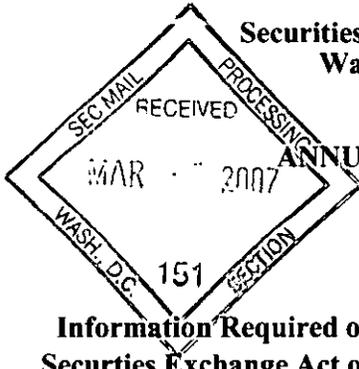


UNITED STATES  
Securities and Exchange Commission  
Washington, D.C. 20549

OMB APPROVAL  
OMB Number: 3235-0123  
Expires: February 28, 2010  
Estimated average burden  
per response..... 12.00



ANNUAL AUDITED REPORT  
FORM X-17A-5



07005387

SEC FILE NUMBER  
8-27640

PART III

FACING PAGE

Information Required of Brokers and Dealers Pursuant to Section 17 of the  
Securities Exchange Act of 1934 and Rule 17a-5 Thereunder

REPORT FOR THE PERIOD BEGINNING 1/1/2006 AND ENDING 12/31/2006  
MM/DD/YY MM/DD/YY

A. REGISTRANT IDENTIFICATION

NAME OF BROKER-DEALER:

Countrywide Securities Corporation

OFFICIAL USE ONLY  
FIRM ID. NO.

ADDRESS OF PRINCIPAL PLACE OF BUSINESS (Do not use P.O. Box No.)

4500 Park Granada  
(No. and Street)

Calabasas CA 91302  
(City) (State) (Zip Code)

NAME AND TELEPHONE NUMBER OF PERSON TO CONTACT IN REGARD TO THIS REPORT

Steven E. Hively (818) 225-3574  
(Area Code - Telephone No.)

B. ACCOUNTANT IDENTIFICATION

INDEPENDENT PUBLIC ACCOUNTANT whose opinion is contained in this Report\*

KPMG LLC  
(Name - if individual, state last, first, middle name)

PROCESSED  
MAR 29 2007  
J THOMSON  
FINANCIAL

355 South Grand Avenue, Suite 2000 Los Angeles CA 90071-1568  
(Address) (City) (State) (Zip Code)

CHECK ONE:

- Certified Public Accountant
- Public Accountant
- Accountant not resident in United States or any of its possessions.

FOR OFFICIAL USE ONLY

\*Claims for exemption from the requirement that the annual report be covered by the opinion of an independent public accountant must be supported by a statement of facts and circumstances relied on as the basis for the exemption. See section 240.17a-5(e)(2).

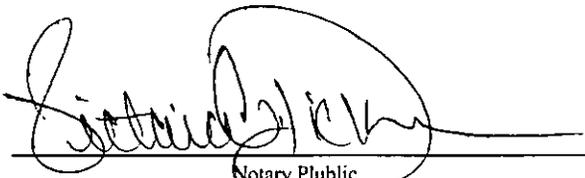
OATH OR AFFIRMATION

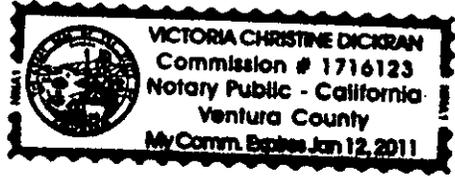
I, Steven E. Hively, swear (or affirm) that, to the best of my knowledge and belief the accompanying financial statement and supporting schedules pertaining to the firm of Countrywide Securities Corporation, as of December 31, 2006, are true and correct. I further swear (or affirm) that neither the company nor any partner, proprietor, principal officer or director has any proprietary interest in any account classified solely as that of a customer, except as follows:

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

  
signature

Chief Financial Officer  
Title

  
Notary Public



This report \*\* contains (Check all applicable boxes)

- (a) Facing page.
- (b) Statement of Financial Condition.
- (c) Statement of Income (Loss).
- (d) Statement of Changes in Financial Condition.
- (e) Statement of Changes in Stockholders' Equity or Partners' or Sole Proprietor's Capital.
- (f) Statement of Changes in Liabilities Subordinated to Claims of Creditors.
- (g) Computation of Net Capital.
- (h) Computation for Determination of Reserve Requirements Pursuant to Rule 15c3-3.
- (i) Information Relating to the Possession or control Requirements Under Rule 15c3-3.
- (j) A Reconciliation, including appropriate explanation, of the Computation of Net Capital Under Rule 15c3-1 and the Computation for Determination of the Reserve Requirements Under Exhibit A of Rule 15c3-3.
- (k) A Reconciliation between the audited and unaudited Statements of Financial Condition with respect to methods of consolidation.
- (l) An Oath or Affirmation.
- (m) A copy of the SIPC Supplemental Report.
- (n) A report describing any material inadequacies found to exist or found to have existed since the date of the previous audit.

\*\* For conditions of confidential treatment of certain portions of this filing, see section 240.17a-5(e)(3).

**COUNTRYWIDE SECURITIES CORPORATION AND SUBSIDIARY**  
(A Wholly Owned Subsidiary of Countrywide Capital Markets, Inc.)

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**KPMG LLP**  
Suite 2000  
355 South Grand Avenue  
Los Angeles, CA 90071-1568

## **Independent Auditors' Report**

The Board of Directors  
Countrywide Securities Corporation:

We have audited the accompanying consolidated statement of financial condition of Countrywide Securities Corporation and subsidiary (the Company), a wholly owned subsidiary of Countrywide Capital Markets, Inc., as of December 31, 2006, and the related consolidated statements of earnings, changes in stockholder's equity and comprehensive income, changes in subordinated borrowings, and cash flows for the year then ended that you are filing pursuant to rule 17a-5 under the Securities Exchange Act of 1934. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Countrywide Securities Corporation and subsidiary as of December 31, 2006, and the results of their operations and their cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Our audit was conducted for the purpose of forming an opinion on the basic consolidated financial statements taken as a whole. The information contained in Schedules I, II, and III is presented for purposes of additional analysis and is not a required part of the basic consolidated financial statements, but is supplementary information required by rule 17a-5 under the Securities Exchange Act of 1934. Such information has been subjected to the auditing procedures applied in the audit of the basic consolidated financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic consolidated financial statements taken as a whole.

**KPMG LLP**

February 28, 2007

**COUNTRYWIDE SECURITIES CORPORATION AND SUBSIDIARY**  
(A Wholly Owned Subsidiary of Countrywide Capital Markets, Inc.)

Consolidated Statement of Financial Condition

December 31, 2006

(Dollars in thousands)

<b>Assets</b>	
Cash	\$ 7,585
Cash segregated in compliance with federal regulations	97,500
Securities purchased under agreements to resell	21,877,772
Receivables from broker/dealers and clearing organizations	4,287,843
Receivables from customers	570,488
Trading securities owned, at fair value (\$1,465,517 pledged as collateral)	21,247,920
Memberships in exchanges, at cost (market value \$1,020)	686
Furniture, equipment, and leasehold improvements, at cost, less accumulated depreciation and amortization of \$9,179	17,307
Deferred tax assets, net	59,313
Other assets	255,658
Total assets	<u>\$ 48,422,072</u>
<b>Liabilities and Stockholder's Equity</b>	
Bank loan payable	\$ 105,049
Payables to broker/dealers and clearing organizations	179,982
Payables to customers	319,230
Trading securities sold, not yet purchased, at fair value	4,105,694
Securities sold under agreements to repurchase	42,014,023
Accounts payable and accrued liabilities	326,732
Intercompany income taxes payable	9,761
Due to affiliates	32,170
Total liabilities	<u>47,092,641</u>
Commitments and contingencies	
Stockholder's equity:	
Capital stock – no par value. Authorized 100,000 shares; issued and outstanding 30 shares	288
Additional paid-in capital	174,900
Accumulated other comprehensive loss – foreign currency translation adjustment	(697)
Retained earnings	1,154,940
Total stockholder's equity	<u>1,329,431</u>
Total liabilities and stockholder's equity	<u>\$ 48,422,072</u>

See accompanying notes to consolidated financial statements.

