

## Articles re: Gain on Sale Accounting at Green Tree Financial

(NOTE CAREFULLY THE DATES!!!)

- Article 1: (10-17-97) Motley Fool explains gain on sale accounting, how it can lead to problems, but how Green Tree is “conservative”.
- Article 2: (6-30-98) Conseco finalizes acquisition of Green Tree.
- Article 3: (7-13-98) Conseco announces a \$500 million after-tax charge because of bad estimates associated with gain on sale accounting.
- Articles 4 and 5 (2001 and 2002) Conseco files for bankruptcy – the third largest in US history.

### EXCERPTS FROM THE MOTLEY FOOL – OCT 17, 1997

**GREEN TREE FINANCIAL** ([NYSE: GNT](#)) posted quarterly earnings of \$0.85 per share, up 39% over the year-ago period and two cents ahead of the consensus forecast.

Getting back to **Green Tree**, should you look at the company's [press release](#), you'll see that a bit over \$200 million of Green Tree's \$348.3 million in quarterly income derived from something called "gain on contract sales." Since many individual investors -- and not a few analysts -- are unsure about just what gain on contract sales is, I thought I might offer a brief explanation.

Unlike banks or "thrifts," financial services businesses such as Green Tree do not have a ready source of capital from deposits. Instead, they raise capital by bundling up loans that they've made and offering for sale to investors -- that is, "securitizing" -- the stream of income the loan portfolio will provide as borrowers repay their loans over time. You may have read that rock star David Bowie did much the same thing not too long ago: he securitized the future earnings he'd be receiving from his composing, recording, and performing.

Anyhow, when Green Tree securitizes the loans it makes to finance, say, purchases of manufactured homes (MH), it retains the rights to service those loans and also much of the credit risk. For that, it expects to keep for itself a share of the income.

To take a simple example, suppose Green Tree made a bunch of MH loans at an average rate of 12%. These loans are then packaged and offered for sale in the asset-backed market at a "coupon" of, let's say, 9%. The three percentage-point "spread" is kept by Green Tree, and that's called the "residual."

That residual is not pure profit, of course. After all, Green Tree has to service the loans: collect the payments, dun the delinquents, repossess and resell the mobile homes in extreme instances, and otherwise manage risks of default and early prepayment. Whatever is likely to be left over after all those costs are factored in that's the "gain on sale."

Now comes the complicated part. According to accounting rules, companies like Green Tree record a gain on sales on the day the loan package is securitized. In order to calculate that gain, the company must estimate default rates, prepayment rates, and whatnot and discount back to present value the expected stream of income to Green Tree resulting from the "residual."

Even without following all the details, it's pretty obvious that there's plenty of room in this factoring and discounting for, um, "aggressive" companies to utilize various rosy scenarios in order to maximize their reported gains on sales. And just as they did not too long ago for a certain nation near and dear to our hearts, Rosy Scenarios have a way of eventually transforming themselves into Darkness at Noon. A quick look at the wreckage of a MERCURY FINANCE ([NYSE: MFN](#)) or a JAYHAWK ACCEPTANCE ([Nasdaq: JACQE](#)) will illustrate the point amply.

Happily, not all financial services outfits practice the accounting chicanery of a Mercury Finance or a David Stockman. Green Tree, in particular, has demonstrated to the satisfaction of the green eyeshade crowd at [Standard & Poor's](#) that it employs appropriately conservative assumptions in figuring its gains on sales. Historical results for Green Tree have shown actual gains to be in line with, or even occasionally greater than, those that the company had projected.

### **Excerpts from: Conseco Completes Green Tree Acquisition**

CARMEL, Ind.--(BUSINESS WIRE)--June 30, 1998--**Conseco**, Inc. (NYSE:CNC) today completed its acquisition of **Green Tree Financial** Corporation (NYSE:GNT) for approximately \$6 billion in stock. The transaction was approved earlier today by the shareholders of both companies.

**Conseco** Chairman Stephen C. Hilbert said, "We are thrilled to welcome Green Tree's outstanding management team, its 6,000 employees and its 20,000 consumer finance dealers to the **Conseco** family. **Conseco** has become one of the largest financial service companies in America, with more than \$65 billion of balance sheet assets, managed investments and finance receivables. **Conseco** now offers a full range of life insurance, health insurance and consumer finance products and services to more than 11 million customers throughout middle America.

"With the addition of Green Tree," Hilbert said, "**Conseco** is better prepared to fulfill its long-standing mission: Protect wealth. Create wealth. Our goal for life.(SM) Our customers get a wider array of product choices and the security of **Conseco's** financial strength. Our agents gain a leadership position in the market--and the means to keep it. Our employee associates benefit by having more opportunities to serve our customers. And our investors get new avenues for growth with the company that posted the best total returns in the Fortune 500 from 1987 to 1997."

The Green Tree acquisition, **Conseco's** 20th in its 16 years as an operating company, is the largest in **Conseco's** history.

Also as previously announced, the acquisition is being accounted for as a pooling of interests, and **Conseco** expects the acquisition to be accretive to its earnings per share beginning with 3Q98 results. **Conseco** will report quarterly results on a pooled basis beginning with 2Q98.

