

**“The Global Financial Crisis:
Securitization and Fair Value Reporting Practices”**

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❧ CERTIFICATE OF AUTHORSHIP/ORIGINALITY ❧

I certify that the work in this thesis has not previously been submitted for a degree nor has it been submitted as part of requirements for a degree except as fully acknowledged within the text.

I also certify that the thesis has been written by me. Any help that I have received in my research work and the preparation of the thesis itself has been acknowledged. In addition, I certify that all information sources and literature used are indicated in the thesis.

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ABBREVIATIONS

AFS	Available-for-Sale
BCBS	Basel Committee on Banking Supervision
CEO	Chief executive officer
CFC	Countrywide Financial Corporation
COP	Congressional Oversight Panel
Countrywide	Countrywide Financial Corporation
CRMPG	Counterparty Risk Management Policy Group
EESA	Emergency Economic Stabilization Act of 2008
EITF	Emerging Issues Task Force
ERP	Economic Report of the President
Fannie Mae	Federal National Mortgage Association
FASB	Financial Accounting Standards Board
FHA	Federal Housing Administration
Freddie Mac	Federal Home Loan Mortgage Corporation
Form 8-K	The <i>current report</i> that U.S. listed companies must file with the U.S. Securities and Exchange Commission to announce major events that shareholders should know about
Form 10-K	The <i>annual report</i> that U.S. listed companies must file with the U.S. Securities and Exchange Commission which provides a comprehensive overview for the company's business and financial conditions and includes the audited financial statements.
Form 10-Q	The <i>quarterly report</i> that U.S. listed companies must file with the U.S. Securities and Exchange Commission which includes unaudited financial statements and provides a continuing view of the company's financial position during the year
FVO	Fair Value Option
GAAP	Generally Accepted Accounting Principles

ABBREVIATIONS CONTINUED

GAO	U.S. Government Accountability Office
GFC	Global Financial Crisis
Ginnie Mae	Government National Mortgage Association
GSEs	Government Sponsored Enterprises which include Ginnie Mae, Freddie Mac, and Fannie Mae
HFS	Held-for-Sale
IMF	International Monetary Fund
<i>Level 1</i>	Assets (liabilities) measured in to accord to FAS 157, that require the use of quoted prices (unadjusted) in active markets for identical assets or liabilities
<i>Level 2</i>	Assets (liabilities) measured in to accord to FAS 157, that require the use of inputs other than quoted prices included within <i>Level 1</i> that are observable for the asset or liability, either directly or indirectly
<i>Level 3</i>	Assets (liabilities) measured in to accord to FAS 157 that require the use of inputs that are unobservable for the asset or liability
LIBOR	London Inter Bank Offering Rate
MBSs	Mortgage-backed securities
MSRs	Mortgage Servicing Rights
OFHEO	Office of Federal Housing Enterprise Oversight
OLS	Ordinary Least Squares
OPS	Office of the Press Secretary
Originate-to-distribute	The business of originating mortgage loans and selling those mortgage loans by way of securitization
OTS	Office of Thrift Supervision
PWGFM	President's Working Group on Financial Markets
QSPE	Qualifying special purpose entity

ABBREVIATIONS CONTINUED

Schedule RC-P	Schedule RC-P, <i>1-4 Family Residential Mortgage Banking Activities in Domestic Offices</i> is to be completed by all banks with \$1 billion or more in total assets and those banks with less than \$1 billion in total assets where the residential mortgage banking activities exceeds \$10 million for two consecutive quarters
SEC	United States Securities and Exchange Commission
SFAS	Statement of Financial Accounting Standards
SFAS 140	Financial Accounting Statement No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities-a replacement of FASB Statement No. 125
SFAS 157	Financial Accounting Statement No. 157, Fair Value Measurement
SIFMA	Securities Industry and Financial Markets Association
SOX	The Sarbanes-Oxley Act of 2002
SPE	Special Purpose entity
U.S.	United States
VA	Veterans Administration

❧ ABSTRACT ❧

This thesis examines securitization and fair value reporting practices during the global financial crisis. Specifically, Chapter 2 evaluates the circumstances surrounding the financial distress experienced by Countrywide Financial Corporation (Countrywide). Chapter 3 evaluates whether the information disclosures released by Countrywide in the lead up to its near-bankruptcy provided information about the risks that other firms were exposed to more generally, and whether this information was reflected in the stock prices of the other firms. Finally, Chapter 4 examines whether the concerns relating to the relevance of *Level 3* financial assets measured under Statement of Financial Accounting No. 157 are primarily attributable to those assets arising as a consequence of securitization transactions (i.e., retained interests and mortgage service rights) rather than *Level 3* assets generally. The primary motivation for this thesis is to contribute to the regulatory debate that is occurring in the aftermath of the global financial crisis (GFC). Of particular concern is whether this debate is correctly identifying the causes of the GFC and to provide evidence relating to: claims of the lack of transparency associated with securitization transactions, and whether the criticism directed at financial reporting is correctly focused.

The key findings of this thesis suggest that while Countrywide perhaps is an extreme example, its mortgage banking activities and the sudden financial distress it experienced as a consequence of these activities, typified the problems that beset firms in the financial services sector during the GFC. The risks associated with Countrywide's securitization activities were not well reflected in the financial statements, and the disclosures of these transactions and their cumulative impacts are not clearly disclosed which likely impeded investors' pricing decisions. The results of Chapter 3 provide evidence consistent with the concern that the opacity and complexity of securitization activities reduced the capacity of investors to value the firms' equity. During the six months preceding Countrywide's acceptance of the Bank of America's offer of a \$4.1 billion merger deal (January 11, 2008), Countrywide released material disclosures to the Securities and Exchange Commission (on Form 8-K). These disclosures generated significant abnormal returns to the common stock of the (non-) regulated and non-financial firms' common stock which is consistent with the disclosures releasing information that alerted investors to the true risk levels common to other firms. The magnitude of the returns realized can partially be explained by the firms' securitization activities, leverage, liquidity and profitability.

Chapter 4 provides evidence that concerns relating to the reduced relevance of *Level 3* fair value assets are primarily attributable to those assets arising as a consequence of securitization transactions (i.e., retained interests and mortgage service rights) rather than *Level 3* assets generally. Furthermore there is evidence that the disclosures relating to securitization transactions are likely insufficient and potentially relevant information is being omitted from the financial reports. Accordingly, the criticism being leveled against Statement of Financial Accounting Standards No. 157 might more correctly be directed towards Statement of Financial Accounting Standards No. 140 (FASB 2000).