**COUNTRYWIDE SECURITIES CORPORATION AND SUBSIDIARY**  
(A Wholly Owned Subsidiary of Countrywide Capital Markets, Inc.)

Consolidated Statement of Earnings

Year ended December 31, 2006

(Dollars in thousands)

Revenues:		
Securities trading	\$	22,092
Underwriting activities		268,252
Conduit management fees		301,976
Interest earned		3,071,803
Other income		16,359
		<u>3,680,482</u>
Expenses:		
Employee compensation and benefits		269,456
Interest expense		2,889,644
Clearance fees		6,034
Occupancy and equipment		5,100
Communications and data processing		11,351
Other expenses		63,104
		<u>3,244,689</u>
Earnings before income taxes		435,793
Provision for income taxes		169,660
Net earnings	\$	<u><u>266,133</u></u>

See accompanying notes to consolidated financial statements.

**COUNTRYWIDE SECURITIES CORPORATION AND SUBSIDIARY**  
(A Wholly Owned Subsidiary of Countrywide Capital Markets, Inc.)

Consolidated Statement of Changes in Stockholder's Equity and Comprehensive Income

Year ended December 31, 2006

(Dollars in thousands)

	<u>Capital stock</u>	<u>Additional paid-in capital</u>	<u>Accumulated other comprehensive loss – foreign currency translation adjustment</u>	<u>Retained earnings</u>	<u>Total stockholder's equity</u>
Balances at December 31, 2005	\$ 288	165,940	(603)	888,807	1,054,432
Comprehensive income:					
Net earnings	—	—	—	266,133	266,133
Change in foreign currency translation adjustment	—	—	(94)	—	(94)
Total comprehensive income					<u>266,039</u>
Noncash capital contribution pursuant to stock-based compensation plans		4,698			4,698
Excess tax benefit related to stock-based compensation	—	4,262	—	—	4,262
Balances at December 31, 2006	\$ <u>288</u>	<u>174,900</u>	<u>(697)</u>	<u>1,154,940</u>	<u>1,329,431</u>

See accompanying notes to consolidated financial statements.

**COUNTRYWIDE SECURITIES CORPORATION AND SUBSIDIARY**  
(A Wholly Owned Subsidiary of Countrywide Capital Markets, Inc.)

Consolidated Statement of Changes in Subordinated Borrowings

Year ended December 31, 2006

(Dollars in thousands)

Subordinated borrowings at December 31, 2005	\$	—
Increases:		
Issuance of subordinated notes		—
Decreases:		
Payment of subordinated notes		—
Subordinated borrowings at December 31, 2006	\$	<u>—</u>

See accompanying notes to consolidated financial statements.

**COUNTRYWIDE SECURITIES CORPORATION AND SUBSIDIARY**  
(A Wholly Owned Subsidiary of Countrywide Capital Markets, Inc.)

Consolidated Statement of Cash Flows

Year ended December 31, 2006

(Dollars in thousands)

Cash flows from operating activities:	
Net earnings	\$ 266,133
Adjustments to reconcile net earnings to net cash used in operating activities:	
Depreciation and amortization	4,400
Stock-based compensation expense	4,698
Deferred tax benefit	(4,081)
Increase in cash segregated in compliance with federal regulations	(7,900)
Increase in securities purchased under agreements to resell	(2,487,479)
Decrease in receivables from broker/dealers and clearing organizations	700,216
Increase in receivables from customers	(273,649)
Increase in trading securities owned, at market value	(10,518,438)
Decrease in due from affiliates	3,065
Increase in other assets	(73,140)
Decrease in payables to broker/dealers and clearing organizations	(472,735)
Increase in payables to customers	180,606
Increase in trading securities sold, not yet purchased, at market value	1,844,707
Increase in securities sold under agreements to repurchase	10,985,485
Increase in accounts payable and accrued liabilities	25,587
Decrease in intercompany income taxes payable	(136,596)
Decrease in due to affiliates	(142,139)
Net cash used in operating activities	<u>(101,260)</u>
Cash flows used in investing activities:	
Purchase of furniture, equipment, and leasehold improvements	<u>(7,810)</u>
Net cash used in investing activities	<u>(7,810)</u>
Cash flows provided by financing activities:	
Excess tax benefits related to stock-based compensation	3,957
Net increase of short-term bank loan	<u>105,049</u>
Net cash provided by financing activities	<u>109,006</u>
Foreign currency translation adjustment	<u>(94)</u>
Decrease in cash	(158)
Cash at beginning of year	<u>7,743</u>
Cash at end of year	<u>\$ 7,585</u>
Supplemental disclosures of cash flow information:	
Interest paid	\$ 2,886,825
Taxes paid	308,075

See accompanying notes to consolidated financial statements.

**COUNTRYWIDE SECURITIES CORPORATION AND SUBSIDIARY**  
(A Wholly Owned Subsidiary of Countrywide Capital Markets, Inc.)

Notes to Consolidated Financial Statements

December 31, 2006

**(1) Organization and Nature of Business**

**(a) Organization**

Countrywide Securities Corporation and subsidiary (the Company) is a California corporation and is a wholly owned subsidiary of Countrywide Capital Markets, Inc. (the Parent), which in turn is a wholly owned subsidiary of Countrywide Financial Corporation, Inc. (CFC). The Company has a wholly owned subsidiary, Countrywide Capital Markets Asia Ltd. (the Subsidiary), that is incorporated in the Cayman Islands.

**(b) Nature of Business**

CSC is a broker/dealer registered with the Securities and Exchange Commission (SEC), is a member of the National Association of Securities Dealers, Inc. (NASD), and is an authorized counterparty (primary dealer) with the Federal Reserve Bank of New York in the performance of its open market operations. CSC trades mortgage-backed securities (MBS), U.S. government securities, and other fixed income securities with broker/dealers, institutional investors, and affiliates.

The Subsidiary is a securities dealership regulated by the Financial Services Agency, is a member of the Japanese Securities Dealers Association and the Japanese Investor Protection Fund, and maintains a sales office in Tokyo, Japan. The Subsidiary offers U.S. mortgage and government securities for sale to non-U.S. major financial institutions in Japan and other Asian countries.

**(2) Significant Accounting Policies**

**(a) Basis of Presentation**

The consolidated financial statements include the accounts of the Company. The Company is engaged in a single line of business as a securities broker/dealer, which comprises several classes of services, including principal transactions, agency transactions, and underwriting new issuances of securities. In addition, it performs conduit management activities, which include brokering and managing the acquisition, sale or securitization of whole loans on behalf of an affiliate. All material intercompany balances and transactions are eliminated in consolidation.

**(b) Use of Estimates**

In preparing financial statements in conformity with accounting principles generally accepted in the United States of America, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and revenues and expenses during the reporting period. Significant items subject to such estimates and assumptions include valuation of trading securities, valuation of whole loans underlying the conduit management fees, and accrued liabilities for guarantees. Actual results could differ from those estimates.