### **Excerpts from: Big Prepays Hurt 2 Subprime Lenders**

Eric Avidon

**13 July 1998**

National Mortgage News

New York-Two leading subprime mortgage lenders, ContiFinancial Corp. here and Carmel, Ind.-based Conseco Inc., now the parent company of Green Tree Financial, took a hit to their earnings for the quarter ended June 30, as a result of high loan prepayment volume.

Each company released an earnings preview statement last Monday in which they said that because of higher than expected prepayment speeds their earnings from securitized loan pools will be lower than initially projected, projections that were already put on the balance sheet as income gained.

Conseco said that it will take charges of \$498 million as a result of its acquisition of Green Tree, \$148 million in merger-related charges and a \$350 million writedown related to securitized loan pools.

Commenting on the hit related to Green Tree, Conseco chairman Stephen C. Hilbert said, "We have increased the assumed prepayment speeds used in calculating the value of Green Tree's interest-only securities. Existing loans, especially those securitized from 1995 to 1997, have in recent months been prepaying faster than Green Tree expected in its yearend 1997 model because of the continued decline in interest rates.

"Our higher estimates of prepayment speeds take current prepayment levels into account, as well as our expectation that some further interest rate declines may occur," Mr. Hilbert added.

Following Conseco's preview statement, which was also made on July 6th, the company's shares dropped a mere six cents per share to \$50 and throughout the week continued trading at or around \$50 per share. The hits to ContiFinancial and **Conseco** are just the latest two in a long line of subprime lenders who have been caught off guard by prepayment speeds, including: Advanta, Cityscape, Mego Mortgage, Green Tree once before, First Alliance and FirstPlus.

## Excerpts from articles on Conseco's bankruptcy

*November 25, 2001*

Hundreds of thousands of lower-income trailer-home owners face tough times ahead as the economy slows and the results of poor lending practices become evident. Trailers, also called manufactured homes, made up more than half of all new homes sold in 1997 and 1998. From 1991 to 1998, annual sales of the units more than doubled, from 174,000 to 374,000.

But the wheels began coming off around the turn of the century, when it became clear that [Green Tree Financial](#) and other lenders had written hundreds of thousands of loans on terms that made it nearly impossible for the homeowners to meet their monthly payments. Tens of thousands have already defaulted and been evicted and it's expected that hundreds of thousands more will follow.

Consumers who default on their loans not only lose their homes, they wind up with huge debts and ruined credit.

The go-go years in manufactured homes were driven by loose accounting practices, inflated reports to investors and high-pressure sales tactics at the local level. Green Tree and other lenders began offering 30-year loans instead of the 15-year notes that had been standard in the business. The longer mortgage lowers the monthly payment slightly but more than doubles the cost of the loan.

Many consumers who bought mobile homes looked only at the monthly payment and did not realize they were committing to a 30-year loan on a temporary structure, what accountants call a "wasting asset."

Trailers are vehicles, after all, and they depreciate nearly as fast as cars and trucks, having practically no value after ten years, whereas traditional single-family homes nearly always appreciate, becoming more valuable as time goes by.

With interest rates of 15 percent or more on 30-year loans, trailer home buyers wind up being "upside down," with a debt that far exceeds the value of their home. This makes it impossible for them to trade up to a larger home, refinance or take out a second mortgage when their financial situation changes.

Green Tree is now Conseco Finance, the lending arm of Conseco, a large financial services company headquartered in Indiana. Conseco now has serious problems of its own and is saddled with \$26 billion in loans on trailer homes. It expects to take huge losses on the trailer loans and is also facing problems in its insurance division. Many Wall Street analysts are predicting the company will slide into bankruptcy later this year. Its stock is down 92 percent from its peak in 1998.

The company says it is working with borrowers who run into trouble. But even so, it concedes that it will repossess one in five of the new trailer homes it finances, *The New York Times* reported. It expects a default rate of 50 percent on the loans it writes on repossessed homes.

Meanwhile, sales have fallen back to 1990 levels. Only about 180,000 are expected to be sold this year. The resulting glut further erodes the resale value of existing units.

*December 18, 2002*

Long teetering on the brink, insurance and finance giant Conseco has filed for Chapter 11 bankruptcy protection. It's the third-largest corporate bankruptcy filing in history.

The company collapsed under a huge debt load resulting from a rash of acquisitions in the 1990s, including the \$6 billion purchase of Green Tree, the nation's largest lender to mobile-home buyers.

The portfolio of mobile-home loans and other consumer finance products will be sold under an agreement with two groups of investors. The bankruptcy filing does not include Conseco's insurance operations, which regulators and the company insist are sound.

Under the terms of a tentative bankruptcy agreement, Conseco Finance Corp. will be sold to CFN Investment Holdings LLC. Conseco Finance became insolvent after it failed to make a \$4.7 million payment that was due Dec. 4.

Conseco is the nation's 26th-largest life insurance company. It collected \$5.6 billion in premiums last year and has 5.7 million policyholders. Its portfolio includes traditional life insurance, annuities and supplemental health coverage.

Conseco's troubles began two years ago, in what some say was a foreshadowing of Enron and other celebrated collapses. The company went on an acquisition binge, taking on a huge debt load that is now the basis of its plight.

Most observers see Conseco's purchase of [Green Tree Financial](#) as its downfall ([story](#)). Green Tree was the nation's largest lender in the mobile home market, which turned out to be much riskier than Conseco had realized.