. The Company recorded \$1.9 million and \$2.3 million of impairment for its asset- and mortgage-backed securities and on retained interests from securitizations for the three months and nine months ended September 30, 2006, respectively. These charges were primarily confined to securities rated below "AA" in what the Company believes are the two highest risk categories within the asset-backed portfolio: CDOs and securities collateralized by second lien mortgages. The Company did not sell any of these securities during the period ended September 30, 2007; however, it is the Company's intent to sell them in future periods as expeditiously as the market will bear. The securities underlying the impairments were written down by an average of 53% of the current face value to an amortized cost of \$201.6 million as of September 30, 2007.

We expect conditions in the overall residential real estate and credit markets to remain uncertain for the foreseeable future. Due to the inherent leverage within our asset-backed securities, even a slight deterioration in the performance of the underlying loans could result in a significant deterioration in the performance of our asset-backed securities. Therefore, continued deterioration in market conditions would likely cause additional write downs in our securities portfolio, primarily in our asset-backed portfolio.

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We expect these declines will result in significant write downs to these securities during the fourth quarter; however, we cannot predict the amount for the fourth quarter as the write downs will depend on future market developments, including potential additional downgrades, and the estimated fair values of these securities on December 31, 2007.

In addition to our asset-backed CDO and second lien portfolio, we hold approximately \$2.6 billion in amortized cost in other asset-backed securities, mainly securities backed by prime residential first-lien mortgages. These securities have also declined in fair value subsequent to September 30, 2007; however, the decline has not been as significant.

Investing in Loans (Including Subprime Mortgage Loans)

Residential Funding LLC 3rd Quarter 10-Q

During the third quarter, the mortgage and capital markets have continued to experience stress due to credit concerns and housing market contractions in the United States. The reduced accessibility to cost efficient capital in the secondary markets has made the residential mortgage industry even more capital intensive. In the short-term, it is probable the mortgage industry will continue to experience both declining mortgage origination volumes and reduced total mortgage indebtedness due to the deterioration of the nonprime and non-conforming mortgage market and a challenging interest rate environment. Due to these market factors, particularly interest rates, the business of acquiring and selling mortgage loans is cyclical. The industry is experiencing a downturn in this cycle.

Our continued focus is to ensure we effectively manage our liquidity and capital requirements within the current market conditions and align our operations for long-term growth opportunities.

On October 17, 2007, we announced that we are restructuring our mortgage operations, as severe weakness in the housing market and mortgage industry continues to prevail. We will streamline our operations and revise our cost structure, which will enhance our flexibility to meet changing market conditions.

Our ability to generate income and cash flow is highly dependent on the volume of our loan production and our ability to sell or otherwise finance our loans. Our business is also dependent on the acquisition and valuation of our other financial assets, including our mortgage loans held for investment from our on-balance sheet securitizations, interests that continue to be held by us from our off-balance sheet securitizations, mortgage servicing rights, other mortgage loans held for investment and lending receivables.

In the quarter, we have reduced our exposure to nonprime and non-conforming loans through changes to product pricing and changing our product offerings and targeted asset sales, but we remain committed to offering a broad and competitive menu of high quality product offerings. We will continue our growth plans in areas of opportunity and in areas where we continue to maintain a competitive advantage.

Our business is dependent on our sources of liquidity and funding. We sell almost all of our prime conforming residential mortgage loans to Fannie Mae or Freddie Mac in the form of agency-sponsored mortgage-backed securitizations. For other loan types, we primarily use aggregation facilities and our own securitizations as funding sources.

In the quarter, we managed our liquidity through access to secured and unsecured facilities. We have increased our loan production through GMAC Bank, which offers a competitive cost of funding. In addition, GMAC LLC ("GMAC") entered into an agreement with a financial service lender pursuant to which the entity has committed to provide various asset-backed funding facilities. A portion of this facility is available to us.

In the quarter, we received a capital contribution from GMAC of \$1.0 billion. In addition, our wholly owned subsidiaries, Residential Funding Company, LLC ("RFC") and Equity Investments II, LLC, sold substantially all of the assets and operations comprising their healthcare finance business to GMAC Commercial Finance LLC, a wholly owned subsidiary of GMAC, for which we received \$900.5 million.

We fund a large portion of our business in the capital markets using securitization structures. These structures can take the form of on-balance sheet financings or off-balance sheet transactions. Economically, the two structures yield similar results. The form of the

securitization is largely driven by prevailing capital market pricing conditions based on the market's appetite and willingness to invest in different types of risk. We continually evaluate our strategy and the amount of interests that continue to be held by us from our off-balance sheet securitizations in light of market conditions. As an example, as we monitor how the secondary market reacts to changing conditions, we may structure our loan sales and securitizations such that we retain no residual interests in the loans we sell if we believe the market pricing is attractive or it would assist us with our retained risk profile. At September 30, 2007, the unpaid principal balance of mortgage loans held for investment relating to securitization transactions accounted for as securitized borrowings in securitization trusts and pledged as collateral totaled \$39.0 billion. The investors in these on-balance sheet securitizations and the securitization trusts have no recourse to our other assets beyond the loans pledged as collateral. The related securitized borrowings in these securitization trusts totaled \$38.2 billion at September 30, 2007.

The persistence of the global dislocation in the mortgage and credit markets referred to above may continue to negatively affect the value of our mortgage related assets. These markets continue to experience greater volatility, less liquidity, widening of credit spreads, repricing of credit risk and a lack of price transparency. We operate in these markets with exposure to its loans, trading securities, derivatives and lending commitments. It is difficult to predict how long these conditions will exist and which markets, products and businesses of will continue to be affected. Accordingly, these factors could adversely impact our results of operations in the near-term.

E*TRADE Financial Corporation 3rd Quarter 10-Q

Provision for Loan Losses

Provision for loan losses increased to \$186.5 million and to \$237.8 million for the three and nine months ended September 30, 2007, respectively, compared to the same periods in 2006. The increase in the provision for loan losses in the third quarter of 2007 was related primarily to deterioration in the performance of our home equity loan portfolio. We believe this deterioration was caused by several factors, which are described below. First, the combined impact of rising mortgage rates and home price depreciation in key markets contributed to the declining performance of our home equity loan portfolio. Second, concerns that began in the sub-prime mortgage loan market spread to the broader credit markets in the third quarter of 2007 resulting in a significant deterioration in the overall credit markets. This deterioration led to a dramatic tightening of lending standards across the industry, and general liquidity pressure for many mortgage lenders, some of whom ultimately ceased operations as a result. The factors described above dramatically reduced the ability of borrowers to refinance their mortgage loans, specifically their home equity loans, therefore drastically increasing the risk of loss once a loan becomes delinquent. During the third quarter of 2007, we also observed a decline in the percentage of delinquent loans that cure prior to charge-off or foreclosure once they have become delinquent. We attribute this change in behavior to the factors described above, which have significantly limited borrowers' alternatives to avoid defaulting on their loans. In addition, because of the decline in value of the homes collateralizing our home equity loans, our ability to recover our investment by foreclosing on the underlying properties has diminished as well.

We believe the provision for loan losses will continue at historically high levels in future periods as the instability in the residential real estate and credit markets continues to impact the performance of our portfolio.

Citigroup Inc. 3rd Quarter 10-Q

Citi's approximately \$11.7 billion of sub-prime related exposures in the lending and structuring business as of September 30, 2007 compares to approximately \$13 billion of sub-prime related exposures in the lending and structuring business at the end of the second quarter and approximately \$24 billion at the beginning of the year. The \$11.7 billion of sub-prime related exposures includes approximately \$2.7 billion of CDO warehouse inventory and unsold tranches of ABS CDOs, approximately \$4.2 billion of actively managed sub-prime loans purchased for resale or securitization at a discount to par primarily in the last six months, and approximately \$4.8 billion of financing transactions with customers secured by sub-prime collateral. These amounts represent fair value determined based on observable transactions and other market data. Following the downgrades and market developments referred to above, the fair value of the CDO warehouse inventory and unsold tranches of ABS CDOs has declined significantly, while the declines in the fair value of the other sub-prime related exposures in the lending and structuring business have not been significant.

Luminent Mortgage Capital Inc. 3rd Quarter 10-Q

Within the loan market, we have focused on acquiring prime quality, first lien Alt-A adjustable-rate mortgage loans. In the Alt-A market, borrowers choose the convenience of less than full documentation in exchange for a slightly higher mortgage rate. We neither directly originate mortgage loans nor directly service mortgage loans. We purchase pools of mortgage loans from our diverse network of well-capitalized origination providers. We employ a comprehensive underwriting process, driven by our experienced personnel, to review the credit risk associated with each mortgage loan pool we purchase. We require mortgage insurance on all loans with loan-to-value ratios in excess of 80% and, in all recent securitizations, we purchase supplemental mortgage insurance down to a 75% loan-to-value ratio level. In addition, we obtain representations and warranties from each originator to the effect that each loan is underwritten in accordance with the agreed-upon guidelines. An originator who breaches its representations and warranties may be obligated to repurchase loans from us.

We have also acquired mortgage loans that permit negative amortization. A negative amortization provision in a mortgage allows the borrower to defer payment of a portion or all of the monthly interest accrued on the mortgage and to add the deferred interest amount to the mortgage's principal balance. As a result, during periods of negative amortization, the principal balances of negatively amortizing mortgages will increase and their weighted-average lives will extend. Our mortgage loans generally can experience negative amortization ranging from 110-125% of the original mortgage loan balance. As a result, given the relatively low average loan-to-value ratio of 71.6%, net of mortgage insurance, on our portfolio at September 30, 2007, we believe that our portfolio would still have a significant homeowners' equity cushion even if all negatively-amortizing loans reached their maximum permitted amount of negative amortization. Our securitization structures allow the reallocation of principal prepayments on mortgage loans to be used for interest payments on the debt issued in the securitization trusts. To date, prepayments on securitized loans have been sufficient to offset negative amortization such that all our securitization structures have made their required payments to bond holders.

