



**What Your Company Needs to Know About
the Subprime Crisis
May 8, 2008**

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Know About the Subprime Crisis**

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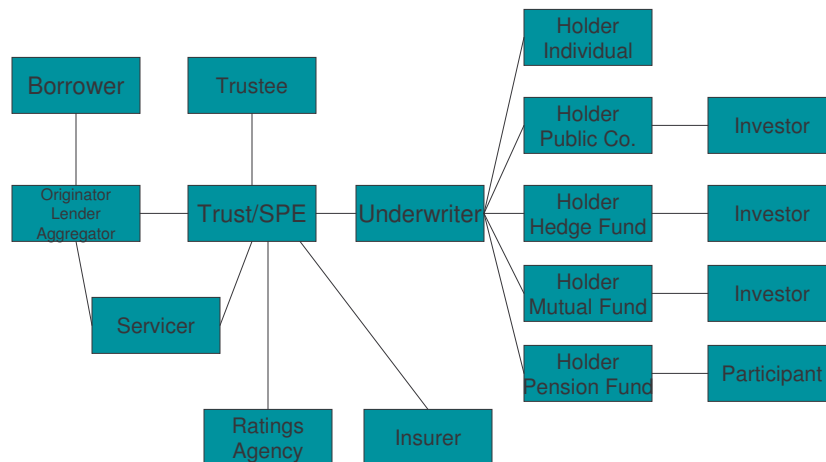
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It All Started When...



Credit: Jack Ohman, The Oregonian

Basic Structure of the Deals



Directors' And Officers' Duties

- Applies to directors and senior managers
- Fiduciary duties
 - Due care
 - Loyalty
 - Good faith
- Business Judgment Rule applies

D&O Duties – Before The Fall

- Risk Management and Disclosure
 - Risk Management as Part of Controls
 - Identification
 - Assessment
 - Evaluation
 - Mitigation
 - Valuation

D&O Duties – After The Fall

🌐 Risk Management and Disclosure

- Types of Risks
 - Operational
 - Performance
 - Capital/Assets
 - Liquidity
- Disclosure
 - Risk Factors
 - Critical Accounting Estimates/Policies
 - Current Situation and Consequences
 - SEC Guidance

Fair Value Accounting Requirements

- 🌐 FAS 157/9 defines “fair value” under US GAAP as well as provide guidance on fair value disclosures
- 🌐 *“Fair value is the price that would be received for an asset or paid to transfer a liability in a current transaction between marketplace participants in the reference market for the asset or liability.”* (FAS 157)
- 🌐 Goal of FAS 157/9 is to arrive at fair value, but to also use as many observable, market based parameters as possible
- 🌐 Additional disclosures are needed when parameters are used with significant management judgments

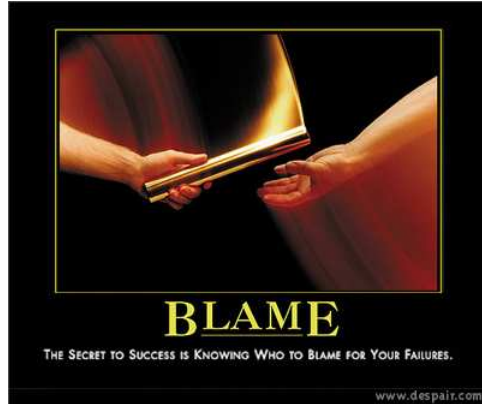
Challenges Of Fair Value Accounting

- In current markets, it has been difficult to determine fair values, particularly in the area of subprime
- Limited transactions and the breadth of collateral and structures have made it difficult to estimate fair value
- Companies have had to develop or enhance processes to value transactions
 - Use of proxy data
 - Model driven prices
 - Assessing quality of Rating Agency rating
 - Enhanced controls, documentation and governance

Outcome Of Reporting Fair Values

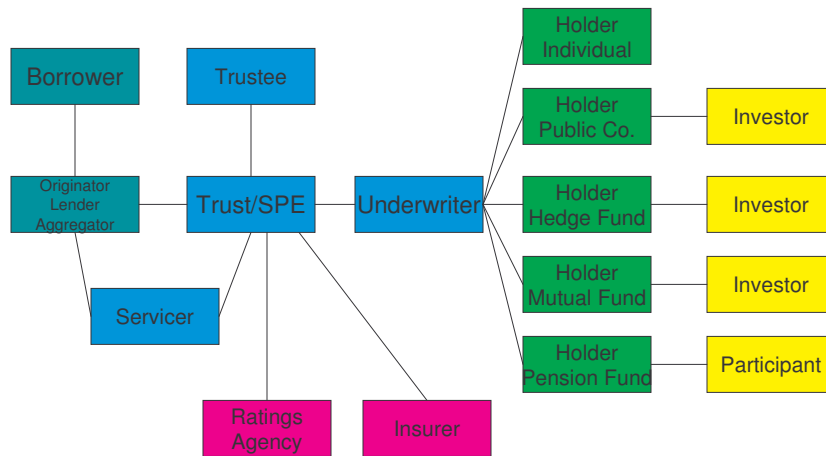
- Arguably more volatility in earnings – significant write downs with losses taken sooner
- Potentially less comparability of results between companies
- Business and process changes