**COUNTRYWIDE SECURITIES CORPORATION AND SUBSIDIARY**  
(A Wholly Owned Subsidiary of Countrywide Capital Markets, Inc.)

Notes to Consolidated Financial Statements

December 31, 2006

**(c) *Securities Transactions***

Proprietary securities transactions in regular-way trades are recorded on the trade date, as if they had settled. Profit and loss arising from all securities transactions entered into for the account and risk of the Company are recorded on a trade-date basis. Customers' securities transactions are reported on a settlement-date basis with income and expenses reported on a trade-date basis.

Amounts receivable and payable for securities transactions that have not reached their contractual settlement date are recorded net on the consolidated statement of financial condition. Trading securities are carried at fair value, which is generally based on observable market prices. If observable market prices are not available, fair value is determined in good faith by management.

Fair values of forwards, interest rate swaps, and options contracts are recorded in trading securities owned or sold, not yet purchased, as appropriate. Open equity positions in futures transactions are recorded as receivables and payables from broker/dealers and clearing organizations.

**(d) *Securities Purchased under Agreements to Resell and Securities Sold under Agreements to Repurchase***

Transactions involving purchases of securities under agreements to resell (reverse repurchase agreements) or sales of securities under agreements to repurchase (repurchase agreements) are recorded at their contractual amounts plus accrued interest and are accounted for as secured borrowings except where the Company does not have an agreement to sell (or purchase) the same or substantially the same securities before maturity at a fixed or determinable price. It is the policy of the Company to obtain possession of collateral with a fair value equal to or in excess of the principal amount loaned under reverse repurchase agreements. Collateral is valued daily and the Company may require counterparties to deposit additional collateral or return collateral pledged when appropriate. These instruments are collateralized principally by mortgage-backed securities and government agency securities and generally have terms ranging from overnight to one year. The Company reports reverse repurchase agreements and repurchase agreements net by counterparty, when applicable, pursuant to FASB Interpretation 41, *Offsetting of Amounts Related to Certain Repurchase and Reverse Repurchase Agreements* (FIN 41). Excluding the impact of FIN 41, reverse repurchase agreements had a carrying amount of \$49.8 billion and repurchase agreements had a carrying amount of \$71.9 billion.

At December 31, 2006, the fair value of the collateral accepted related to reverse repurchase agreements was \$50.1 billion, of which \$2.8 billion was sold and \$46.7 billion was replpledged. Collateral pledged where the secured party does not have the right to sell or replpledge such collateral is included in securities purchased under agreements to resell and had a fair value of \$15.5 billion at December 31, 2006.

**(e) *Securities-Lending Activities***

Securities borrowed and securities loaned are recorded based upon the amount of cash collateral advanced or received. Securities borrowed transactions facilitate the settlement process and require the Company to deposit cash, letters of credit, or other collateral with the lender. With respect to

**COUNTRYWIDE SECURITIES CORPORATION AND SUBSIDIARY**  
(A Wholly Owned Subsidiary of Countrywide Capital Markets, Inc.)

Notes to Consolidated Financial Statements

December 31, 2006

securities loaned, the Company receives collateral in the form of cash or other collateral. The amount of collateral required to be deposited for securities borrowed, or received for securities loaned, is an amount generally in excess of the fair value of the applicable securities borrowed or loaned. The Company monitors the fair value of securities borrowed and loaned, with additional collateral obtained or excess collateral received, when deemed appropriate. Securities borrowed and securities loaned are included in receivables from and payables to broker/dealers and clearing organizations in the consolidated statement of financial condition. The Company reports securities borrowed and securities loaned net by counterparty, when applicable, pursuant to FASB Interpretation 39, *Offsetting Amounts Related to Certain Contracts* (FIN 39). Excluding the impact of FIN 39, securities borrow contracts had a carrying amount of \$5.4 billion at December 31, 2006.

At December 31, 2006, the fair value of the collateral accepted related to securities borrowed was \$5.3 billion, of which \$1.0 billion was sold and \$4.2 billion was repledged. Collateral pledged where the secured party does not have the right to sell or repledge such collateral is included in securities borrowed and had a fair value of \$0.6 billion at December 31, 2006.

**(f) Collateral**

The Company reports assets it has pledged as collateral in secured borrowing and other arrangements as trading securities owned, at fair value, when the secured party cannot sell or repledge the assets. All trading securities pledged as collateral to counterparties where the counterparty has the right, by contract or custom, to sell or repledge the securities are included in trading securities owned, at fair value, pledged as collateral, as required by SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities – a Replacement of SFAS No. 125*.

**(g) Trading Gains and Losses**

The Company buys, sells, and holds securities for trading purposes and to facilitate customer activity. Trading gains and losses arising from these buys and sells, as well as unrealized gains and losses arising from changes in the market value of trading inventory, are recorded net in gains and losses on principal transactions. All trading gains and losses associated with securities trading are recorded in the consolidated statement of earnings on the trade date.

Derivatives used for hedging and risk management purposes include interest rate swaps, forwards, futures, purchased options, and options written. Unrealized and realized gains or losses on these derivative contracts are recognized currently in the consolidated statement of earnings as trading gains and losses.

**(h) Underwriting Income**

Revenue earned is recognized on the settlement date of the respective underwritten transactions.

**(i) Translation of Foreign Currencies**

Assets and liabilities denominated in foreign currencies are translated at year-end rates of exchange, while the income statement accounts are translated at rates of exchange in effect at the time

**COUNTRYWIDE SECURITIES CORPORATION AND SUBSIDIARY**  
(A Wholly Owned Subsidiary of Countrywide Capital Markets, Inc.)

Notes to Consolidated Financial Statements

December 31, 2006

transactions occur. Gains or losses resulting from foreign currency transactions are included in net earnings.

**(j) Capitalized Software Costs**

Internal software development costs are capitalized to the extent of external direct costs of materials and services consumed and of salary costs relating to employees' time spent on the software project during the application development stage. Internally developed software is amortized over six to ten years using the straight-line method.

Capitalized software costs are evaluated for impairment annually or when changing circumstances indicate that amounts capitalized may be impaired. Impaired items are written down to their estimated fair value at the date of evaluation.

**(k) Depreciation**

Depreciation is provided on a straight-line basis using estimated useful lives of three to ten years. Leasehold improvements are amortized over the lesser of the economic useful life of the improvement or the term of the lease.

**(l) Exchange Memberships**

The Company's exchange memberships, which represent ownership interests in the exchanges and provide the Company with the right to conduct business on the exchanges, are recorded at cost or, if other-than-temporary impairment in value has occurred, at a value that reflects management's estimate of the impairment. Management believes that no such impairment existed before or at December 31, 2006 and the exchange memberships are recorded at cost.

**(m) Income Taxes**

The Company uses the balance sheet method to account for income taxes. Under this method, the net deferred tax asset or liability is based on the tax effects of the differences between the book and tax basis of assets and liabilities, and recognizes enacted changes in tax rates and laws. A valuation allowance is recognized if, based on the weight of available evidence, it is more likely than not that some portion or all of a deferred tax asset will not be realized.

Effective January 1, 2005, the Company and CFC entered into a Tax Allocation Agreement (the Tax Agreement). The Tax Agreement sets forth an agreement between the Company and CFC in filing a consolidated federal income tax return and various combined or consolidated state income tax or franchise tax returns. The Company pays CFC an amount equal to the lesser of the income tax liability that the Company would have paid if they filed a separate income tax return or the marginal increase in tax liability resulting from the Company's inclusion in the combined or consolidated income tax returns. The Tax Agreement provides for settlement via recordation through the intercompany account.