The subprime mortgage banking environment has been experiencing considerable strain from rising delinquencies and liquidity pressures and some subprime mortgage lenders have failed. The increased scrutiny of the subprime lending market is one of the factors that have impacted general market conditions as well as perceptions of our business. Our credit underwriting standards have been structured to limit our exposure to the types of loans that

are currently experiencing high foreclosure and loss rates. Our mortgage loan portfolio has virtually no exposure to loans with FICO scores of less than 620 which are generally considered to be subprime loans. The number of seriously delinquent loans in our loan portfolio was 311 basis points (3.11%) of total loans at September 30, 2007. This percentage is well within our expectations for performance. Our mortgage loan portfolio compares favorably with the most recently available industry statistics for prime ARM loans. At June 30, 2007, our serious delinquencies were 127 basis points (1.27%) compared to the serious delinquency rate reported by the Mortgage Banker's Association of 202 basis points (2.02%) at June 30, 2007. Our credit performance compares favorably to subprime performance, for which the Mortgage Banker's Association reports a serious delinquency rate of 1,240 basis points (12.40%) at June 30, 2007.

Washington Mutual Inc. 3rd Quarter 10-Q

Deteriorating conditions in the U.S. housing market that became evident in the first half of 2007 accelerated sharply throughout the third quarter. The significant and abrupt evaporation of secondary market liquidity for any home loan other than those which can be sold to housing government-sponsored enterprises has decreased the availability of housing credit. As many lenders have been forced out of business or have severely curtailed their operations and most remaining lenders have increased nonconforming mortgage interest rates and tightened underwriting standards, many borrowers, particularly subprime borrowers and borrowers in markets with declining housing prices, have been unable to refinance existing loans. Borrowers in markets with declining housing prices may find themselves unable to refinance their loans as a result of diminished equity in their homes.

Faced with these deteriorating conditions, some borrowers have been unable to either refinance or sell their properties and consequently have defaulted on their loans. Included in this category are borrowers with adjustable-rate mortgages that repriced upward at the expiration of their fixed rate periods. In certain circumstances, especially with loans that were funded more recently, these factors have resulted in increased delinquency rates and loss severities as lower collateral values on foreclosed properties have been insufficient to cover the recorded investment in the loan. Due to the continued weakening of the housing market in the third quarter of 2007, the Company expects that delinquencies and charge-offs in the fourth quarter of 2007 will be greater than in the third quarter of 2007, which is expected to result in a higher provision for loan and lease losses in the fourth quarter.

In economic conditions in which housing prices generally appreciate, the Company believes that loan-to-value ratios and credit scores are the two key determinants of future loan performance. In a stressed housing market with increasing delinquencies and declining housing prices, such as currently exists, the adequacy of collateral securing the loan becomes a much more important factor in determining future loan performance as a borrower with more equity in the property has a greater vested interest in keeping the loan current than a borrower with little to no equity in the property. Also, in the event that the Company has to foreclose on a property, the extent to which the outstanding balance on the loan exceeds the collateral value will determine the severity of loss.

Severity of loss is therefore largely determined by the amount of equity a borrower has in the property and is also influenced by lien position. Homes that were purchased prior to the end of 2004 have generally benefited from more home price appreciation than homes purchased more recently and approximately one third of residential mortgage loans in the Company's held for investment portfolio at September 30, 2007 were originated prior to the end of 2004. In addition, while all home loans are in first lien position, 27% of prime home equity loans and lines of credit at September 30, 2007 were in first lien position.

Both loan-to-value ratios at origination and estimated current loan-to-value ratios are key inputs in the statistical models used to determine the allocated allowance. Loan-to-value

ratios on residential mortgages are updated quarterly based on metropolitan area-level home price indices.

To the extent that the Company believes its statistical models do not capture the full effects of weakening housing markets, adjustments are made to the allowance. When housing prices are volatile, lags in data collection and reporting increase the likelihood of adjustments being made to the allowance. More current data evidencing conditions in the housing market are obtained from analyzing data from the National Association of Realtors on median sales and on housing inventory levels. Current estimates of property values are also used in estimating the amount of any required charge-offs.

Investing in Auction Rate Securities

3M Company 3rd Quarter 10-Q

In the third quarter of 2007, certain auction rate securities failed auction due to sell orders exceeding buy orders. Of 3M's \$1.6 billion marketable securities portfolio at September 30, 2007, \$34 million (at cost) is currently associated with failed auctions, all of which have been in a loss position for less than 12 months. The funds associated with failed auctions will not be accessible until a successful auction occurs or a buyer is found outside of the auction process. These securities are rated AAA. Based on third party valuation models and an analysis of other-than-temporary impairment factors, 3M recorded a temporary impairment within Accumulated Other Comprehensive Income of approximately \$8 million pre-tax at September 30, 2007 related to these auction rate securities. These securities are being analyzed each reporting period for other-than-temporary impairment factors.

Valuations of Financial Instruments, Especially Illiquid Securities With Little or No Price Transparency

Luminent Mortgage Capital Inc. 3rd Quarter 10-Q

Our Spread portfolio of mortgage-backed securities has fair values based on estimates provided by independent pricing services and dealers in mortgage-backed securities. Because the price estimates may vary between sources, we make certain judgments and assumptions about the appropriate price to use. Different judgments and assumptions could result in different presentations of value.

We estimate the fair value of our Residential Mortgage Credit portfolio of mortgage-backed securities using internally generated cash flow analysis, available market information and other appropriate valuation methodologies. We believe the estimates we use reflect the market values we may be able to receive should we choose to sell the mortgage-backed securities. Our estimates involve matters of uncertainty, judgment in interpreting relevant market data and are inherently subjective in nature. Many factors are necessary to estimate market values, including, but not limited to, interest rates, prepayment rates, amount and timing of credit losses, supply and demand, liquidity, cash flows and other market factors. We apply these factors to our portfolio as appropriate in order to determine market values.

We evaluate the determination of other-than-temporary impairment at least quarterly. When the fair value of an available-for-sale security is less than amortized cost, we consider whether there is an other-than-temporary impairment in the value of the security. We consider several factors when evaluating securities for an other-than-temporary impairment, including the length of time and the extent to which the market value has been less than the amortized cost, whether the security has been downgraded by a rating agency and our continued intent and ability to hold the security for a period of time sufficient to allow for any anticipated recovery in market value. The determination of other-than-

temporary impairment is a subjective process, requiring the use of judgments and assumptions. If we determine other-than-temporary impairment exists, we write down the cost basis of the security to the then-current fair value, and record the unrealized loss as a reduction of current earnings as if we had realized the loss in the period of impairment. If future evaluations conclude that impairment now considered to be temporary is other-than-temporary, we may need to realize a loss that would have an impact on income. See Note 3 to our consolidated financial statements for further detail of temporary and other-than-temporary impairment on our mortgage-backed securities.

Recently, due to disruptions in the mortgage market resulting in our sale of securities to repay lenders and our ongoing liquidity concerns, we have determined that we may not have the ability to hold available-for-sale securities that are at an unrealized loss until the loss in market value is recovered. These securities are considered to be other-than-temporarily impaired and therefore we have recognized all unrealized losses on available-for-sale securities in the statement of operations.

Countrywide Financial Corporation 3rd Quarter 10-Q

The Company generally estimates the fair value of loans held for sale based on quoted market prices for securities backed by similar types of loans. If quoted market prices are not available, fair value is estimated based on other relevant factors, including dealer price quotations, prices available for similar instruments, and valuation models intended to approximate the amounts that would be received from a third party. We regularly compare the values developed from our valuation models to executed trades to assure that the valuations are reflective of actual sale prices. However, due to the illiquidity of the mortgage marketplace prevalent at September 30, 2007, it was necessary to look for alternative sources of value, including the whole loan purchase market for similar loans, and to apply more judgment to the valuations of non-conforming prime, home equity and nonprime loans, which represented approximately 60% of mortgage loans originated or purchased for resale excluding commercial real estate at September 30, 2007, because of a lack of executed trades that could be used to assure that the valuations are reflective of fair value.

Merrill Lynch & Co. Inc. 3rd Quarter 10-Q

A review of fair value hierarchy classifications is conducted on a quarterly basis. Changes in the observability of valuation inputs may result in a reclassification for certain financial assets or liabilities. Reclassifications impacting Level 3 of the fair value hierarchy are reported as transfers in/out of the Level 3 category as of the beginning of the quarter in which the reclassifications occur. During the third quarter of 2007, a significant amount of assets and liabilities was reclassified from Level 2 to Level 3. This reclassification primarily relates to U.S. sub-prime residential mortgage-related assets and liabilities, including ABS CDOs, due to a significant decrease in the observability of market pricing for these assets and liabilities in the third quarter.

Level 3 Assets and Liabilities

Level 3 trading assets primarily include U.S. sub-prime residential mortgage-related and ABS CDO positions of \$2.5 billion and corporate bonds and loans of \$5.9 billion. Level 3 contractual agreements (assets) primarily include long-dated equity derivatives of \$4.6 billion and derivatives on U.S. sub-prime residential mortgage-related and ABS CDO positions, primarily in the form of credit default swaps of \$3.8 billion. Level 3 investment securities primarily relate to U.S. sub-prime residential mortgage-related and ABS CDO positions of \$1.8 billion that are accounted for as trading securities under SFAS No. 115 as well as certain private equity and principal investment positions of \$3.6 billion. Level 3 contractual agreements (liabilities) primarily relate to long-dated equity derivatives of

\$5.5 billion and derivatives on U.S. sub-prime residential mortgage-related and ABS CDO positions, primarily in the form of total return swaps and credit default swaps of \$8.5 billion. Level 3 long-term borrowings primarily relate to structured notes with embedded long-dated currency derivatives of \$544 million.

U.S. sub-prime residential mortgage-related and ABS CDO activities

During the third quarter of 2007, Merrill Lynch recorded a net loss of approximately \$7.9 billion related to U.S. ABS CDO securities positions and warehouses, as well as U.S. sub-prime mortgage-related assets including whole loans, warehouse lending, residual positions and residential mortgage-backed securities. These losses primarily related to assets and liabilities recorded at fair value on a recurring basis and are included in principal transactions losses in the table below.

At September 28, 2007, the remaining net exposure for these positions was approximately \$21.5 billion. This \$21.5 billion net exposure includes:

- Assets and liabilities, including derivative positions, that are recorded at fair value on a recurring basis of \$5.0 billion (includes Level 2 and Level 3);
- Assets that are recorded at fair value on a non-recurring basis of \$2.3 billion (i.e., loans recorded at lower of cost or market);
- Additional off-balance sheet exposures on derivative positions (i.e., notional amounts) of \$13.6 billion; and
- Additional off-balance sheet exposures on loan commitments of \$0.6 billion.

