



Letters to the Editor

July 1, 2008

The following letter is in response to Robert Pardes' article last week, [The Mortgage Crisis Part II - Is the Bleeding Over?](#):

Dear Editor

I enjoyed reading your article on The Mortgage Crisis. Could you please provide more explanation on Recourse Exposure and its potential losses? If these loans are not reflected on balance sheets, then where are they reflected?

Anonymous

Dear Anonymous,

I am pleased to address your question. Specifically, you asked where the loss reserves for recourse exposure reside if not on the balance sheet of the Issuer/Depositor.

The pool of mortgages formerly on the balance sheet of the Issuer is transferred to a special purpose vehicle or trust which is the securitization. This transaction, under current accounting rules, is treated as a sale and any profit is recorded based upon the proceeds from sale of interests in the trust (MBS tranches) and the assets are no longer deemed to be on the balance sheet (hence no reserve for loan losses) of the Issuer. They are on the balance sheet of the Trust (which technically doesn't maintain financial statements, just reporting detail regarding cash flow, loan level data, etc.). The trust doesn't establish reserves but rather takes losses as they are incurred and shortfalls in interest or principal in underlying collateral impact the various tranches in the securitization based upon established priorities and subordinations.

The point of the article is that, based upon defects in the collateral amounting to breach of representations and warranties provided by the Issuer/Depositor or some other party, many of the loans will find themselves back on the balance sheet of the original transferee along with the related losses or loss reserve requirements. To the extent that this has not happened yet due to delay in



forensic reviews of securitization, then there will be a delay in the recording of the exposure.

I hope this is helpful.

Robert M. Pardes

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