...And the fingers started to be pointed

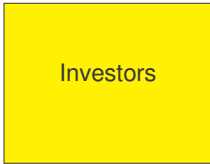


Credit: www.despair.com

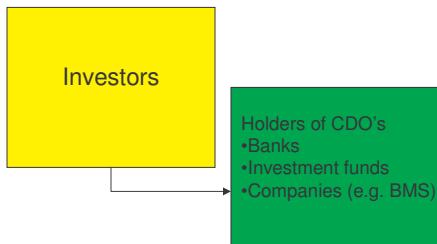
Structure of the Deals



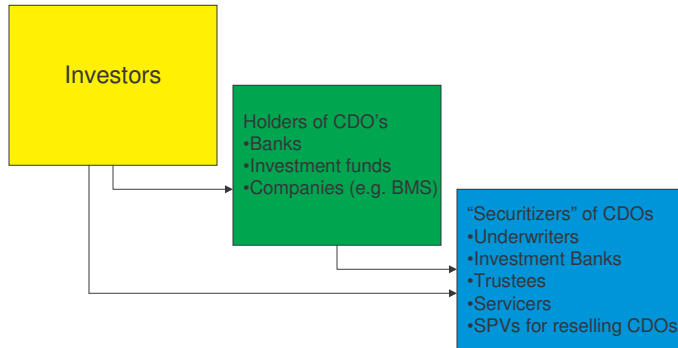
The Subprime Waterfall – Who’s Suing Whom – or Who Might...



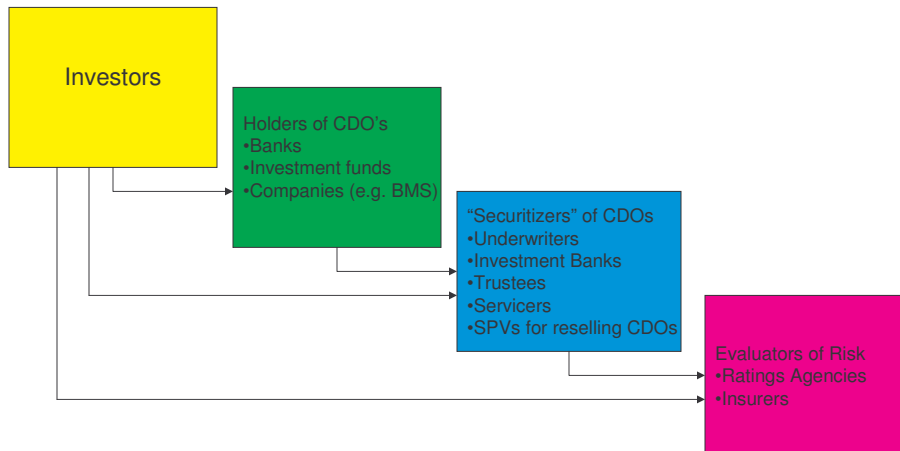
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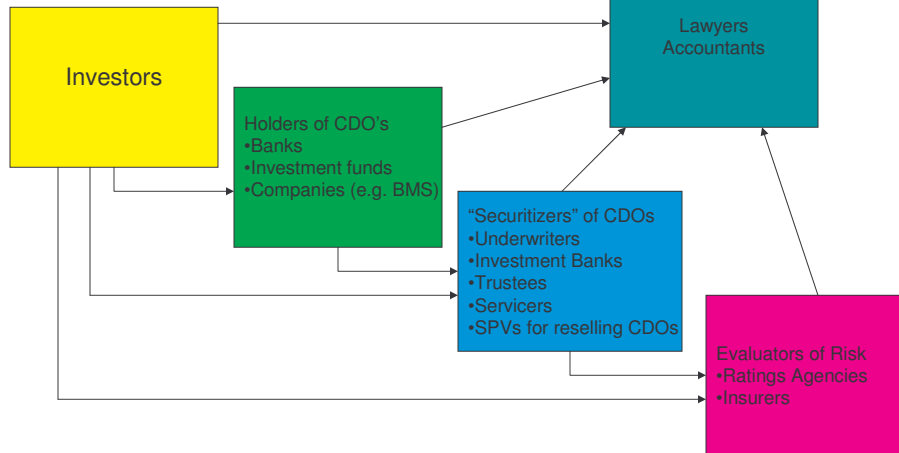
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Types of Claims