In addition, Merrill Lynch through its U.S. bank subsidiaries has SFAS 115 investment securities and off-balance sheet arrangements that have exposure to U.S. sub-prime residential mortgage-related assets of \$5.7 billion at September 28, 2007. Valuation of these exposures will continue to be impacted by external market factors including default rates, rating agency actions, and the prices at which observable market transactions occur. Merrill Lynch's ability to mitigate its risk by selling or hedging its exposures is limited by the market environment. Merrill Lynch's future results may continue to be materially impacted by the valuation adjustments applied to these positions.

Net losses in principal transactions were due primarily to \$7.9 billion of write-downs taken on U.S. sub-prime residential mortgage-related and ABS CDO positions that are classified as Level 3, partially offset by approximately \$0.9 billion of gains in other fixed income and equity related products. The increases attributable to purchases, issuances, and settlements of Level 3 assets and liabilities were primarily due to the exercise of certain purchase obligations that required Merrill Lynch to buy underlying assets, primarily U.S. sub-prime residential mortgage-related and ABS CDO positions of \$1.4 billion. These purchase obligations were previously included in contractual agreements and were primarily classified as Level 2 in prior periods.

The increases attributable to net transfers in of Level 3 assets and liabilities were due primarily to the decrease in observability of market pricing for instruments which had previously been classified as Level 2, primarily U.S. sub-prime residential mortgage-related and ABS CDO positions and related instruments of \$1.2 billion and other notes and loans of \$4.8 billion that are classified as trading assets.

Merrill Lynch & Co. Inc. 3rd Quarter 10-Q

We early adopted the provisions of SFAS No. 157 *Fair Value Measurements* ("SFAS No. 157") in the first quarter of 2007. SFAS No. 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction

between marketplace participants at the measurement date (i.e., the exit price). An exit price notion does not assume that the transaction price is the same as the exit price, thus permitting the recognition of inception gains and losses on a transaction in certain circumstances. In addition, an exit price notion requires the valuation to consider what a marketplace participant would pay to buy an asset or receive to assume a liability. Therefore, Merrill Lynch must rely upon observable market data before it can utilize internally derived valuations.

Fair values for exchange-traded securities and certain exchange-traded derivatives, principally certain options contracts, are based on quoted market prices. Fair values for over-the-counter ("OTC") derivatives, principally forwards, options, and swaps, represent amounts estimated to be received from or paid to a market participant in settlement of these instruments. These derivatives are valued using pricing models based on the net present value of estimated future cash flows and directly observed prices from exchange-traded derivatives, other OTC trades, or external pricing services and other inputs such as quoted interest and currency indices, while taking into account the counterparty's credit rating, or our own credit rating as appropriate.

New and/or complex instruments may have immature or limited markets. As a result, the pricing models used for valuation often incorporate significant estimates and assumptions that market participants would use in pricing the instrument, which may impact the results of operations reported in the Condensed Consolidated Financial Statements. For long-dated and illiquid contracts, we apply extrapolation methods to observed market data in order to estimate inputs and assumptions that are not directly observable. This enables us to mark to fair value all positions consistently when only a subset of prices is directly observable. Values for OTC derivatives are verified using observed information about the costs of hedging the risk and other trades in the market. As the markets for these products develop, we continually refine our pricing models to correlate more closely to the market risk of these instruments. Obtaining the fair value for OTC derivative contracts requires the use of management judgment and estimates. In addition, during periods of market illiquidity, the valuation of certain cash products can also require significant judgment and the use of estimates by management.

Prior to adoption of SFAS No. 157, Merrill Lynch followed the provisions of EITF 02-3, *Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in Energy Trading and Risk Management Activities* ("EITF 02-3"). Under EITF 02-3, recognition of day one gains and losses on derivative transactions where model inputs that significantly impact valuation are not observable were prohibited. Day one gains and losses deferred at inception under EITF 02-3 were recognized at the earlier of when the valuation of such derivative became observable or at the termination of the contract. SFAS No. 157 nullifies this guidance in EITF 02-3. Although this guidance in EITF 02-3 has been nullified, the recognition of significant inception gains and losses that incorporate unobservable inputs are reviewed by management to ensure such gains and losses are derived from observable inputs and/or incorporate reasonable assumptions about the unobservable component, such as implied bid-offer adjustments.

Morgan Stanley 3rd Quarter 10-Q

A substantial percentage of the fair value of the Company's financial instruments used for trading is based on observable market prices, observable market parameters, or is derived from such prices or parameters. The availability of observable market prices and pricing parameters can vary from product to product. Where available, observable market prices and pricing parameters in a product (or a related product) may be used to derive a price without requiring significant judgment. In certain markets, such as for products that are less actively traded, observable market prices or market parameters are not available, and

fair value is determined using techniques appropriate for each particular product. These techniques can, at times, involve a significant degree of judgment.

In the case of financial instruments transacted on recognized exchanges, the observable prices represent quotations for completed transactions from the exchange on which the financial instrument is principally traded. Also as a result of the adoption of SFAS No. 157 on December 1, 2006, the Company no longer utilizes block discounts in cases where it has large holdings of unrestricted financial instruments with quoted prices that are readily and regularly available in an active market.

In the case of over-the-counter ("OTC") derivative contracts, fair value is derived primarily using pricing models, which may require multiple market input parameters. Where appropriate, valuation adjustments are made to account for various factors, including credit quality and market liquidity. These adjustments are applied on a consistent basis and are based upon observable market data where available. The Company also uses pricing models to manage the risks introduced by OTC derivatives. Depending on the product and the terms of the transaction, the fair value of OTC derivative products can be modeled using a series of techniques, including closed-form analytic formulae, such as the Black-Scholes option pricing model, simulation models or a combination thereof, applied consistently. In the case of more established derivative products, the pricing models used by the Company are widely accepted by the financial services industry. Pricing models take into account the contract terms, including the maturity, as well as market parameters such as interest rates, volatility and the creditworthiness of the counterparty. As a result of the Company's adoption of SFAS No. 157, the impact of the Company's own credit spreads are also considered when measuring the fair value of liabilities, including OTC derivative contracts.

Morgan Stanley 3rd Quarter 10-Q

The fair value of the Company's financial instruments are generally based on or derived from bid prices or parameters for Financial instruments owned and ask prices or parameters for Financial instruments sold, not yet purchased.

A substantial percentage of the fair value of the Company's financial instruments used for trading is based on observable market prices, observable market parameters, or is derived from such prices or parameters. The availability of observable market prices and pricing parameters can vary from product to product. Where available, observable market prices and pricing parameters in a product (or a related product) may be used to derive a price without requiring significant judgment. In certain markets, such as for products that are less actively traded, observable market prices or market parameters are not available, and fair value is determined using techniques appropriate for each particular product. These techniques can, at times, involve a significant degree of judgment.

In the case of financial instruments transacted on recognized exchanges, the observable prices represent quotations for completed transactions from the exchange on which the financial instrument is principally traded. Also, as a result of the adoption of SFAS No. 157 on December 1, 2006, the Company no longer utilizes block discounts in cases where it has large holdings of unrestricted financial instruments with quoted prices that are readily and regularly available in an active market.

The price transparency of the particular product will determine the degree of judgment involved in determining the fair value of the Company's financial instruments. Price transparency is affected by a wide variety of factors, including, for example, the type of product, whether it is a new product and not yet established in the marketplace, and the characteristics particular to the transaction. Products for which actively quoted prices or pricing parameters are available or for which fair value is derived from actively quoted prices or pricing parameters will generally have a higher degree of price transparency. By

contrast, products that are thinly traded or not quoted will generally have reduced to no price transparency. Even in normally active markets, the price transparency for actively quoted instruments may be reduced for periods of time during periods of market dislocation. Alternatively, in thinly quoted markets, the participation of market-makers willing to purchase and sell a product provides a source of transparency for products that otherwise are not actively quoted or during periods of market dislocation. For further information on the observability of the pricing inputs used to determine the fair value of the Company's financial instruments, see Note 18 to the condensed consolidated financial statements.

The Company's financial instruments used for trading include both cash and derivative products. Cash products include securities issued by the U.S. government and its agencies, other sovereign debt obligations, certain corporate and other debt securities, corporate equity securities, exchange traded funds and physical commodities. The fair value of these products is based principally on observable market prices or is derived using observable market parameters. These products generally do not entail a significant degree of judgment in determining fair value. Examples of products for which actively quoted prices or pricing parameters are available or for which fair value is derived from actively quoted prices or pricing parameters include securities issued by the U.S. government and its agencies, exchange traded corporate equity securities, most municipal debt securities, most corporate debt securities, most high-yield debt securities, physical commodities, certain tradable loan products and most mortgage-backed securities.

In certain circumstances, principally involving loan products and other financial instruments held for securitization transactions, the Company determines fair value from within the range of bid and ask prices such that fair value indicates the value likely to be realized in a current market transaction. Bid prices reflect the price that the Company and others pay, or stand ready to pay, to originators of such assets. Ask prices represent the prices that the Company and others require to sell such assets to the entities that acquire the financial instruments for purposes of completing the securitization transactions. Generally, the fair value of such acquired assets is based upon the bid price in the market for the instrument or similar instruments. In general, the loans and similar assets are valued at bid pricing levels until structuring of the related securitization is substantially complete and such that the value likely to be realized in a current transaction is consistent with the price that a securitization entity will pay to acquire the financial instruments. Factors affecting securitized value and investor demand relating specifically to loan products include, but are not limited to, loan type, underlying property type and geographic location, loan interest rate, loan to value ratios, debt service coverage ratio, investor demand and credit enhancement levels.

In addition, some cash products exhibit little or no price transparency, and the determination of fair value requires more judgment. Examples of cash products with little or no price transparency include certain high-yield debt, certain collateralized mortgage obligations, certain tradable loan products, distressed debt securities (i.e., securities of issuers encountering financial difficulties, including bankruptcy or insolvency) and equity securities that are not publicly traded. Generally, the fair value of these types of cash products is determined using one of several valuation techniques appropriate for the product, which can include cash flow analysis, revenue or net income analysis, default recovery analysis (i.e., analysis of the likelihood of default and the potential for recovery) and other analyses applied consistently.

The Company's derivative products include exchange traded and OTC derivatives. Exchange traded derivatives have valuation attributes similar to the cash products valued using observable market prices or market parameters described above. OTC derivatives, whose fair value is derived using pricing models, include a wide variety of instruments, such as

interest rate swap and option contracts, foreign currency option contracts, credit and equity swap and option contracts, and commodity swap and option contracts.