**COUNTRYWIDE SECURITIES CORPORATION AND SUBSIDIARY**  
(A Wholly Owned Subsidiary of Countrywide Capital Markets, Inc.)

Notes to Consolidated Financial Statements

December 31, 2006

**(n) Stock-Based Compensation**

Effective January 1, 2006, the Company adopted SFAS No. 123R, *Share-Based Payment*, (SFAS 123R), an amendment of SFAS No. 123, *Accounting for Stock-Based Compensation*, using the modified prospective application approach. In accordance with SFAS 123R, the Company began charging the unamortized value of previously granted employee stock options to compensation expense during the current period. For awards after January 1, 2006 made to retirement-eligible employees that vest upon retirement, the Company is required under SFAS 123R to immediately charge the associated value to expense. The value of grants made on or after January 1, 2006, to other employees must be amortized over the lesser of (a) the nominal vesting period or (b) for options that vest upon retirement, the period until the grantee becomes retirement-eligible.

As of December 31, 2006, the Company has awarded stock options and shares of restricted stock that, depending on the year granted and other factors, have different vesting requirements. Generally, stock options issued before 2004 vest over a period of three to four years and expire five or ten years after the grant date. Stock options awarded in 2004 become vested upon attainment of specific earnings performance targets or, in any event, four and a half years after the grant date regardless of attainment of the earnings targets and expire five years after the date of grant. Generally, stock options granted in 2005 were fully vested on the grant date. Stock options and stock appreciation rights awarded in 2006 vest over a three-year period and expire five to ten years after grant date. Off-cycle awards and awards to new employees have various vesting schedules. Generally, restricted stock awards vest over three years although some restricted stock awards granted in 2004 had a performance-based component similar to the stock options granted that year.

Stock option and stock appreciation right transactions for the Company under the Plans are as follows:

	<b>Number of shares</b>	<b>Weighted average exercise price</b>
Outstanding at beginning of year	2,428,426	\$ 23.39
Granted	915,133	36.45
Exercised	(672,990)	22.06
Expired, canceled, or transferred	(61,255)	31.85
Outstanding at end of year	2,609,314	\$ 27.87
Exercisable at end of year	1,333,645	\$ 24.08

**COUNTRYWIDE SECURITIES CORPORATION AND SUBSIDIARY**  
(A Wholly Owned Subsidiary of Countrywide Capital Markets, Inc.)

Notes to Consolidated Financial Statements

December 31, 2006

Outstanding stock options and stock appreciation rights under the Plans as of December 31, 2006 are summarized below:

Exercise price range	Outstanding			Exercisable		
	Weighted average remaining contractual life (years)	Number	Weighted average exercise price	Number	Weighted average exercise price	
\$ 4.25-8.50	0.4	4,000	\$ 6.77	4,000	\$ 6.77	
8.51-12.74	5.0	388,566	10.64	326,881	10.36	
12.75-16.99	6.1	266,668	14.69	150,664	14.69	
17.00-21.24	6.3	129,843	18.98	80,125	18.98	
29.75-33.98	2.7	965,104	32.25	771,975	32.34	
33.99-38.23	4.2	855,133	36.45	—	—	
	4.1	<u>2,609,314</u>	27.86	<u>1,333,645</u>	24.08	

Stock option and stock appreciation right exercise activity for the year ended December 31, 2006 is summarized below (dollars in thousands):

Cash proceeds	\$ 14,848
Intrinsic value	11,013

The table below summarizes restricted stock activity and related information for the year ended December 31, 2006 (dollars in thousands):

	Number of shares	Weighted average grant date fair value
Outstanding at beginning of year	91,056	\$ 26.57
Granted	—	—
Vested	(50,040)	24.16
Canceled	(876)	16.73
Outstanding at end of year	<u>40,140</u>	\$ 29.79

Prior to January 1, 2006, the Company accounts for stock-based compensation under the recognition and measurement principles of APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and related interpretations. CFC generally grants stock options for a fixed number of shares with an exercise price equal to the fair value of the shares at the date of grant to eligible employees. The Company recognized compensation expense related to its stock option plans only to the extent that the fair value of the shares at the grant date exceeds the exercise price. Through December 31, 2005,

**COUNTRYWIDE SECURITIES CORPORATION AND SUBSIDIARY**  
(A Wholly Owned Subsidiary of Countrywide Capital Markets, Inc.)

Notes to Consolidated Financial Statements

December 31, 2006

no compensation expense related to these stock options had been recognized in earnings, as all options granted under the Plans had an exercise price equal to the market value of the underlying common stock on the date of the grant.

The impact of adopting SFAS 123R for the year ended December 31, 2006, was a charge of approximately \$3.8 million to compensation expense. The remaining unrecognized compensation cost related to unvested awards as of December 31, 2006, was \$6.4 million and the weighted average period of time over which this cost will be recognized 1.5 years. Restricted stock expense for the year ended December 31, 2006, amounted to approximately \$0.9 million.

The weighted average assumptions used to value grants of stock options and stock appreciation rights and the resulting average estimated values were as follows:

Expected life (in years)	4.3
Risk-free interest rate	4.7%
Dividend yield	1.7%
Expected volatility	0.3

The average fair value of options and stock appreciation rights granted in 2006 was \$10.16 per share.

The Company began using a lattice model to estimate the fair value of certain stock awards (i.e., stock appreciation rights and options) granted after the first quarter of 2006. Management believes the lattice model provides a better estimate of the fair value of those awards because it permits probabilities to be assigned to future changes in key assumptions (e.g., risk-free interest rate, stock volatility, and dividend rate). It also derives an expected term that captures patterns of exercise by participants prior to the end of the stated terms of those awards.

**(o) Recently Issued but not Adopted Accounting Standards**

**Statement of Financial Accounting Standards No. 155 (SFAS 155)**

In February 2006, the FASB issued SFAS No. 155, *Accounting for Certain Hybrid Financial Instruments*, an amendment of SFAS 133, *Accounting for Derivative Instruments and Hedging Activities* and SFAS 140. This statement:

- establishes a requirement to evaluate interests in securitized financial instruments that contain an embedded derivative requiring bifurcation;
- permits fair value remeasurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation;
- clarifies which interest-only strips and principal-only strips are not subject to SFAS 133; and
- clarifies that concentration of credit risks in the form of subordination are not embedded derivatives.

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SFAS 155 is effective for all financial instruments acquired or issued after the beginning of an entity's first fiscal year that begins after September 15, 2006. The adoption of SFAS 155 is not expected to have a significant impact on the consolidated financial position or earnings of the Company.

**FASB Interpretation No. 48 (FIN 48)**

During July 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48). FIN 48 was issued to clarify the requirements of SFAS No. 109, *Accounting for Income Taxes*, relating to the recognition of income tax benefits.

FIN 48 provides a two-step approach to recognizing and measuring tax benefits when the benefits' realization is uncertain. The first step is to determine whether the benefit is to be recognized; the second step is to determine the amount to be recognized:

- Income tax benefits should be recognized when, based on the technical merits of a tax position, the entity believes that if a dispute arose with the taxing authority and were taken to a court of last resort, it is more likely than not (i.e. a probability of greater than 50 percent) that the tax position would be sustained as filed; and
- If a position is determined to be more likely than not of being sustained, the reporting enterprise should recognize the largest amount of tax benefit that is greater than 50 percent likely of being realized upon ultimate settlement with the taxing authority.

FIN 48 is applicable to the Company beginning in the first quarter of 2007. The cumulative effect of applying the provisions of FIN 48 upon adoption will be reported as an adjustment to beginning retained earnings. The adoption of FIN 48 is not expected to have a significant impact on the consolidated financial position or earnings of the Company.

