



To: Board Members

From: Servicing Rights (Hamilton, ext. 330)

Subject: Minutes of the May 19, 2004 Board Meeting **Date:** May 24, 2004

cc: Bielstein, L. Smith, Petrone, Wilkins, Lott, E. Smith, Laurenzano, Hamilton, Thompson, Gabriele, Sutay, Lapolla, FASB Intranet

Topics: What alternatives should be taken related to certain decisions on the servicing rights project?

Basis for Discussion: Board memorandum dated May 7.

Length of Discussion: 9:00 a.m. to 9:40 a.m.

Attendance:

Board members present: Herz, Batavick, Crooch, Schieneman, Schipper, Seidman, Trott (by phone)

IASB Board/Staff present: None

Board members absent: None

Staff in charge of topics: Laurenzano

Other Staff at Board table: L. Smith, Lott, Wilkins, E. Smith, Hamilton

Outside Participants: None

Summary of Decisions Reached:

The Board reached the following decisions:

- Entities should be permitted to choose either fair value or the lower-of-carrying amount-or-market as the subsequent measurement attribute for all servicing rights that are separately accounted for under GAAP.
- Subsequent changes in the fair value of all servicing rights accounted for using the fair value measurement attribute will be recognized in earnings.

The Board also discussed amending FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, to require that servicing rights, or potentially all retained interests, be initially accounted for at fair value. The Board did not make a decision, and the issue will be discussed again at a future meeting.

Objective of the Meeting:

The objective of the meeting was for the Board to consider the alternatives presented for decisions related to accounting for servicing rights and select an alternative for each decision.

Matters Discussed:

The staff introduced the first two decisions to be made with regard to accounting for servicing rights:

Decision 1: For those servicing rights that are accounted for separately under GAAP, which servicing rights should be reported at fair value (whether initially, subsequently, or both)?

Primary Decision:

Alternative A: Only mortgage servicing rights (MSRs)

Alternative B: All loan servicing rights

Alternative C: All servicing rights

Secondary Decision:

Does the primary decision apply only to those rights created by securitizations or all rights regardless of how they were created?

Decision 2: Due to concerns about reliability and the absence of active markets, should entities be permitted to choose either fair value or lower-of-carrying-amount-or-market as their subsequent measurement attribute for any of the following groups of servicing rights?

Alternative A: All nonloan servicing rights
Alternative B: All nonmortgage servicing rights
Alternative C: All servicing rights, including MSRs

Decision 1 and Decision 2

The staff stated that all decisions in this project, unless otherwise specified, apply only to servicing rights that are separately accounted for under existing GAAP.

The staff stated that since some Board members believe that the decision reached on Decision 2 would impact their recommendation for Decision 1, both decisions should be considered jointly. The staff recommended that all servicing rights be required to be accounted for at fair value. The staff stated that measurement techniques are already in place for servicing rights as they are required to be accounted for at lower-of-carrying-amount-or-market in existing guidance. The staff stated that allowing entities to account for servicing rights at fair value or lower-of-carrying-amount-or-market would introduce comparability issues between servicing rights.

Ms. Schipper stated that she supports the staff's recommendation. She believes that all servicing rights should be accounted for at fair value and that techniques have already been developed by entities to measure servicing rights at fair value due to requirements in existing accounting guidance.

Ms. Seidman stated that while she believes fair value is the most relevant measurement attribute for servicing rights, she believes that the scope of the project should be limited to MSRs if accounting for servicing rights at fair value is required. She believes that the practical purpose of this project is to provide banks that are hedging risks associated with MSRs relief from the onerous

requirements of qualifying for a fair value hedge under FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*. She believes that the guidance on how to account for all servicing rights should be included in the Board's project on revenue recognition.

Ms. Seidman further stated that in practice, certain servicing contracts are determined to have no value or are being accounted for as liabilities. Ms. Seidman stated she believes that requiring all servicing rights to be accounted for at fair value would be a substantial departure from existing guidance. Ms. Seidman stated that she recommends elective fair value accounting for all servicing rights.

Ms. Schipper asked whether an entity would be allowed to account for servicing rights using existing guidance if the elective fair value option were recommended by the Board. Ms. Seidman stated that an entity would be allowed to account for servicing rights using existing guidance.

Mr. Trott stated that he supports the staff's recommendation to require that all servicing rights be accounted for at fair value.

Mr. Batavick stated that he supports elective fair value accounting for all servicing rights. He stated that if fair value is required for servicing rights, he would recommend that the requirement only apply to MSRs.

Mr. Crooch stated that he supports requiring that all servicing rights be accounted for at fair value.

Mr. Schieneman stated that he supports elective fair value accounting for all servicing rights.

Mr. Herz stated that he supports elective fair value accounting for all servicing rights. He believes that the accounting for servicing rights should be reflective of the economics related to the servicing activity.

The Board recommended that elective fair value accounting apply to all servicing rights. [Four Board members agreed; three did not: EWT, KAS, GMC.]

The staff introduced the third and fourth decisions to be made with regard to accounting for servicing rights:

Decision 3: When should fair value measurement be applied?

Alternative A: Apply fair value at initial recognition only.

Alternative B: Apply fair value both at initial recognition and in subsequent periods.

Alternative C: Do not change the existing guidance for initial recognition, but require the use of fair value measurement in subsequent periods.

Decision 4: How should changes in fair value be recognized in the Financial Statements?

Alternative A: Recognize the changes in fair value in earnings.

Alternative B: Recognize the changes in fair value in earnings or other comprehensive income.

Decision 3 and Decision 4

The staff recommended that fair value measurement be applied to all servicing rights at initial recognition and in subsequent periods with changes in fair value recognized in earnings.

Mr. Trott stated that he supports initial and subsequent fair value measurement of servicing rights with changes in fair value recognized through earnings. He also supports initially measuring all servicing rights at fair value regardless of whether the option to allow elective fair value of servicing rights is recommended by the Board.

Ms. Seidman expressed concern with servicing rights being initially accounted for at fair value. She stated that certain servicing rights are accounted for on an allocated carrying amount because they are retained. She expressed concern with initial fair value measurement of servicing rights because, under existing Statement 140 guidance, only proceeds and liabilities are accounted for at fair value. A sale (and therefore, a gain or loss) is not recognized to the extent that the transferor only receives a beneficial interest in the transferred asset (according to paragraph 9 of Statement 140). She stated that requiring initial fair

value measurement of retained servicing rights would require a change to the principle of accounting for retained interests on an allocated basis and asserted that extensive changes would be required to the standard section and examples in Statement 140.

Mr. Trott stated that he believes that treating servicing rights as proceeds (initially accounting for servicing rights at fair value) would simplify the application of Statement 140 and create more consistent treatment of similar transactions.

Mr. Crooch stated that he favors subsequent fair value accounting for servicing rights with changes in fair value recognized in earnings. Mr. Crooch asked the Board what the potential shortcoming of initially accounting for servicing rights at fair value would be. Ms. Seidman responded that initially accounting for servicing rights at fair value would be a substantial change in principle from existing guidance.

Mr. Herz asked the Board if it was in favor of recognizing subsequent changes in the fair value of all servicing rights electing fair value measurement through earnings. There were no objections.

Mr. Herz asked the Board if it was in favor of requesting that additional research be performed by the staff regarding the treatment of retained servicing rights as proceeds or retained interests. There were no objections.

Follow-up Items:

The objective of the meeting was met.

The Board also asked the staff to explore the viability of amending Statement 140 to require that servicing rights, or potentially all retained interests, be initially accounted for at fair value.

General Announcements:

None