The fair value of OTC derivative contracts is derived primarily using pricing models, which may require multiple market input parameters. Where appropriate, valuation adjustments are made to account for various factors, including credit quality and market liquidity. These adjustments are applied on a consistent basis and are based upon observable market data where available. The Company also uses pricing models to manage the risks introduced by OTC derivatives. Depending on the product and the terms of the transaction, the fair value of OTC derivative products can be modeled using a series of techniques, including closed-form analytic formulae, such as the Black-Scholes option pricing model, simulation models or a combination thereof, applied consistently. In the case of more established derivative products, the pricing models used by the Company are widely accepted by the financial services industry. Pricing models take into account the contract terms, including the maturity, as well as market parameters such as interest rates, volatility and the creditworthiness of the counterparty. As a result of the Company's adoption of SFAS No. 157 on December 1, 2006, the impact of the Company's own credit spreads are also considered when measuring the fair value of liabilities, including OTC derivative contracts.

Prior to the adoption of SFAS No. 157 on December 1, 2006, the Company followed the provisions of EITF Issue No. 02-3 (see "Other Items—Accounting Developments" herein). Under EITF Issue No. 02-3, in the absence of observable market prices or parameters in an active market, observable prices or parameters of other comparable current market transactions, or other observable data supporting a fair value based on a pricing model at the inception of a contract, revenue recognition at the inception of an OTC derivative financial instrument was not permitted. Such revenue was recognized in income at the earlier of when there was market value observability or at the end of the contract period. In the absence of observable market prices or parameters in an active market, observable prices or parameters of other comparable current market transactions, or other observable data supporting a fair value based on a pricing model at the inception of a contract, fair value was based on the transaction price. With the adoption of SFAS No. 157, the Company is no longer applying the revenue recognition criteria of EITF Issue No. 02-3.

Many pricing models do not entail material subjectivity because the methodologies employed do not necessitate significant judgment, and the pricing inputs are observed from actively quoted markets, as is the case for generic interest rate swap and option contracts. A substantial majority of OTC derivative products valued by the Company using pricing models fall into this category. Other derivative products, typically the newest and most complex products, will require more judgment in the implementation of the modeling technique applied due to the complexity of the modeling assumptions and the reduced price transparency surrounding the model's market parameters. The Company manages its market exposure for OTC derivative products primarily by entering into offsetting derivative contracts or other related financial instruments. The Company's trading divisions, the Financial Control Department and the Market Risk Department continuously monitor the price changes of the OTC derivatives in relation to the offsetting positions. For a further discussion of the price transparency of the Company's OTC derivative products, see "Quantitative and Qualitative Disclosures about Market Risk—Risk Management—Credit Risk" in Part II, Item 7A of the Form 10-K.

Washington Mutual Inc. 3rd Quarter 10-Q

A portion of the Company's assets are carried at fair value, including: mortgage servicing rights, trading assets including certain retained interests from securitization activities, available-for-sale securities and derivatives. Generally, for assets that are reported at fair value, the Company uses quoted market prices or internal valuation models that utilize

observable market data inputs to estimate their fair value. In certain cases observable market prices and data may not be readily available or availability may be diminished due to market conditions. In those cases, different assumptions could result in significant changes in valuation.

Each of the factors can significantly impact the Company's businesses, operations, activities, condition and results in significant ways that are not described in the foregoing discussion and which are beyond the Company's ability to anticipate or control, and could cause actual results to differ materially from the outcomes described in the forward-looking statements.

Lending and Related Activities

Originating Loans (Including Subprime Mortgage Loans) and Commitments to Originate Loans

Countrywide Financial Corporation 3rd Quarter 10-Q

Increased estimates of inherent losses in our portfolio of loans held for investment and increased charge-offs resulted in significant increases to credit costs during the third quarter of 2007. Higher estimates of inherent losses were attributable to continued deterioration in housing market conditions, worsening delinquency trends, and the significant tightening of available credit which occurred during the third quarter and which is expected to further adversely impact credit performance. The revised expectations relative to credit losses impacted third quarter results as follows:

- **Increased provision for loan loss on our portfolio of loans held for investment** of \$934.3 million, compared to \$38.0 million in the third quarter of 2006. The increase in provision during the quarter primarily relates to additional valuation allowances provided for the home equity and pay-option loans held in Banking Operations.
- **Impairment of credit-sensitive residuals** of \$689.8 million, compared to recovery of \$26.4 million in the third quarter of 2006. Third quarter 2007 impairment includes \$540.6 million for prime home equity residuals and \$156.2 million for nonprime and related residuals, offset by a recovery of \$7.0 million on prime residual securities.
- **Increased provision for representations and warranties** in the amount of \$291.5 million, compared to \$41.0 million in the third quarter of 2006. This increase relates primarily to increased expectations of future representation and warranty claims on loans sold or securitized resulting from higher levels of expected future defaults. It is our intention to defend our positions vigorously.

Securitizing Financial Assets

Merrill Lynch & Co. Inc. 3rd Quarter 10-Q

Merrill Lynch securitized assets of approximately \$154.4 billion and \$98.7 billion for the nine months ended September 28, 2007 and September 29, 2006, respectively. For the nine months ended September 28, 2007 and September 29, 2006, Merrill Lynch received \$156.8 billion and \$99.1 billion, respectively, of proceeds, and other cash inflows, from securitization transactions, and recognized net securitization gains of \$286.8 million and \$200.7 million, respectively, in Merrill Lynch's Condensed Consolidated Statements of Earnings.

Retained interests in securitized assets were approximately \$10.1 billion and \$6.8 billion at September 28, 2007 and December 29, 2006, respectively, which related primarily to residential mortgage loan, commercial loan and bond, and municipal bond securitization transactions. A portion of the retained interest balance consists of mortgage-backed securities that have limited price transparency. The majority of these retained interests include mortgage-backed securities that Merrill Lynch had expected to sell to investors in the normal course of its underwriting activity. However, the timing of any sale is subject to current and future market conditions. A portion of the retained interests represent residual

interests in U.S. sub-prime mortgage securitizations and is included in the Level 3 U.S. ABS CDO exposure disclosed in Note 3 to the Condensed Consolidated Financial Statements

Washington Mutual Inc. 3rd Quarter 10-Q

In the ordinary course of business, the Company sells loans to third parties and in certain circumstances, such as in the event of first payment default, retains credit risk exposure on those loans and may be required to repurchase them. The Company may also be required to repurchase sold loans when representations and warranties made by the Company in connection with those sales are breached. When a loan sold to an investor fails to perform according to its contractual terms, the investor will typically review the loan file to search for errors that may have been made in the process of originating the loan. If errors are discovered and it is determined that such errors constitute a breach of a representation or warranty made to the investor in connection with the Company's sale of the loan, then if the breach had a material adverse effect on the value of the loan, the Company will be required to either repurchase the loan or indemnify the investors for losses sustained. In connection with the sales of mortgage servicing rights, the Company may be required to indemnify the purchaser for losses that resulted from deficiencies associated with the Company's prior servicing obligations. The Company has recorded reserves of \$239 million as of September 30, 2007 and \$220 million as of December 31, 2006, to cover its estimated exposure related to all of the aforementioned loss contingencies.

Servicing Financial Assets

Washington Mutual Inc. 3rd Quarter 10-Q

The value of the MSR asset is subject to prepayment risk. Future expected net cash flows from servicing a loan in the servicing portfolio will not be realized if the loan pays off earlier than expected. Moreover, since most loans within the servicing portfolio do not impose prepayment fees for early payoff, a corresponding economic benefit will not be received if the loan pays off earlier than expected. The fair value of the MSR is estimated from the present value of the future net cash flows the Company expects to receive from the servicing portfolio. Accordingly, prepayment risk subjects the MSR to potential declines in fair value. During the second quarter of 2007, the Company adopted an option-adjusted spread ("OAS") valuation methodology for estimating the fair value of substantially all of its MSR asset. This methodology projects MSR cash flows over multiple interest rate scenarios, and discounts those cash flows using risk-adjusted discount rates to arrive at an estimate of the fair value of the MSR asset. As the Company's OAS model was calibrated to the prior model's valuation results, the conversion to the new methodology did not result in a fair value adjustment to the Company's MSR asset upon its implementation.

MSR valuation and risk management results were gains of \$222 million and \$77 million for the three and nine months ended September 30, 2007, compared with losses of \$78 million and \$275 million for the same periods in 2006. Decreases in mortgage interest rates during the third quarters of 2007 and 2006 led to a decline in MSR value, as expected prepayment speeds increased, and a corresponding increase in value of risk management instruments. However, the impact of lower interest rates on projected MSR prepayment speeds in the third quarter of 2007 was mitigated by the weakening housing market, tighter underwriting standards across the mortgage banking industry and higher rates for nonconforming loan products, all of which reduced the opportunity for borrowers to refinance. The performance of the MSR risk management instruments was adversely affected by the flat-to-inverted slope of the yield curve for the three and nine months ended September 30, 2006, which had the effect of increasing hedging costs during both of those periods.

Home mortgage loan servicing revenue decreased by \$9 million and \$126 million for the three and nine months ended September 30, 2007, compared with the same periods in 2006. The decrease for the nine month period was largely the result of the sale of \$2.53 billion of mortgage servicing rights in July 2006. Those declines were more than offset by a decrease in the rate of MSR fair value changes from loan payments of \$59 million and \$170 million for the same comparative periods, as actual payment rates on the servicing portfolio decreased in the third quarter of 2007 due to significantly lower levels of refinancing activity.

Issuing Financial Products

MBIA Inc. 3rd Quarter 10-Q

Through MBIA Corp., the Company regularly insures derivative instruments as part of its core financial guarantee business, which represent the majority of the Company's notional derivative exposure. These derivative instruments do not qualify for the financial guarantee scope exception under SFAS 133. MBIA has insured credit derivatives that reference primarily structured pools of cash securities and credit default swaps. The Company's insured credit derivatives generally provide credit default swap protection on the most senior liabilities of structured finance transactions, and the Company's exposure generally has more subordination than needed to achieve triple-A ratings from credit rating agencies (referred to as "Super Triple-A" exposure). The underlying reference obligations of these cash securities and credit default swaps principally consist of corporate, asset-backed, residential mortgage-backed and commercial mortgage-backed securities. The fair values of the Company's derivative instruments are estimated using observable market prices when they are available. Such observable market prices are typically obtained for regularly traded contracts in active markets. Most of the derivative contracts insured by MBIA are structured transactions that are not traded but rather insured to maturity by MBIA. As they are illiquid, there are no observable market prices for these derivative contracts. For these contracts, the Company estimates fair values using available market credit spreads for the underlying reference obligations within valuation models. The Company utilizes both vendor-developed and proprietary models, depending on the type and structure of contracts. The significant data that influence the Company's valuation models include market credit spreads, current interest rates, portfolio credit quality ratings and correlation assumptions within portfolios. Market data inputs are determined based on the specific attributes of each structured credit derivative. If observable market credit spreads are not available for the underlying reference obligations, then a market index is used that most closely resembles the underlying reference obligations, specified by asset class, credit quality rating and maturity of the underlying.