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**Statement of Financial Accounting Standards No. 157 (SFAS 157)**

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS 157). SFAS 157 provides a framework for measuring fair value when such measurements are utilized for accounting purposes. The framework focuses on an exit price in the principal (or, alternatively, the most advantageous) market determined in an orderly transaction between willing market participants. SFAS 157 establishes a three-tiered fair value hierarchy with the highest tier (Level 1) representing quoted prices for identical assets or liabilities in an active market and the lowest tier (Level 3) representing estimated values based on unobservable inputs. Under SFAS 157, related disclosures are segregated for assets and liabilities measured at fair value based on the level used within the hierarchy to determine their fair values. For the Company, SFAS 157 is effective January 1, 2008, with early adoption permitted as of January 1, 2007. The Company has determined that it will adopt SFAS 157 effective January 1, 2008, but has not yet determined the financial impact, if any, upon adoption.

**(3) Cash Segregated under Federal Regulations**

Cash of \$97.5 million at December 31, 2006 has been segregated in a special reserve bank account for the exclusive benefit of customers under Rule 15c3-3 of the Securities and Exchange Commission.

**(4) Receivables from and Payables to Broker/Dealers and Clearing Organizations**

The receivables from and payables to broker/dealers and clearing organizations at December 31, 2006 consist of the following:

	<u>Receivables</u>	<u>Payables</u>
	(Dollars in thousands)	
Deposits for securities borrowed/loaned	\$ 3,460,703	—
Securities failed to deliver/receive	81,437	165,696
Receivables from/payables to clearing organizations	107,131	10,769
Margin deposited and open trade equity on commodity transactions	19,449	—
Unsettled trades, net	614,657	—
Other	4,466	3,517
	<u>\$ 4,287,843</u>	<u>179,982</u>

Securities failed to deliver and failed to receive represent the contract value of securities that have not been delivered or received by the settlement date of the trade.

**(5) Receivables from and Payables to Customers**

Customer securities transactions are recorded on a settlement-date basis, which is generally one to three business days after the trade-date, while the related revenues are recorded on a trade-date basis. Receivables from and payables to customers include amounts related to cash transactions. Securities

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owned by customers, including those that collateralize these transactions, are generally not reflected in the consolidated statement of financial condition.

**(6) Trading Securities Owned and Trading Securities Sold, Not Yet Purchased**

Trading securities owned, at fair value, including amounts pledged as collateral, and trading securities sold, not yet purchased, at fair value, consist of the following at December 31, 2006:

	<b>Owned</b>	<b>Sold, not yet purchased</b>
	(Dollars in thousands)	
Mortgage pass-through certificates	\$ 14,884,078	26,024
Collateralized mortgage obligations	3,326,170	—
U.S. Treasury securities	1,668,016	3,706,643
Agency debt securities	781,657	305,826
Asset-backed securities	203,979	—
Derivative financial instruments	182,523	67,185
Commercial paper and certificates of deposit	149,105	—
Residual interests	52,097	—
Options	295	16
	\$ 21,247,920	4,105,694

The fair value of trading securities is generally based on observable market prices. If observable market prices are not available, fair value is determined in good faith by management based on other relevant factors including dealer price quotations, prices available for similar instruments, and valuation pricing models intended to approximate the amounts that would be received from or paid to a third party in settlement. Judgment is required to determine the fair values of trading securities owned and the exercise of such judgment can impact the Company's earnings.

Collateral pledged, including deposits of \$60.3 million with clearing organizations to fulfill margin requirements, is included in trading securities owned and had a fair value of \$1.5 billion. Collateral pledged where the secured party does not have the right to sell or repledge such collateral is included in trading securities owned and had a fair value of \$18.0 billion at December 31, 2006.

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**(7) Other Assets**

Amounts included in other assets as of December 31, 2006 consist of the following (dollars in thousands):

Accrued and purchased interest	\$ 116,644
Cash surrender value of Company-owned life insurance	60,835
Restricted investments	53,013
Capitalized software, net	14,930
Prepaid expenses	3,692
Other	6,544
	<u>\$ 255,658</u>

The cash surrender value of Company-owned life insurance policies and the restricted investments (which consist of mutual funds recorded at fair value) have been deposited in a rabbi trust created to fund a nonqualified pension plan. These assets may only be used to pay the obligations of the Company arising from that nonqualified pension plan; they are not available to meet the general obligations of the Company, except in the event of insolvency filing by CFC. The accrued liability associated with this nonqualified pension plan was \$108.3 million as of December 31, 2006 and is included in accounts payable and accrued liabilities in the consolidated statement of financial condition. See notes 8 and 12.

**(8) Accounts Payable and Accrued Liabilities**

Amounts included in accounts payable and accrued liabilities as of December 31, 2006 consist of following (dollars in thousands):

Accrued compensation	\$ 220,041
Securitization and underwriting liabilities	50,626
Accrued interest	29,828
Accounts payable	13,377
Other	12,860
	<u>\$ 326,732</u>

**(9) Bank Loans**

The Company obtains short-term borrowings through unsecured bank loans. At December 31, 2006, the overnight bank loan was \$105.0 million. The interest rates on short-term borrowings are generally based on the federal funds rate plus a margin determined at the time of the transactions. During the year ended December 31, 2006, the weighted average interest rate on bank loans was 5.25%.

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**(10) Transactions with Affiliates**

The Company receives fees from its affiliates for trading, underwriting transactions, and conduit management activities. The Company also provides underwriting services for an affiliate for which it does not receive a fee, and compensates an affiliate for arrangement of trades. For the year ended December 31, 2006, these fees consisted of the following (dollars in thousands):

Conduit management fees	\$	301,976
Underwriting fees		141,096
Compensation paid for an arranger fee agreement		11,511

In addition, the Company earned \$11.9 million of net interest and \$9.3 million in net fees related to conduit management activities.

The Company reimburses affiliates, or is reimbursed by affiliates, for certain operating expenses. For the year ended December 31, 2006, these reimbursed expenses consisted of the following (dollars in thousands):

Occupancy and equipment	\$	2,527
Employee benefit plans		2,452
Group insurance		2,835
Legal fees		2,199
Management fees paid to an affiliate		21,530
Management fees received from affiliates		(4,087)
Other direct allocation by an affiliate		8,233

Gains and losses arising from securities and underwriting transactions with affiliates are settled through the standard securities settlement process. Compensation for arranger fees is cash settled on a monthly basis. All other fees and expenses are charged or credited through the intercompany accounts.

The Company maintains intercompany payables and receivables with various affiliates to facilitate the reimbursement of fees and expenses. As of December 31, 2006, the intercompany payables amounted to \$32.2 million. Interest is incurred or credited at market rates. The net interest expense on this net payable was based upon a weighted average interest rate of 5.01% for the year. Net interest on the intercompany balances amounted to an expense of \$6.9 million for the year ended December 31, 2006.

Outstanding at December 31, 2006 with affiliates, at contractual amounts including accrued interest, were reverse repurchase agreements in the amount of \$1.7 billion, and repurchase agreements in the amount of \$160.9 million. Net interest earned on these agreements was \$91.3 million for the year ended December 31, 2006. In addition, during the year ended December 31, 2006, the Company purchased \$279.5 billion of trading securities from and sold \$94.7 billion of trading securities to affiliates at prevailing market prices.

The Company has available, but did not draw against during the year ended December 31, 2006, \$650.0 million in subordination agreements with affiliates (note 14).