- 1933 Act
 - Misstatements in registration statement or prospectus
 - Control person liability
- 1934 Act
 - Securities fraud (Rule 10b-5)
 - Control person liability
- Investment Company Act of 1940
 - Investment Advisors Act of 1940
- Derivative Actions – breaches of fiduciary duties
- ERISA
- Contract Claims
- Borrower Claims

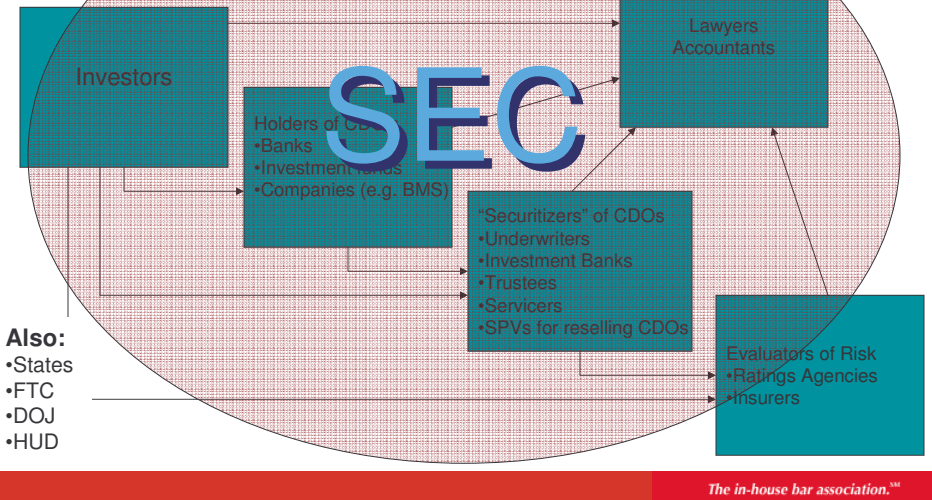
Potential Defenses

- For 1933 Act claims
 - Misstatement or Omission
 - Securities purchased in the IPO or the secondary market?
 - Loss Causation

Potential Defenses

- For 1934 Act Claims (Rule 10b-5)
 - Misstatement or Omission
 - Scienter (intent to deceive)
 - Loss Causation

The Subprime Waterfall - Who's Suing Whom - or Who Might...



SEC Enforcement - Task Force

- Subprime Task Force Formed
 - At least 120 attorneys assigned in NY offices alone
 - Task Force reportedly has 48 active investigations underway
 - Commissioner Christopher Cox and Director Linda Chatham Thomson actively speaking on subprime regulatory and enforcement issues

SEC Enforcement – Priorities

- Lenders - - how accounted for loan portfolio
- Investment banks – what they disclosed to buyers and their investors
- Brokers/dealers – what they said to purchasers
- Inside traders – whether they made money from material, non-public information
- Also, credit rating agencies, insurers, investment advisers and home builders.

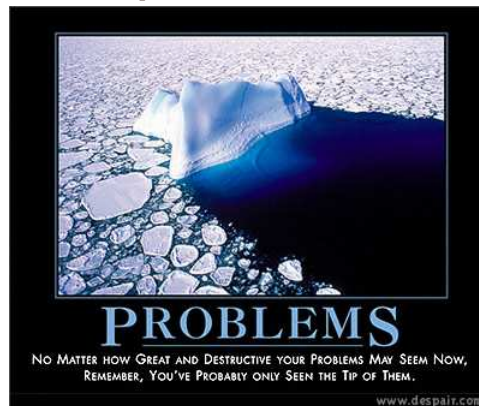
Insurance Issues And Risks

- Policies Affected:
 - D&O
 - E&O/Costs of Corrections
 - ERISA/Fiduciary

Insurance Issues And Risks

- Coverage Issues:
 - Insuring Agreement & Definitions
 - Intentional conduct exclusions
 - Personal profit exclusions
 - Insured v. Insured exclusions
 - Diminution of value exclusions
 - Professional services exclusions (D&O)
 - Breach of contract exclusions
 - ERISA exclusions (D&O/E&O)
 - Consent of insurer to settlement
 - Subrogation
 - Rescission

Just the tip of the iceberg?



Credit: www.despair.com

Q&A