Sponsoring Off-Balance-Sheet Entities (Including ABCP Conduits and CDOs)

Merrill Lynch & Co. Inc. 3rd Quarter 10-Q

The liquidity facilities and default facilities in the above table relate primarily to municipal bond securitization SPEs and asset-backed commercial paper conduits (“Conduits”).

Merrill Lynch acts as liquidity provider to municipal bond securitization SPEs. As of September 28, 2007, the value of the assets held by the SPE plus any additional collateral pledged to Merrill Lynch exceeds the amount of beneficial interests issued, which provides additional support to Merrill Lynch in the event that the standby facility is drawn. As of September 28, 2007, the maximum payout if the standby facilities are drawn was \$39.3 billion and the value of the municipal bond assets to which Merrill Lynch has recourse in the event of a draw was \$42.8 billion. In certain instances, Merrill Lynch also provides default protection in addition to liquidity facilities. If the default protection is drawn, Merrill Lynch may claim the underlying assets held by the SPEs. As of September 28, 2007, the maximum payout if an issuer defaults was \$7.9 billion, and the value of the assets to which Merrill Lynch has recourse, in the event that an issuer of a municipal bond held by the SPE defaults on any payment of principal and/or interest when due, was \$8.8 billion.

In addition, Merrill Lynch, through a U.S. bank subsidiary has liquidity and credit facilities outstanding to Conduits. The assets in these Conduits are loans and asset-backed securities. In the event of a disruption in the commercial paper market, the Conduit may draw upon their liquidity facility and sell certain of their assets to Merrill Lynch, thereby protecting commercial paper holders against certain changes in the fair value of the assets held by the Conduits. The credit facilities protect commercial paper investors against credit losses for up to a certain percentage of the portfolio of assets held by the respective Conduits. The outstanding amount of the facilities is approximately \$4.8 billion as of September 28, 2007. This amount is net of \$5.1 billion of assets that Merrill Lynch purchased and \$1.2 billion that Merrill Lynch loaned to the Conduits under these liquidity facilities during the three months ended September 28, 2007. In addition, Merrill Lynch purchased \$523 million of commercial paper from these Conduits, including \$300 million from Conduits for which it has a significant variable interest. These liquidity and credit facilities are recorded off-balance sheet, unless a liability is deemed necessary when a contingent payment is deemed probable and estimable. A liability of \$41 million related to this contingency was recorded as of September 28, 2007.

Citigroup Inc. 3rd Quarter 10-Q

CAI's Global Credit Structures investment center is the investment manager for seven Structured Investment Vehicles (SIVs). SIVs are special purpose investment companies that seek to generate attractive risk-adjusted floating-rate returns through the use of financial leverage and credit management skills, while hedging interest rate and currency risks and managing credit, liquidity and operational risks. The basic investment strategy is to earn a spread between relatively inexpensive short-term funding (commercial paper and medium-term notes) and high quality asset portfolios with a medium-term duration, with the leverage effect providing attractive returns to junior note holders, who are third-party investors and who provide the capital to the SIVs.

Citigroup has no contractual obligation to provide liquidity facilities or guarantees to any of the Citi-advised SIVs and does not own any equity positions in the SIVs. The SIVs have no direct exposure to U.S. sub-prime assets and have approximately \$70 million of indirect exposure to sub-prime assets through CDOs which are AAA rated and carry credit

enhancements. Approximately 98% of the SIVs' assets are fully funded through the end of 2007. Beginning in July 2007, the SIVs which Citigroup advises sold more than \$19 billion of SIV assets, bringing the combined assets of the Citigroup-advised SIVs to approximately \$83 billion at September 30, 2007. See additional discussion on page 46.

The current lack of liquidity in the Asset-Backed Commercial Paper (ABCP) market and the resulting slowdown of the CP market for SIV-issued CP have put significant pressure on the ability of all SIVs, including the Citi-advised SIVs, to refinance maturing CP.

While Citigroup does not consolidate the assets of the SIVs, the Company has provided liquidity to the SIVs at arm's-length commercial terms totaling \$10 billion of committed liquidity, \$7.6 billion of which has been drawn as of October 31, 2007. Citigroup will not take actions that will require the Company to consolidate the SIVs.

Citigroup Inc. 3rd Quarter 10-Q

The Company administers several third-party-owned, special purpose, asset-backed commercial paper conduits that purchase pools of trade receivables, credit card receivables, and other financial assets from multiple third-party clients of the Company. As administrator of these multi-seller finance companies, the Company provides accounting, funding, and operations services to these conduits. Generally, the Company has no ownership interest in the conduits. The sellers continue to service the assets they transferred. The conduits' asset purchases are funded by issuing commercial paper and medium-term notes. The sellers absorb the first losses of the conduits by providing collateral in the form of excess assets. Typically, the issuance of commercial paper is done on a revolving basis, in which the maturing paper is retired with the funds received from issuing new commercial paper at current market terms. The Company, along with other financial institutions, provides liquidity facilities, such as liquidity asset purchase agreements and commercial paper backstop lines of credit to the conduits, which offer an alternative source of funding should the conduit be unable to replace fully the maturing commercial paper in the commercial paper market. In the event of liquidity problems in the commercial paper market, the Company's asset purchase agreements require the Company to purchase only high quality performing assets from the conduits at their fair values. The Company also provides loss enhancement in the form of letters of credit and other guarantees. All fees are charged on a market basis.

To comply with FIN 46-R, many of the conduits issued "first loss" subordinated notes such that one third-party investor in each conduit would be deemed the primary beneficiary and would consolidate the conduit.

A SIV is a special purpose investment company, which holds high quality asset portfolios that are funded through the issuance of junior notes, medium-term notes and short-term commercial paper. The junior notes are subject to the "first loss" risk of the vehicle. The spread between the short-term funding (commercial paper and medium-term notes) and high quality asset portfolios provides a leveraged return to the junior note holders. SIVs are subject to liquidity and refinancing risk and must repay a significant portion of maturing commercial paper and medium-term notes through the issuance of new debt. Should a SIV not be able to meet its funding needs due to a lack of liquidity in the market, it may be forced to sell assets at a time when prices are depressed.

CAI's Global Credit Structures investment center is the investment manager for seven SIVs. Citigroup has no contractual obligation to provide liquidity facilities or guarantees to any of the Citi-advised SIVs. Citigroup is not the primary beneficiary of any of the Citi-advised SIVs and therefore does not include the SIVs in its consolidated financial statements.

Bank of America Corporation 3rd Quarter 10-Q

Corporation-sponsored multi-seller conduits

The Corporation administers three multi-seller conduits which provide a low-cost funding alternative to its customers by facilitating their access to the commercial paper market. These customers sell or otherwise transfer assets to the conduits, which in turn issue high-grade, short-term commercial paper that is collateralized by the underlying assets. The Corporation receives fees for providing combinations of liquidity and standby letters of credit (SBLCs) or similar loss protection commitments to the conduits. The Corporation is the primary beneficiary of one conduit which is included in the Consolidated Financial Statements of the Corporation. The Corporation does not consolidate the other two conduits which issued capital notes to independent third parties as it does not expect to absorb a majority of the variability of the conduits. The assets of the consolidated conduit are recorded in AFS and held-to-maturity debt securities and other assets.

At September 30, 2007, the Corporation's liquidity commitments to these conduits were collateralized by various classes of assets, including student loans of 24 percent, credit card loans of 13 percent, auto loans and trade receivables of eight percent each, and prime residential mortgages of four percent. Less than one percent of these commitments are collateralized by subprime residential mortgages. In addition, 27 percent of the Corporation's commitments were collateralized by the conduits' short-term lending obligations to investment funds (e.g., real estate limited partnerships, private equity or venture capital funds). Amounts advanced under these obligations are expected to be repaid when the investment funds issue capital calls to their qualified equity investors. Net revenues earned from fees associated with these commitments were \$51 million and \$135 million for the three and nine months ended September 30, 2007, and \$34 million and \$89 million for the three and nine months ended September 30, 2006.

Collateralized debt obligations

Collateralized debt obligations (CDOs) are special purpose entities (SPEs) that hold diversified pools of fixed income securities. They issue multiple tranches of debt securities, including commercial paper, and equity securities. The Corporation receives fees for structuring the CDOs and/or placing debt securities with third party investors.

At September 30, 2007 and December 31, 2006, the Corporation provided liquidity support in the form of written put options on \$10.0 billion and \$2.1 billion of commercial paper issued by CDOs including \$3.2 billion issued by the consolidated CDO at September 30, 2007. The commercial paper is the most senior class of securities issued by the CDOs and benefits from the subordination of all other securities, including AAA-rated securities, issued by the CDOs. The Corporation is obligated under the written put options to provide funding to the CDOs by purchasing the commercial paper at predetermined contractual yields in the event of a severe disruption in the short-term funding market. See *Note 11 – Commitments and Contingencies* to the Consolidated Financial Statements for more information on the written put options. These written put options are recorded as derivatives on the Consolidated Balance Sheet and are carried at fair value with changes in fair value recorded in trading account profits (losses). Derivative activity related to these entities is included in *Note 4 – Derivatives* to the Consolidated Financial Statements. The assets of the consolidated conduit are recorded in trading account assets.

The Corporation also administers a CDO conduit that obtains funds by issuing commercial paper to third party investors. The conduit held \$5.5 billion of assets at both September 30, 2007 and December 31, 2006 consisting of super senior tranches of debt securities issued by other CDOs. These securities benefit from overcollateralization exceeding the amount

that would be required for a AAA rating. The Corporation provides liquidity support equal to the amount of assets in this conduit which obligates it to purchase the commercial paper at a predetermined contractual yield in the event of a severe disruption in the short-term funding market.

Net revenues earned from fees associated with these liquidity commitments were \$2 million and \$5 million for the three and nine months ended September 30, 2007, and \$1 million and \$2 million for the three and nine months ended September 30, 2006.