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**(11) Net Capital Requirements**

The Company is subject to the Securities and Exchange Commission Uniform Net Capital Rule (SEC rule 15c3-1), which requires the maintenance of minimum net capital. The Company has elected to use the alternative method, permitted by the rule, which requires that the Company maintain minimum net capital, as defined in the rule, equal to the greater of \$250,000 or 2% of aggregate debit balances arising from customer transactions, as defined in the rule. At December 31, 2006, the Company's net capital was \$586.4 million and net capital in excess of the minimum required was \$554.0 million. The rule prohibits the Company from withdrawing equity capital or making distributions to its stockholder (the Parent) if resulting net capital would be less than 5% of aggregate debits arising from customer-related receivables as computed in accordance with the rule.

**(12) Employee Benefit Plans**

Eligible full-time employees of the Company are covered under CFC's employee benefit plans, including dental, medical, life insurance, dependent care, and others. A portion of the employee benefit plan expense is allocated to the Company based on the Company's employees' participation in these plans. The Company's expense related to these plans was \$2.8 million for the year ended December 31, 2006 (see note 10).

Eligible full-time employees of the Company are also covered under a variety of CFC plans. For employees hired prior to January 1, 2006, CFC has a defined benefit pension plan. For employees hired after December 31, 2005, CFC makes supplemental contributions to tax deferred savings and investment plans. A portion of the defined benefit pension plan expense is allocated to the Company based upon the percentage of the Company's salary expense to the total salary expense of CFC and its subsidiaries, and based on the Company's employees' participation in these plans. The Company's expense related to these plans was \$2.5 million for the year ended December 31, 2006 (see note 10). Because the Company participates in these plans with other subsidiaries of CFC, an analysis setting forth the funded status at December 31, 2006 cannot be separately determined for the Company.

In September 2006, the FASB issued SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans* (SFAS 158), an amendment of FASB Statement Nos. 87, 88, 106, and 132(R). The Company is part of a multiemployer plan and, consequently, records no pension liability other than one attributable to our contribution to that plan is recognized. Therefore, the adoption of SFAS 158 resulted in no additional liability being recorded.

The Company has also established a nonqualified pension plan for certain key employees. The Company's expense related to this plan was \$32.8 million for the year ended December 31, 2006. Such expense is funded by the performance of the underlying life insurance policies and restricted investments held by a rabbi trust.

**(13) Commitments and Contingencies**

**(a) Underwriting**

In connection with the Company's underwriting activities, the Company had commitments to purchase \$7.6 billion and sell \$6.0 billion new issues of securities at December 31, 2006.

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**(b) Leases**

The Company occupies office space under leases that expire at various dates through 2016. Future minimum aggregate annual rentals payable under noncancelable leases are approximately as follows (dollars in thousands):

Year ending December 31:	
2007	\$ 2,953
2008	2,352
2009	2,143
2010	2,084
2011	1,632
Thereafter	4,467
	<u>\$ 15,631</u>

The various leases contain provisions for periodic escalations evolving from increased operating and other costs. Rental expense under these leases was \$1.5 million for 2006 and is included in other operating expenses in the consolidated statement of earnings.

**(c) Litigation**

The Company is a defendant in various legal proceedings involving matters generally incidental to its business. Although it is difficult to predict the ultimate outcome of these proceedings, management believes, based on discussions with counsel, that liabilities beyond those already recorded, if any, will not materially affect the consolidated financial position, results of operations, or liquidity of the Company.

**(14) Liabilities Subordinated to Claims of General Creditors**

All borrowing lines under subordination agreements are with affiliates. The Company has total lines of credit from affiliates subject to subordination agreements of \$650.0 million. These lines of credit were not utilized by the Company at any time during the year ended December 31, 2006.

**(15) Financial Instruments**

Substantially all of the Company's assets and liabilities are carried at fair value or contracted amounts that approximate fair value. Assets which are recorded at contracted amounts approximating fair value consist largely of short-term secured receivables, including reverse repurchase agreements, securities borrowed, customer receivables, and certain other receivables. Similarly, the Company's short-term liabilities, such as bank loans, repurchase agreements, securities loaned, customer payables, and certain other payables are recorded at contract amounts approximating fair value. These instruments generally have variable interest rates and short-term maturities, in many cases overnight; therefore, their fair values are not materially affected by changes in interest rates.

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Fair values of forwards, swaps, and options contracts are recorded in trading securities owned or trading securities sold, not yet purchased, as appropriate. Open equity in futures transactions are recorded as receivables from or payables to brokers/dealers and clearing organizations, as applicable.

Derivative financial instruments used for trading purposes, including hedges of trading instruments and for risk management purposes relating to conduit management activities, are carried at market value or fair value. Market values for exchange-traded derivatives, principally futures and certain options, are based on quoted market prices. Fair values for over-the-counter derivative financial instruments, principally forward contracts of to-be-announced securities (TBAs), interest rate swaps, and options, are based on pricing models intended to approximate the amounts that would be received from or paid to a third party in settlement of the contracts. Factors taken into consideration include credit spreads, market liquidity, concentrations, and funding and administrative costs incurred over the life of the instruments.

The following table summarizes the notional amounts of these derivative contracts and fair values of the related assets and liabilities at December 31, 2006:

	<u>Notional amount</u>	<u>Gross fair value assets</u>	<u>Gross fair value liabilities</u>
	(Dollars in thousands)		
Sale of forward contracts	\$ 99,178,719	322,534	—
Purchase of forward contracts	83,233,042	—	(221,978)
Futures contracts	47,846,200	6,788	(7,583)
Options held	9,450,000	295	—
Options written	4,500,000	—	(16)
Swap agreements	849,500	17,773	(2,991)

**(16) Financial Instruments with Off-Balance-Sheet Risk**

The Company enters into various transactions involving derivatives and other off-balance-sheet financial instruments. These financial instruments include futures, exchange-traded and over-the-counter options, delayed deliveries, TBAs, securities purchased and securities sold on a when-issued basis (when-issued securities), and interest rate swaps. These derivative financial instruments are used to conduct trading activities and manage market risks and are, therefore, subject to varying degrees of market and credit risk.

Futures, forwards, options, TBAs, and when-issued securities provide for the delayed delivery of the underlying instrument. Interest rate swaps involve the exchange of payments based on fixed or floating rates applied to notional amounts. The contractual or notional amounts related to these financial instruments reflect the volume and activity and do not reflect the amounts at risk. Futures contracts are executed on an exchange, and cash settlement is made on a daily basis for market movements. Accordingly, futures contracts generally do not have credit risk. The credit risk for forward contracts, TBAs, options, and when-issued securities is limited to the unrealized market valuation gains recorded in the statement of financial condition. Market risk is substantially dependent upon the value of the underlying financial instruments and is affected by market forces such as volatility and changes in interest.

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In addition, the Company has sold securities that it does not currently own and therefore will be obligated to purchase such securities at a future date. The Company has recorded these obligations in the consolidated financial statements at December 31, 2006 at the fair values of the related securities and will incur a loss if the fair value of the securities increases subsequent to December 31, 2006.

In the normal course of business, the Company's customer activities involve the execution, settlement, and financing of various customer securities transactions. These activities may expose the Company to off-balance-sheet risk in the event the customer or other broker is unable to fulfill its contracted obligations and the Company has to purchase or sell the financial instrument underlying the contract at a loss.

The Company's customer financing and securities settlement activities may require the Company to pledge customer securities as collateral in support of various secured financing sources such as bank loans and repurchase agreements. In the event the counterparty is unable to meet its contractual obligation to return customer securities pledged as collateral, the Company may be exposed to the risk of acquiring the securities at prevailing market prices in order to satisfy its customer obligations. The Company controls this risk by monitoring the market value of securities pledged on a daily basis and by requiring adjustments of collateral levels in the event of excess market exposure. In addition, the Company establishes credit limits for such activities and monitors compliance on a daily basis.

