

FSP FAS 157-4 – AAA CMBS Example

I. Security Characteristics

- CMBS security originally issued in 2007
- AAA, Super Senior tranche
- 30% credit enhancement
- 2016 maturity, 5.45% coupon at inception

II. Comparative Prices Determined Under Previous, Proposed, and New Guidance

- **FAS 157:** Exit Value as determined by Independent Pricing Service (“IPS”) = **65.5**
- **Proposed FSP FAS 157-e:** Modeled fair value as defined in 157-e assuming active market = **90.9**
- **FSP FAS 157-4:** Exit Value as weighted based on various information available = **66.9**

III. Additional Support for FSP FAS 157-4 Valuation Exercise

- Determined there has been a significant decrease in volume and level of activity when compared to normal market activity for the asset. Indicators of inactivity included: (a) significantly reduced # of bidders, (b) price quotations vary substantially by source, (c) AAA CMBX and cash instruments vary substantially, (d) implied yield of greater than 15%, and (e) bid-ask spreads increased from 1-2 bps to 25 bps.
 - Minimal information available to reliably determine if observed transactions are orderly;
 - As a result, prices from different sources weighted to derive FSP FAS 157-4 estimated price
- Determination of Relative Price Weights to Determine Single Price Estimate Under FSP FAS 157-4:
 - IPS price: **65.5**; 40% weighting due to lack of transparency into support for pricing;
 - Internally determined price based on assumed “active” market: **90.9**, 0% weighting due to departure from exit value
 - Internally determined price based on information obtained from analyst reports: **67.8**, 60% weighting due to increased transparency
- Detail Supporting Calculated Values:
 - **Cash flows used for “internally determined” prices obtained from an independent third-party provider; cash flows are stochastically projected and loss-adjusted contractual cash flows**
 - **Internally determined price based on assumed “active” market:**
 - **Risk-free rate = 1.67%** (5-year Constant Maturity Treasury, as of 3/31/2009)
 - **Credit spread for this security assumed to be 583 bps (calculated as 7.5% target rate less risk free rate);** rate is consistent with a 3-6 year WAL and low probability of default.
 - Does not include full illiquidity adjustment observed in current market
 - Resulting discount rate of **7.5%**
 - **Company calculated valuation using relevant reports issued by analysts:**
 - **Risk-free rate = 1.67%** (5-year Constant Maturity Treasury, as of 3/31/2009)
 - **Add 1,300 bps:** According to a research report from external bank, AAA-rated commercial mortgage-backed securities traded at Swaps plus 1300 bps
 - **Add 54 bps:** Benchmark used for discount rate is risk-free 5-yr Treasury rate, and published credit spread is spread to swaps; basis adjustment required obtained from Bloomberg.
 - **Subtract 100 bps:** Adjust for difference between the AAA 5-yr CMBS published spreads and the 30% Subordinated AAA Super Senior security chosen for this example.
 - Total market rate of return used **14.21%**

Based on the preceding, it is clear that FSP FAS 157-4 purports to allow reporting entities to use significant judgment in: determining whether a market is active or inactive; determining whether a transaction in an inactive market is orderly or disorderly and; estimating the value through the use of a discounted cash flow model of a security that is associated with an inactive market. The fundamental issue, however, is that after all of the management judgment described is applied, 157-4 says that you nonetheless have to arrive at a value that is consistent with the notion of “exit value” contained in SFAS 157 based on the market as it exists at the measurement date. Accordingly, if the market is inactive at the measurement date and credit/liquidity spreads are significantly wider than historically noted or what we think is reasonable based on the risk of the asset we nonetheless have to conform to prices indicative of the current market at the measurement date which is representative of liquidation prices when markets are inactive. So while management judgment is allowed, the guidance nonetheless brings you back to a liquidation value.