Bank of America Corporation 3rd Quarter 10-Q

The Corporation enters into commitments to extend credit such as loan commitments, SBLCs and commercial letters of credit to meet the financing needs of its customers. For additional information on commitments to extend credit, see *Note 13 – Commitments and Contingencies* to the Consolidated Financial Statements filed on Exhibit 99.2 to the Corporation's Current Report on Form 8-K filed on May 23, 2007. The unfunded legally binding lending commitments shown in the following table are net of amounts distributed (e.g., syndicated) to other financial institutions of \$35.4 billion and \$30.5 billion at September 30, 2007 and December 31, 2006. The carrying amount of these commitments, excluding fair value adjustments as discussed below, was \$422 million and \$444 million at September 30, 2007 and December 31, 2006 and was recorded in accrued expenses and other liabilities. At September 30, 2007, the carrying amount included deferred revenue of \$30 million and a reserve for unfunded legally binding lending commitments of \$392 million. At December 31, 2006, the carrying amount included deferred revenue of \$47 million and a reserve for unfunded legally binding lending commitments of \$397 million

Written Put Options

At September 30, 2007 and December 31, 2006, the Corporation provided liquidity support in the form of written put options on \$10.0 billion and \$2.1 billion of commercial paper issued by CDOs, including \$3.2 billion issued by a consolidated CDO at September 30, 2007. The commercial paper is the most senior class of securities issued by the CDOs and benefits from the subordination of all other securities, including AAA-rated securities, issued by the CDOs. The Corporation is obligated under the written put options to provide funding to the CDOs by purchasing the commercial paper at predetermined contractual yields in the event of a severe disruption in the short-term funding market. These agreements have various maturities ranging from two to five years. The underlying collateral in the CDOs includes mortgage-backed securities, asset-backed securities, and CDO securities issued by other vehicles. These written put options are recorded as derivatives on the Consolidated Balance Sheet and are carried at fair value with changes in fair value recorded in trading account profits (losses). Derivative activity related to these entities is included in *Note 4 – Derivatives* to the Consolidated Financial Statements.

State Street Corporation 3rd Quarter 10-Q

In our business activities, we assume liquidity risk and a modest amount of interest-rate risk in managing longer-term assets or asset pools which are funded on a short-term basis, or where the customers participating in these products may have a right to the return of cash or assets on limited notice. These business activities include, among others, the unconsolidated asset-backed commercial paper conduits managed by our Structured Products group, securities finance collateral pools and money market and other short-term investment funds. In the commercial paper conduits, for example, pools of medium- and long-term financial instruments, principally mortgage- and other asset-backed securities, are financed through the issuance of short-term commercial paper. The conduits strive to maintain a positive margin between the rate of return on their longer-term assets and the

short-term cost of funding, and they mitigate their interest-rate risk primarily by investing in longer-term, higher-return floating-rate securities. This mismatch in the maturity of the investment pools and funding creates risk if disruptions occur in the liquidity of the short-term debt or asset-backed securities markets, or if the cost of short-term borrowings exceeds the conduits' rate of return on the investment securities portfolio. In connection with the administration of the activities of the commercial paper conduits, we provide contractual back-up liquidity to the conduits if they cannot meet their liquidity needs through the issuance of commercial paper. These contractual obligations include the liquidity asset purchase agreements, described in the "Off-Balance Sheet Arrangements" section of Management's Discussion and Analysis in Part I of this Form 10-Q. Other institutions can and do provide liquidity to the conduits. In the event that maturing commercial paper cannot be placed by the conduits, the liquidity providers are required by contract to, among other things, provide liquidity to the conduits by purchasing portfolio assets from them. We may also provide liquidity by purchasing commercial paper or providing other extensions of credit to the conduits. Beginning in the third quarter of 2007, asset-backed commercial paper conduits, including those sponsored by State Street, experienced significantly less liquidity and higher borrowing costs in the global fixed-income securities markets, and in a few cases, required liquidity support from their sponsoring bank. Although conditions have improved since late August and early September 2007, the fixed-income markets remain significantly disrupted, and the potential for decreased liquidity, increased funding costs and adverse asset valuations remains a material risk. While the conduits historically have rarely drawn upon our contractual back-up liquidity support, we on occasion have purchased, and during the third quarter of 2007 did purchase, commercial paper from the conduits, which we recorded in our consolidated balance sheet. We may do so again in the future. These purchases of commercial paper were funded from our general liquidity, and the liquidity asset purchase agreements were not drawn upon. The conduits are not recorded in our consolidated financial statements. However, if circumstances change we may be required, under existing accounting standards, to consolidate the conduits onto our consolidated balance sheet. For example, if changes in market conditions require us to update the assumptions in our expected loss model, we may be required to increase the amount of first-loss notes in order for the investors in the first-loss notes to continue to be considered the primary beneficiaries of the conduits. If, for some reason, the conduits are not able to issue additional first-loss notes or take other actions, we may be determined to be the primary beneficiary of the conduits, and would be required to consolidate the conduits' assets and liabilities onto our consolidated balance sheet. Additional information about our use of an expected loss model and the third-party investors in first-loss notes is provided in note 8 to the consolidated financial statements in this Form 10-Q. Existing accounting standards may be changed or interpreted differently in the future in a manner that increases the risk of consolidation of the conduits. Consolidation, or the purchase of assets of the conduits pursuant to the contractual agreements described above, could affect the size of our consolidated balance sheet and related funding requirements, our financial and regulatory capital ratios and, if the conduit assets include unrealized losses, could require us to recognize those losses. Because of our contractual agreements to purchase assets from the conduits through the liquidity asset purchase agreements under specified conditions, we are also exposed to the credit risks in the conduits' portfolios. Additional information about the size and composition of the conduits' balance sheets is included in the "Off-Balance Sheet Arrangements" section of Management's Discussion and Analysis in Part I of this Form 10-Q.

Other of our business activities that involve managing pools of assets that are funded in the short-term markets and invested in longer-term markets include managing securities finance collateral pools and money market and other short-term investment funds. These businesses involve similar risks inherent in an arbitrage of funding and investment; however, in these businesses, we primarily act in an agency capacity and do not have the

direct principal risk. For example, if a collateral pool or a money market fund that we manage were to have unexpected liquidity demands from investors in the pool that exceeded available liquidity, the investment pools would be required to sell assets to meet those redemption requirements. During periods of disruption in the credit markets, it may be difficult to sell the assets held by these pools at a reasonable price. In those circumstances, the financial loss accrues to the pools' investors and not to us. Similarly, credit risks inherent in these portfolios are attributable to the investors in the investment pools and not to State Street. These investment pools may have significant exposure to individual credits. While we do not bear the direct financial risks of these pools, the incurrence of substantive losses in these pools, particularly in money market funds, could result in significant harm to our reputation and significantly and adversely affect the prospects of our associated business units. In some circumstances, we may seek to mitigate that risk by compensating the investment pools for all or a portion of such losses even if not contractually obligated to do so; however, that would potentially result in the recognition of significant losses or a greater use of capital than we have available. Investment, operational and other decisions and actions, often made to achieve scale and other benefits, are implemented over multiple investment pools as applicable, increasing the opportunity for losses, even small losses, to have a significant effect. To mitigate these risks to the investment pools, we seek to prudently manage the duration and credit exposure of the pools, to satisfy large liquidity demands by the in-kind delivery of securities held by the pools and to closely monitor liquidity demand from investors; however, market conditions or increased defaults could result in our inability to effectively manage those risks. To some degree, all of our investment management pools hold potential risks to our reputation and business prospects if the asset pools that we manage have higher than anticipated redemption or other liquidity requirements and the pools incur losses to meet such demands.

State Street Corporation 3rd Quarter 10-Q

Asset-Backed Commercial Paper Programs

We established our first asset-backed commercial paper program in 1992, primarily to satisfy the demand from our institutional customers, particularly mutual fund customers, for commercial paper for their money market funds. Currently, we administer four third-party owned, multi-seller asset-backed commercial paper programs, or "conduits," that purchase financial instruments, predominantly securities from the capital markets. These conduits, which are structured as special purpose, bankruptcy-remote entities, provide our customers with short-term investment products for cash management and other investment purposes, and asset sellers with access to the efficiencies of the global commercial paper markets, which have historically offered an attractive cost of financing relative to bank-based borrowing. Our relationship with the conduits is contractual. We hold no direct or indirect equity ownership in these entities.

Under FASB Interpretation No. 46(R), or FIN 46(R), issued in December 2003, the conduits meet the definition of variable interest entities. In applying the provisions of FIN 46(R), we apply an expected loss model to the activities of the conduits to determine the primary beneficiaries of the conduits. As a result of application of this model, we concluded that we were not the primary beneficiary of the conduits, as defined by FIN 46(R), and as a result, we do not record these conduits in our consolidated financial statements. The conduits have third-party investors who hold subordinated debt issued by the conduits. These investors are in a first-loss position and bear the majority of the expected losses, as defined by FIN 46(R), of the conduits. We reperform our expected loss model at least quarterly, and more frequently if specific events occur.

During the third quarter of 2007, as a result of certain disruptions in the global fixed-income securities markets, we reviewed the underlying assumptions incorporated in our FIN 46(R) expected loss model. We concluded that our model assumptions were appropriate and were reflective of market participant assumptions, and appropriately considered the probability of, and potential for, the recurrence of recent events. At September 30, 2007 and December 31, 2006, total assets in these unconsolidated conduits were \$29.21 billion and \$25.25 billion, respectively.

In the normal course of business, asset purchases are funded by the conduits' issuance of commercial paper. We support the conduits' liquidity contractually through liquidity asset purchase agreements and back-up liquidity lines of credit. The majority of these liquidity support arrangements are provided by us. Other institutions can and do provide liquidity to the conduits. In addition, we provide direct credit support to the conduits in the form of standby letters of credit. Our commitments under these liquidity asset purchase agreements and back-up lines of credit totaled \$29.20 billion, and our commitments under the standby letters of credit totaled \$1.04 billion, at September 30, 2007.

We earn fees from our role as administrator, liquidity or credit enhancement provider, derivative counterparty, and as one of the dealers, which fees are priced on a market basis. These fees are recorded in processing fees and other revenue in our consolidated statement of income.