**(17) Credit Risk**

The Company is engaged in various trading activities with counterparties, primarily broker/dealers, banks, and other financial institutions. In the event counterparties do not fulfill their obligations, the Company may be exposed to risk. The risk of nonperformance depends on the creditworthiness of the counterparty or issuer of the instrument. The Company has established credit policies applicable to making commitments involving financial instruments. Such policies include credit reviews, approvals, limits, and monitoring procedures. It is the Company's policy to review, as necessary, the credit standing of each counterparty.

The Company maintains its cash balances, including cash segregated in compliance with federal regulations, in financial institutions. The balances with each of two financial institutions are insured by the Federal Deposit Insurance Corporation up to \$100,000 and the balance in the other financial institution is not insured. As of December 31, 2006, uninsured amounts held at these financial institutions totaled \$104.9 million. The Company has not experienced any losses in such accounts and believes it is not exposed to any significant credit risk on cash.

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**(18) Consolidated Subsidiary**

The following is a summary of certain financial information of the Subsidiary (dollars in thousands):

		<b>Countrywide Capital Markets Asia Ltd.</b>
Total assets	\$	11,245
Stockholder's equity		5,833
Net income		307

The \$5.8 million of stockholder's equity of the broker/dealer subsidiary is not included as capital in a consolidated computation of the Company's net capital, because the assets of the subsidiary are not readily available for the protection of the Company's customers, broker/dealers, and other creditors, as permitted by rule 15c-3-1.

**(19) Income Taxes**

Components of the provision for income taxes (benefits) are presented below (dollars in thousands):

Current:		
Federal	\$	137,745
State		35,775
Foreign		221
		173,741
Deferred:		
Federal		(4,690)
State		609
		(4,081)
Total income tax expense	\$	169,660

The following is a reconciliation of the statutory federal income tax rate to the effective income tax rate as reflected in the consolidated statement of earnings:

Statutory federal income tax rate		35.00%
State income and franchise taxes, net of federal tax effect		5.43
Other		(1.50)
Effective income tax rate		38.93%

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The tax effects of temporary differences that gave rise to deferred income tax assets and liabilities are presented below (dollars in thousands):

Deferred income tax assets:		
Employee benefits	\$	61,653
Other		2,262
		63,915
Deferred income tax liabilities:		
Depreciation and amortization		4,602
		4,602
Deferred income tax assets, net	\$	59,313

Management believes that a valuation reserve is not required for any of the Company's deferred tax assets since it is more likely than not that these assets will be realized either through carry back to the Company's taxable income in prior years or as a result of future taxable income of the Company and CFC's consolidated group, including reversals of existing temporary differences.

Foreign pretax earnings approximated \$528,000 in 2006. Earnings of a foreign subsidiary are subject to U.S. taxation when effectively repatriated. The Company is required to provide U.S. income taxes on the undistributed earnings of non-U.S. subsidiaries except to the extent such earnings are indefinitely invested outside the U.S. At December 31, 2006, \$1.4 million of accumulated undistributed earnings on non-U.S. subsidiaries was indefinitely invested outside the U.S. It is not practicable at this time to determine the income tax liability that would result upon repatriation of these earnings. No income tax is provided against other comprehensive income for the translation adjustments for such unremitted earnings of a subsidiary that are indefinitely invested outside of the U.S.

**(20) Representations and Warranties Related to Conduit and Underwriting Activities**

The Company provides representations and warranties to counterparties in connection with a variety of transactions and may indemnify them against potential losses caused by the breach of those representations and warranties. These indemnifications generally are standard contractual terms and are entered into in the normal course of business related to its conduit and underwriting activities, and are initially recorded at fair value and changes are recorded in earnings based on estimated default rates and loss severities. Such liabilities totaling \$45.1 million are included in accounts payable and accrued liabilities at December 31, 2006. The Company included provisions for losses on representations and warranties in other income totaling \$27.7 million for the year ended December 31, 2006. The Company did not have any material charge-offs relating to its representations and warranties during the year ended December 31, 2006.

In addition, the Company indemnifies and guarantees certain service providers, such as clearing and custody agents, trustees and administrators, against specified potential losses in connection with their acting as an agent of, or providing services to, the Company or its affiliates. The Company believes that it is unlikely it will have to make material payments under these arrangements and has not recorded any contingent liability in the consolidated financial statements for these indemnifications.

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**(21) Guarantees**

FASB Interpretation No. 45 (FIN 45), *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*, requires the Company to disclose information about its obligations under certain guarantee arrangements. FIN 45 defines guarantees as contracts and indemnification agreements that contingently require a guarantor to make payments to the guaranteed party based on changes in an underlying (such as an interest or foreign exchange rate, security or commodity price, an index or the occurrence or nonoccurrence of a specified event) related to an asset, liability, or equity security of a guaranteed party. FIN 45 also defines guarantees as contracts that contingently require the guarantor to make payments to the guaranteed party based on another entity's failure to perform under an agreement as well as indirect guarantees of the indebtedness of others.

**(a) Derivative Contracts**

Certain derivative contracts that the Company has entered into meet the accounting definition of a guarantee under FIN 45. Derivatives that meet the FIN 45 definition of guarantees include certain written options and credit default swaps. Since the Company does not track the counterparties' purpose for entering into a derivative contract, it has disclosed derivative contracts that are likely to be used to protect against a change in an underlying financial instrument, regardless of their actual use.

The maximum potential payout for certain derivative contracts, such as written interest rate caps and written foreign currency options, cannot be estimated as increases in interest or foreign exchange rates in the future could possibly be unlimited. Therefore, in order to provide information regarding the maximum potential amount of future payments that the Company could be required to make under certain derivative contracts, the notional amount of the contracts has been disclosed.

The Company records all derivative contracts at fair value. For this reason, the Company does not monitor its risk exposure to derivative contracts based on derivative notional amounts; rather the Company manages its risk exposure on a fair value basis. Aggregate market risk limits have been established, and market risk measures are routinely monitored against these limits. The Company also manages its exposure to these derivative contracts through a variety of risk mitigation strategies, including, but not limited to, entering into offsetting economic hedge positions. The Company believes that the notional amounts of the derivative contracts generally overstate its exposure.

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**(b) *Exchange Member Guarantees***

The Company is a member of various exchanges that trade and clear securities and/or futures contracts. Associated with its membership, the Company may be required to pay a proportionate share of the financial obligations of another member who may default on its obligations to the exchange. While the rules governing different exchange memberships vary, in general the Company's guarantee obligations would arise only if the exchange had previously exhausted its resources. In addition, any such guarantee obligation would be apportioned among the other nondefaulting members of the exchange. Any potential contingent liability under these membership agreements cannot be estimated. The Company has not recorded any contingent liability in the consolidated financial statements for these agreements and believes that any potential requirement to make payments under these agreements is remote.

**(c) *Other Guarantees***

The Company may indemnify securities lending customers against losses incurred in the event that borrowers do not return securities and the collateral held is insufficient to cover the market value of the securities borrowed.

