

How "Bullet Proof" is Your Asset Transfer Deal?

In an effort to improve their balance sheets and secure attractively priced funding, many companies have turned to asset transfer deals over the past several years. We are generically referring to securitization, off-balance-sheet partnerships and other "special purpose" vehicles that are designed to transfer the benefits and risks of ownership to external investors. As complicated as these transactions often are in and of themselves, recent negative publicity over the propriety and transparency of transactions between companies under common control has produced heightened market and regulatory scrutiny and has introduced de facto documentation standards that sometimes exceed written guidelines. In this article, we will highlight the issues affecting the marketplace and offer a way to provide your investors, creditors, and auditors with greater comfort that asset transfer transactions are soundly executed.

ASSET TRANSFERS

First, a primer on asset transfers. Transaction sponsors will typically structure these deals to sell investors bonds or ownership interests in a specific pool of assets, generally liquid receivables, mortgages, or investment securities. To provide investors with the comfort that the underlying assets are secure (and to secure off-balance-sheet accounting treatment), the assets are often transferred to a Special Purpose Entity (SPE) with a limited operating charter. The SPEs are carefully structured so that, even in the event of bankruptcy of the sponsoring company, the assets will remain isolated from other creditors and dedicated to supporting the debt service requirements of the investors.

Attorneys supporting the work of deal underwriters or sponsors will then be asked to provide a "true sale" opinion in order to provide legal comfort that the desired degree of isolation has, indeed, been accomplished. Since the validity of these true sale opinions is often contingent on the assumption that adequate consideration was received by the sponsor for the transferred assets, management of the sponsoring company needs to provide assurance to its investors, creditors, and auditors that the isolation requirements have not been undermined by a "non-arms-length" pricing structure.

Interpretations of existing technical accounting and auditing literature have led many of the Big Five accounting firms to adopt similarly stringent internal policies for these deals. Furthermore, heightened market scrutiny over the probity of asset transfers between companies under common control has now caused company management to carefully evaluate all aspects of these transactions to ensure that they will not come back to haunt them at a later date.

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How "Bullet Proof" is Your Asset Transfer Deal? *(continued)*

VALUATION PROVIDES SUPPORT FOR TRUE SALE

Here's where Valuation Research can help. We recently completed an engagement for a major utility company that was securitizing receivables from its residential customers. The company's regular auditor, who interpreted existing accounting standards to require an independent valuation opinion on transactions with its SPE, referred us in.

The purpose of the engagement was to provide support for 1) the true sale opinion issued by the company's attorneys, the validity of which was contingent on the assumption that adequate consideration was received by the sponsor, and 2) the financial reporting and disclosure process, which requires an assessment of fair value. As an independent valuation expert, we developed a fair value formula that considered charge-offs, type of receivable, aging history, collection costs, and return requirements, among other factors.

These same considerations apply to other securitizations as well as to off-balance-sheet partnership arrangements, and we can extend similar procedures to other deal structures and asset types. If you're concerned about the adequacy of the protection provided to your investors, creditors, auditors or attorneys, or simply want to provide greater comfort on your asset transfer transaction, contact Managing Director Mark Brattebo at Valuation Research's Princeton office, (609) 243-7006.

Lastly, it is particularly important for current or prospective deal sponsors to recognize that this topic is currently receiving a lot of scrutiny and is best viewed as a "moving target." Congressional inquiries stemming from the accounting and reporting activities that contributed to the demise of Enron has created an opportunity for the Securities and Exchange Commission to take an activist stance in reviewing these deals. This, in turn, has caused the SEC to push the Financial Accounting Standards Board (FASB) to quickly close perceived loopholes. As a result, sponsoring companies should carefully consider both the technical requirements and practical consequences of these deals and remain in constant contact with their underwriters, attorneys, and accountants as this marketplace continues to unfold. **VR**