The conduit structure is not designed to distribute interest-rate and/or foreign currency risk to commercial paper investors or the subordinated note holders. Accordingly, the conduits take measures to mitigate these risks through the use of derivative financial instruments. These derivative transactions are generally entered into with State Street Bank as a counterparty, and are based upon market observable rates and indices. Among the most significant derivative transactions are basis swaps, whereby the conduit receives its cost of funds and pays LIBOR plus a spread to State Street Bank. This structure mitigates a portion of the risk of erosion in the expected spread between the conduits' cost of funds and the respective currency LIBOR rate.

Deterioration in asset performance or certain other factors, including the ability of the conduits to continue to access the commercial paper market, may shift the asset risk from the commercial paper investors to us as the liquidity or credit enhancement provider. In addition, the conduits may need to draw upon the back-up facilities to repay maturing commercial paper. In these instances, we would either acquire assets from the conduits or make loans to the conduits secured by the conduit's assets.

Collateralized Debt Obligations

We manage a series of collateralized debt obligations, or CDOs. A CDO is a managed investment vehicle which purchases a portfolio of diversified highly-rated assets. A CDO funds purchases through the issuance of several tranches of debt and equity, the repayment and return of which are linked to the performance of the assets in the CDO. Typically, our involvement is as collateral manager. We may also invest in a small percentage of the debt issued. These entities typically meet the definition of a variable interest entity as defined by existing accounting standards. We are not the primary beneficiary of these CDOs, and as a result do not record these CDOs in our consolidated financial statements. At September 30, 2007 and December 31, 2006, total assets in these CDOs were \$5.93 billion and \$3.48 billion, respectively.

Countrywide Financial Corporation 3rd Quarter 10-Q

The Company has formed two special purpose entities (Park Granada and Park Sienna) to finance certain of its mortgage loans held for sale using commercial paper. These entities issue commercial paper in the form of extendible short-term secured liquidity notes ("SLNs"). SLNs are issued with initial maturities of up to 180 days; under certain conditions, the issuer can extend the maturity dates of the SLNs for an additional period of up to 180 days. The SLNs bear interest at prevailing money market rates approximating LIBOR. While these facilities remain contractually available, given the lack of liquidity in the extendible SLN segment of the commercial paper market, borrowings under these facilities are not available at this time.

For the nine months ended September 30, 2007, the average borrowings under these facilities totaled \$13.5 billion and the weighted-average interest rate of the SLNs was 5.36%. At September 30, 2007, the weighted-average interest rate of the SLNs was 5.36% and the Company had pledged \$0.3 billion in mortgage loans held for sale and \$0.1 billion of loans held for investment to secure the SLNs.

For the nine months ended September 30, 2006, the average borrowings under these facilities totaled \$18.9 billion and the weighted-average interest rate of the SLNs was 5.01%. At September 30, 2006, the weighted-average interest rate of the SLNs was 5.44% and the Company had pledged \$6.9 billion in mortgage loan inventory to secure the SLNs.

Countrywide Financial Corporation 3rd Quarter 10-Q

In the ordinary course of our business we engage in financial transactions that are not reflected on our balance sheet. (See Note 2—*Summary of Significant Accounting Policies* in our 2006 Annual Report for a description of our consolidation policy.) Such transactions are structured to manage our interest rate, credit or liquidity risks, to diversify funding sources or to optimize our capital.

Most of our off-balance sheet arrangements relate to the securitization of mortgage loans. Our mortgage loan securitizations are normally structured as sales in accordance with Statement of Financial Accounting Standards No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* ("SFAS 140"), and involve the transfer of mortgage loans to qualifying special-purpose entities that are not subject to consolidation. In a securitization, an entity transferring the assets is able to sell those assets for cash. Special-purpose entities used in such securitizations obtain cash by issuing securities representing beneficial interests in the transferred assets to investors. In a securitization, we customarily provide representations and warranties with respect to, and we generally retain the right to service, the transferred mortgage loans.

We also generally have the right to repurchase mortgage loans from the special-purpose entity pursuant to a clean-up call, which is exercised when the costs exceed the benefits of servicing the remaining loans.

Our Prime Mortgage Loans generally are securitized on a non-recourse basis, while Prime Home Equity and Nonprime Loans generally are securitized with limited recourse for credit losses. During the nine months ended September 30, 2007, we securitized \$23.0 billion in Nonprime Mortgage and Prime Home Equity Loans with limited recourse for credit losses. Our exposure to credit losses related to our limited recourse securitization activities is limited to the carrying value of our subordinated interests and to the contractual limit of reimbursable losses under our corporate guarantees less the recorded liability for such guarantees. For a further discussion of our exposure to credit risk, see the section in this Report entitled *Management's Discussion and Analysis of Financial Condition and Results of Operations—Credit Risk Management*.

We do not believe that any of our off-balance sheet arrangements have had, or are reasonably likely to have, a current or future material effect on our financial condition, results of operations, liquidity, capital expenditures or capital resources.

Our material contractual obligations were summarized and included in our 2006 Annual Report. There have been no material changes outside the ordinary course of our business in the contractual obligations as summarized in our 2006 Annual Report during the nine months ended September 30, 2007.

Issuing Short-Term Financing

Issuing Commercial Paper (Including ARS and Other Short-Term Liquidity Facilities)

General Motors Corporation 3rd Quarter 10-Q

GMAC's liquidity and ongoing profitability are, in large part, dependent upon its timely access to capital and the costs associated with raising funds in different segments of the capital markets. Currently, its primary sources of financing include public and private securitizations and whole loan sales. To a lesser extent, GMAC also uses institutional unsecured term debt, commercial paper and retail debt offerings. Reliance on any one source can change going forward.

GMAC depends and will continue to depend on its ability to access diversified funding alternatives to meet future cash flow requirements and to continue to fund our operations. Negative credit events specific to GMAC or GM, or other events affecting the overall debt markets have adversely impacted GMAC's funding sources, and continued or additional negative events could further adversely impact its funding sources, especially over the long term. ResCap's access to capital can be impacted by changes in the market value of its mortgage products and the willingness of market participants to provide liquidity for such products.

ResCap's liquidity may also be adversely affected by margin calls under certain of its secured credit facilities that are dependent in part on the lenders' valuation of the collateral securing the financing. Each of these credit facilities allows the lender, to varying degrees, to revalue the collateral to values that the lender considers to reflect market. If a lender determines that the value of the collateral has decreased, it may initiate a margin call requiring ResCap to post additional collateral to cover the decrease. When ResCap is subject to such a margin call, it must provide the lender with additional collateral or repay a portion of the outstanding borrowings with minimal notice. Any such margin call could harm ResCap's liquidity, results of operation, financial condition, and business prospects. Additionally, in order to obtain cash to satisfy a margin call, ResCap may be required to liquidate assets at a disadvantageous time, which could cause it to incur further losses and adversely affect its results of operations and financial condition.

Recent developments in the market for many types of mortgage products (including mortgage-backed securities) have resulted in reduced liquidity for these assets. Although this reduction in liquidity has been most acute with regard to nonprime assets, there has been an overall reduction in liquidity across the credit spectrum of mortgage products. One consequence of this reduction is that ResCap may decide to retain interests in securitized mortgage pools that in other circumstances it would sell to investors, and ResCap will have to secure additional financing for these retained interests. If ResCap is unable to secure sufficient financing for them, or if there is further general deterioration of liquidity for mortgage products, it will adversely impact ResCap's business. If ResCap is unable to maintain adequate financing or if other sources of capital are not available, it could be forced to suspend, curtail or reduce certain aspects of its operations, which could harm ResCap's revenues, profitability, financial condition and business prospects.

Furthermore, GMAC utilizes asset and mortgage securitizations and sales as a critical component of its diversified funding strategy. Several factors could affect its ability to complete securitizations and sales, including conditions in the securities markets generally, conditions in the asset-backed or mortgage-backed securities markets, the credit quality and performance of its contracts and loans, its ability to service its contracts and loans and

a decline in the ratings given to securities previously issued in its securitizations. Any of these factors could negatively affect the pricing of GMAC's securitizations and sales, resulting in lower proceeds from these activities.

Ambac Financial Group Inc. 3rd Quarter 10-Q

Ambac Assurance has a series of perpetual put options on its own preferred stock. The counterparty to these put options are trusts established by a major investment bank. The trusts were created as a vehicle for providing capital support to Ambac Assurance by allowing it to obtain immediate access to new capital at its sole discretion at any time through the exercise of the put option. If the put option were exercised, Ambac Assurance would receive up to \$800 million in return for the issuance of its own perpetual preferred stock, the proceeds of which may be used for any purpose, including the payment of claims. The preferred stock would give investors the rights of an equity investor in Ambac Assurance. Such rights are subordinate to insurance claims, as well as to the general unsecured creditors of Ambac Assurance. Dividend payments on the preferred stock are cumulative, subject to certain limited exceptions, only if Ambac Assurance pays dividends on its common stock. Each trust is restricted to holding high-quality short-term commercial paper investments to ensure that it can meet its obligations under the put option. To fund these investments, each trust has issued its own auction market perpetual securities. The auction for these securities occurs every 28-days. Beginning in August 2007, a disruption in the auction market caused the auction for these securities to fail. As a result, existing investors were required to maintain their position in the securities and the distribution rate on such securities increased to the maximum rate (100 basis points over one month LIBOR). The impact of this failed auction on Ambac Assurance was an increase in the cost of the put option premium paid to the trusts. Due to the timing of each of the auctions the full impact of the higher put option premium will not be realized until the fourth quarter of 2007. Each trust is rated AA/Aa2 by Standard & Poor's and Moody's, respectively. During the nine months ended September 30, 2007 and 2006, Ambac Assurance incurred fees related to these perpetual put options of \$2.9 million and \$2.6 million, respectively. These fees are included as Corporate expenses on the Consolidated Statements of Operations. Each trust is rated AA/Aa2 by Standard & Poor's and Moody's, respectively.

Liquidity and Capital Resources

Luminent Mortgage Capital Inc. 3rd Quarter 10-Q

Liquidity and Capital Resources

As noted previously, we have experienced significant reductions in liquidity since August 2007 due to recent market deterioration in the mortgage industry. Short-term financing methods previously available to us, such as the issuance of commercial paper, the availability of repurchase agreement financing and the use of warehouse lines of credit have become cost prohibitive or significantly less available and, in some cases, have been eliminated.