**SUPPLEMENTARY INFORMATION**

**COUNTRYWIDE SECURITIES CORPORATION AND SUBSIDIARY**  
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Computation of Net Capital under Rule 15c3-1 of the Securities and Exchange Commission

December 31, 2006

(Dollars in thousands)

Net capital:		
Stockholder's equity		\$ 1,329,431
		<hr/>
Total capital and allowable subordinated liabilities		1,329,431
Deductions and/or charges:		
A. (1) Nonallowable assets:		
Receivables from brokers and dealers		4,195
Receivables from customers		26,075
Memberships in exchanges		686
Investments and receivables from affiliates		5,834
Furniture, equipment, and leasehold improvements, net		31,172
Other nonallowable assets		178,734
		<hr/>
		246,696
(2) Additional charges on customers' securities accounts:		2,488
B. Aged fails to deliver		
Number of items - 179		3,947
C. Commodity futures contracts		36,522
D. Other deductions and/or charges		162,214
		<hr/>
		451,867
		<hr/>
Net capital before haircuts on security positions		877,564
Haircuts on securities (computed pursuant to Rule 15c3-1(c)(2)(vi)):		
Trading and investment securities:		
1. Contractual commitments		52,283
2. Bankers' acceptances, CDs, and commercial paper		999
3. U.S. and Canadian government obligations		65,496
4. Corporate obligations		53,329
5. Other securities		65,095
6. Undue concentration		1,866
7. Securities with no ready market		52,097
		<hr/>
		291,165
		<hr/>
Net capital		\$ 586,399
Net capital requirements/percentage:		
Minimum net capital requirement (2% aggregate debit items)		\$ 11,790
Excess reverse repurchase capital requirement		20,638
Net capital requirement (minimum requirement)		32,428
Excess net capital		553,971
Excess net capital greater than 5% of aggregate debits, including excess reverse repurchase requirement		536,286
Percentage, net capital to aggregate debit items		99%

There are no material differences between the above computation and the computation included with the Company's FOCUS Form X-17A-5 for the period ending December 31, 2006 filed on January 26, 2007.

**COUNTRYWIDE SECURITIES CORPORATION AND SUBSIDIARY**

(A Wholly Owned Subsidiary of Countrywide Capital Markets, Inc.)

Computation for Determination of Reserve Requirements under Rule 15c3-3  
of the Securities and Exchange Commission

December 31, 2006

(Dollars in thousands)

## Credit balances:

Free credit balances and other credit balances in customers' security accounts	\$ 356,183
Customers' securities failed to receive	7,810
Credit balances in firm accounts which are attributable to principal sales to customers	284,935
Market value of short securities and credits in all suspense accounts over 7 business days	<u>3,878</u>
Total credits	<u>652,806</u>

## Debit balances:

Debit balances in customers' cash and margin accounts excluding unsecured accounts and accounts doubtful of collection	543,449
Securities borrowed to effectuate short sales by customers and securities borrowed to make delivery on customers' securities failed to deliver	13,819
Failed to deliver of customers' securities not older than 30 calendar days	<u>32,240</u>
Aggregate debit items	589,508
Less 3% (for alternative method only)	<u>(17,685)</u>
Total Rule 15c3-3 debits	<u>571,823</u>
Excess of total credits over total debits	<u>\$ 80,983</u>

Amount held on deposit in "reserve" bank account including value of qualified securities at end of reporting period	\$ 97,500
Deposit on January 3, 2007	20,000

There are no material differences between the above computation and the computation included with the Company's FOCUS II Form X-17A-5 for the period ending December 31, 2006 filed on January 26, 2007.

**COUNTRYWIDE SECURITIES CORPORATION AND SUBSIDIARY**  
 (A Wholly Owned Subsidiary of Countrywide Capital Markets, Inc.)

Information Relating to Possession or Control Requirements under Rule 15c3-3  
 of the Securities and Exchange Commission

December 31, 2006

(Dollars in thousands)

Market valuation and number of items for:

	<u>Value</u>	<u>Number</u>
1. Customers' fully paid securities and excess margin securities not in respondent's possession or control as of the report date (for which instructions to reduce to possession or control had been issued as of the report date) but for which the required action was not taken by respondent within the time frames specified under Rule 15c3-3	\$ —	—
2. Customers' fully paid securities and excess margin securities for which instructions to reduce to possession or control had not been issued as of the report date, excluding items arising from "temporary lags which result from normal business operations" as permitted under Rule 15c3-3	—	—

**INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL  
REQUIRED BY RULE 17A-5 OF THE SECURITIES AND  
EXCHANGE COMMISSION**



**KPMG LLP**  
Suite 2000  
355 South Grand Avenue  
Los Angeles, CA 90071-1568

**Independent Auditors' Report on Internal Control Required by Rule 17a-5  
of the Securities and Exchange Commission**

The Board of Directors  
Countrywide Securities Corporation:

In planning and performing our audit of the consolidated financial statements of Countrywide Securities Corporation and subsidiary (the Company), a wholly owned subsidiary of Countrywide Capital Markets, Inc., as of and for the year ended December 31, 2006, in accordance with auditing standards generally accepted in the United States of America, we considered the Company's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the consolidated financial statements, but not for the purpose of expressing our opinion on the effectiveness of the Company's internal control. Accordingly, we do not express an opinion on the effectiveness of the Company's internal control.

Also, as required by rule 17a-5(g)(1) of the Securities and Exchange Commission (SEC), we have made a study of the practices and procedures followed by the Company, including consideration of control activities for safeguarding securities. This study included tests of compliance with such practices and procedures that we considered relevant to the objectives stated in rule 17a-5(g), in the following:

- Making the periodic computations of aggregate debits and net capital under rule 17a-3(a)(11) and the reserve required by rule 15c3-3(e)
- Making the quarterly securities examinations, counts, verifications, and comparisons, and the recordation of differences required by rule 17a-13
- Complying with the requirements for prompt payment for securities under Section 8 of Federal Reserve Regulation T of the Board of Governors of the Federal Reserve System
- Obtaining and maintaining physical possession or control of all fully paid and excess margin securities of customers as required by rule 15c3-3

The management of the Company is responsible for establishing and maintaining an internal control and the practices and procedures referred to in the preceding paragraph. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of controls, and of the practices and procedures referred to in the preceding paragraph, and to assess whether those practices and procedures can be expected to achieve the SEC's above-mentioned objectives. Two of the objectives of internal control and the practices and procedures are to provide management with reasonable but not absolute assurance that assets for which the Company has responsibility are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in

conformity with accounting principles generally accepted in the United States of America. Rule 17a-5(g) lists additional objectives of the practices and procedures listed in the preceding paragraph.

Because of inherent limitations in internal control and the practices and procedures referred to above, error or fraud may occur and not be detected. Also, projection of any evaluation of them to future periods is subject to the risk that they may become inadequate because of changes in conditions or that the effectiveness of their design and operation may deteriorate.

A *control deficiency* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with accounting principles generally accepted in the United States such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

A *material weakness* is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of internal control was for the limited purpose described in the first and second paragraphs and would not necessarily identify all deficiencies in internal control that might be material weaknesses. We did not identify any deficiencies in internal control and control activities for safeguarding securities that we consider to be material weaknesses, as defined above.

We understand that practices and procedures that accomplish the objectives referred to in the second paragraph of this report are considered by the SEC to be adequate for its purposes in accordance with the Securities Exchange Act of 1934 and related regulations, and that practices and procedures that do not accomplish such objectives in all material respects indicate a material inadequacy for such purposes. Based on this understanding and on our study, we believe that the Company's practices and procedures, as described in the second paragraph of this report, were adequate at December 31, 2006, to meet the SEC's objectives.

This report is intended solely for the information and use of the Board of Directors, management, the SEC, and other regulatory agencies that rely on rule 17a-5(g) under the Securities Exchange Act of 1934 in their regulation of registered brokers and dealers, and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

February 28, 2007

END