Currently, our main source of liquidity is our cash flow from operations, primarily monthly principal and interest payments we receive on our mortgage-backed securities and \$781.5 million of repurchase agreements in good standing including a \$74.0 million repurchase agreement arranged by Arco as of September 30, 2007. In addition, Arco has entered into a definitive credit agreement with us to provide a liquidity line of credit and subsequent to September 30, 2007 increased total available financing to \$190.0 million. See Note 5 and Note 14 to our consolidated financial statements for further information on the Arco agreements.

Our long-term financing includes a combination of the issuance of mortgage-backed notes that provide financing for our whole loan portfolio and CDOs for the financing of certain mortgage-backed securities. At September 30, 2007, we had \$4.0 million of mortgage-backed notes with a weighted-average borrowing rate of 5.37% and \$294.5 million of CDOs with a weighted-average borrowing rate of 6.37%. This long-term financing is non-recourse to us.

Our immediate goal is to stabilize our portfolio by ensuring stable financing for the securities we intend to hold and liquidating assets we do not intend to hold in order to repay borrowings and provide us with additional liquidity. As part of this stabilization effort, management has implemented cost reduction strategies including reductions in personnel in an effort to ensure that our current cash flow meets our liquidity needs. We regularly review opportunities in the market to improve our liquidity and maximize profitability for the long-term. If our cash resources at any time are insufficient to satisfy our liquidity requirements, we may be required to liquidate additional mortgage-related assets or incur additional debt, sell equity securities or consider other strategic alternatives. If required, the sale of mortgage-related assets at prices lower than the carrying value of such assets could result in additional losses.

Countrywide Financial Corporation 3rd Quarter 10-Q

As discussed under the section *Liquidity and Capital Resources*, during the quarter ended September 30, 2007, we were affected by illiquidity in both the secondary mortgage market and in the debt markets that we have historically relied upon to meet our short-term financing needs. We regularly plan for contingencies that include disruptions in the marketplace and we place major emphasis on the adequacy, reliability and diversity of our funding sources. However, the dislocations in the secondary and debt markets that occurred during the quarter ended September 30, 2007, were historically unusual, requiring us to take significant additional steps to maintain our access to financing during the period of disruption.

During the quarter ended September 30, 2007, each of the three major credit rating agencies downgraded our credit ratings. Notwithstanding the downgrades, we maintain "investment grade" credit ratings, with long-term ratings of A-, Baa3 and BBB+ by Standard & Poor's, Moody's Investors Service and Fitch, respectively. Subsequent to September 30, 2007 Standard & Poor's further downgraded our long-term rating to BBB+.

At September 30, 2007, the Bank exceeded the OTS regulatory capital requirements to be classified as "well capitalized," with a Tier 1 capital ratio of 7.3% and a total risk-based ratio of 13.5%.

Washington Mutual Inc. 3rd Quarter 10-Q

Liquidity is essential to the Company's business. The Company's liquidity may be affected by an inability to access the capital markets or by unforeseen demands on cash. This situation may arise due to circumstances beyond the Company's control, such as a general market disruption. During 2007, there has been significant volatility in the capital markets. In the third quarter of 2007, this volatility led to a severe secondary mortgage market disruption resulting in an illiquid market for loans backed by nonconforming mortgage collateral. While these market conditions persist, the Company's ability to raise liquidity through the sale of mortgage loans in the secondary market will be adversely affected. The Company cannot predict with any degree of certainty how long these market conditions may continue, nor can it anticipate the degree of impact such market conditions will have on loan origination volumes and gain on sale results. In response to market conditions and events affecting the Company subsequent to the end of the quarter, (see Part II, Item 1 – "Legal Proceedings") several rating agencies have assigned a negative outlook to the Company. The Company

cannot predict whether rating agencies will take further negative actions with respect to the Company's outlook or credit ratings. Such actions could have the effect of increasing the Company's borrowing costs. For further discussion of liquidity, see Management's Discussion and Analysis – "Liquidity Risk and Capital Management."

E*TRADE Financial Corporation 3rd Quarter 10-Q

Our liquidity and capital resources enable us to fund our operating activities, finance acquisitions and grow our assets. Cash flows are derived from our operations in the retail and institutional segments and our capital market activities. The segment cash flows provide capital to fund growth in our regulated subsidiaries. The Company's cash and equivalents balance decreased to \$1.4 billion for the period ended September 30, 2007.

Corporate Debt

Our current senior debt ratings are Ba2 (positive outlook) by Moody's Investor Service⁽¹⁾, BB- (stable) by Standard & Poor's and BB (high) by Dominion Bond Rating Service ("DBRS"). The Company's long-term deposit ratings are Baa3 (positive outlook) by Moody's Investor Service⁽¹⁾, BB+ (stable) by Standard & Poor's and BBB (low) by DBRS. A significant change in these ratings may impact the rate and availability of future borrowings.

Liquidity Available from Subsidiaries

Liquidity available to the Company from its subsidiaries, other than Converging Arrows, Inc. ("Converging Arrows"), is limited by regulatory requirements. Converging Arrows is a subsidiary of the parent company. At September 30, 2007, Converging Arrows had \$59.4 million of cash and investment securities available as a source of liquidity for the parent company. Converging Arrows is not restricted in its dealings with the parent company and may transfer funds to the parent company without regulatory approval. In addition to Converging Arrows, brokerage and banking subsidiaries may provide liquidity to the parent; however, they are restricted by regulatory guidelines.

E*TRADE Bank is prohibited by regulations from lending to the parent company. At September 30, 2007, E*TRADE Bank had approximately \$192.6 million of capital available for dividend declaration without regulatory approval while still maintaining "well capitalized" status. E*TRADE Bank is also required by Office of Thrift Supervision ("OTS") regulations to maintain tangible capital of at least 1.50% of tangible assets. E*TRADE Bank satisfied this requirement at September 30, 2007 and December 31, 2006. However, events beyond management's control, such as a significant deterioration in residential real estate and credit markets, could adversely affect future earnings and E*TRADE Bank's ability to meet its future capital requirements.

Brokerage subsidiaries are required to maintain net capital equal to the greater of \$250,000 or 2% of aggregate debit balances arising from customer transactions. At September 30, 2007 and December 31, 2006, all of our brokerage subsidiaries met their minimum net capital requirements. The Company's broker-dealer subsidiaries had excess net capital of \$745.2 million at September 30, 2007, of which \$489.8 million is available for dividend while still maintaining a capital level above regulatory "early warning" guidelines.

Other Sources of Liquidity

In addition to the liquidity available from subsidiaries, the parent company held \$103.4 million in cash available as a resource. We maintain committed financing facilities with banks totaling \$250.0 million to meet corporate liquidity needs and \$576.0 million in uncommitted financing to meet margin lending needs. There were no outstanding balances,

and the full \$826.0 million was available under these lines at September 30, 2007 and December 31, 2006.

We rely on borrowed funds, such as FHLB advances and securities sold under agreements to repurchase, to provide liquidity for the Bank. At September 30, 2007, the Bank had approximately \$14.4 billion in additional borrowing capacity.

Other Liquidity Matters

We currently anticipate that our available cash resources and credit will be sufficient to meet our anticipated working capital and capital expenditure requirements for at least the next 12 months. We may need to raise additional funds in order to support more rapid expansion, develop new or enhanced products and services, respond to competitive pressures, acquire businesses or technologies or take advantage of unanticipated opportunities.

Appendix C — Sample SEC Letter

Emphasizing Disclosures About Off-Balance-Sheet Entities

In December 2007, the Division of Corporation Finance sent the following illustrative letter to certain public companies. The letter identifies a number of disclosure issues registrants may wish to consider in preparing MD&A for their upcoming annual reports on Form 10-K or 20-F.

Illustrative Letter

December 2007

Name

Chief Financial Officer

XYZ Corporation

Address

Re: XYZ Corporation

File No. XX-XXXXX

Dear Chief Financial Officer:

We note you have disclosed that you are involved with certain non-consolidated conduits, [structured investment vehicles] and collateralized debt obligations (CDO). In this letter, we highlight some of the disclosure issues that you may want to consider regarding your off-balance sheet entities, to the extent they are material, as you prepare your Management's Discussion and Analysis for your upcoming Form 10-K [or 20-F] annual report.

In addressing the Item 303(a)(4) of Regulation S-K off-balance sheet arrangements disclosure requirement, you may want to consider disclosing the following items, to the extent they are applicable and material, for any non-consolidated conduit, [structured investment vehicle] or

CDO for which you have material exposure:

- Categories and rating of assets the off-balance sheet entity holds;
- Weighted-average life of assets the off-balance sheet entity holds;
- Forms of funding (commercial paper, medium-term notes, etc) and weighted-average life of the funding the off-balance sheet entity holds;
- Any material difficulties the off-balance sheet entity has experienced in issuing its commercial paper or other financing during the period;
- Any material write -downs or downgrades of assets the off-balance sheet entity holds;
- Maximum limit of the losses to be borne by any first loss note holders;
- Types of variable interests you hold in the off-balance sheet entity;
- Detailed disclosure regarding your obligations under the liquidity facilities. For example, consider the following items, to the extent applicable:
 - whether there are triggers associated with your obligations to fund,
 - whether there are any terms that would limit your obligation to perform,

- any obligations under the facilities (e.g., to purchase assets from or commercial paper the off-balance sheet entity issued), and their material terms,
- whether there are any other liquidity providers, and if so, how your obligation ranks with the other liquidity providers;
- Whether you purchased commercial paper or other securities issued by any off-balance sheet entities that you manage, and whether any agreement required you to make these purchases. If not, consider discussing your reasons for the purchase;
- Whether you provided or assisted the off-balance sheet entity in obtaining any other type of support, or whether it is your current intention to do so; and
- Potential impact on debt covenants, capital ratios, credit ratings, or dividends, should you be required to consolidate the entity or incur significant losses associated with the entity.

To the extent that you have identified consolidation and variable interest entities as a critical accounting policy, you may want to consider discussing in your filing:

- the scenarios where you would have to consolidate the off-balance sheet entity, and your expectation of the likelihood of such consolidation; and
- the frequency of which you reconsider, and the typical triggers which require you to reconsider, whether you are the primary beneficiary of the entity.

Finally, we remind you of the Item 303 requirement to discuss any known trends or uncertainties that you may reasonably expect to have a material favorable or unfavorable impact on your income from operations, liquidity and capital resources. In this regard, please consider, to the extent material in light of your particular facts and circumstances, disclosing the amount of any material loss you expect to realize as a result of your involvement with any material off-balance sheet entity.

Please contact me if you have any questions.

Sincerely,

Senior Assistant Chief Accountant