

EITF ABSTRACTS

Issue No. 87-34

Title: Sale of Mortgage Servicing Rights with a Subservicing Agreement

Dates Discussed: December 17, 1987; January 28, 1988

References: FASB Statement No. 13, *Accounting for Leases*
FASB Statement No. 28, *Accounting for Sales with Leasebacks*
FASB Statement No. 65, *Accounting for Certain Mortgage Banking Activities*
FASB Statement No. 66, *Accounting for Sales of Real Estate*
FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*
FASB Statement No. 156, *Accounting for Servicing of Financial Assets*
FASB Technical Bulletin No. 87-3, *Accounting for Mortgage Servicing Fees and Rights*

ISSUE

An enterprise that services mortgage loans ("transferor") enters into a transaction to transfer the mortgage servicing rights to an unrelated entity ("transferee") at a gain. The transferee either does not have the facilities or elects not to perform the required servicing functions and, accordingly, enters into a subservicing agreement with the transferor. The subservicing agreement provides that the transferor will perform the loan servicing for a fixed dollar amount per loan that is equal to or greater than the transferor's estimated cost of servicing. Significant risks and rewards of ownership related to the mortgage servicing right are transferred to the transferee.

The issues are whether the transfer of the mortgage servicing rights and the simultaneous agreement to provide subservicing should be reported by the transferor as a sale or a financing and, if reported as a sale, how the gain should be recognized.

EITF DISCUSSION

The Task Force reached a consensus that income should not be recognized immediately as a result of the transaction. Whether the transaction should be accounted for as a sale with the gain amortized or as a financing would depend on the specific facts and circumstances. [Note: See STATUS section.] Attributes of the transferee (for example, ability to perform servicing) would not be significant to the accounting for the transaction. Some Task Force members stated that the mortgage servicing rights have been sold; however, gain recognition should be deferred. Those members noted that it is difficult to determine what portion of the purchase price relates to the mortgage servicing rights sold and what portion relates to the future servicing obligations. They stated that the transferor should amortize the gain on the sale over the estimated lives of the underlying loans.

Other Task Force members stated that income should not be recognized because they view the transaction as a financing. They indicated that the transaction has only changed the cash flows relating to the servicing rights and the transferor is still required to perform the servicing.

The Task Force agreed that a loss should be recognized currently if the transferor determines that prepayments of the underlying mortgage loans may result in performing the future servicing at a loss. The Task Force also agreed that the consensus does not apply to a temporary subservicing agreement in which the subservicing will be performed by the transferor for only a short period of time.

STATUS

On December 31, 1987, the FASB issued Technical Bulletin 87-3. However, that Technical Bulletin does not address the above issue.

A related issue was discussed in Issue No. 89-5, "Sale of Mortgage Loan Servicing Rights." That Issue considers whether there are any circumstances in which the sale of mortgage loan

servicing rights may be recognized before the date that the sale is closed. The Task Force reached a consensus on Issue 89-5 that a sale of mortgage loan servicing rights should not be recognized before the closing of the sale.

The consensuses in Issue 89-5 were superseded by the Task Force in Issue No. 95-5, "Determination of What Risks and Rewards, If Any, Can Be Retained and Whether Any Unresolved Contingencies May Exist in a Sale of Mortgage Loan Servicing Rights." See Issue 95-5 for details of the consensus reached.

Another related issue was discussed in Issue No. 90-21, "Balance Sheet Treatment of a Sale of Mortgage Servicing Rights with a Subservicing Agreement." That Issue considers whether the transaction discussed in Issue 87-34 should be accounted for as a financing or as a sale with the gain deferred. The Task Force reached a consensus on Issue 90-21 that a sale of mortgage servicing rights with a subservicing agreement should be treated as a sale with gain deferred if substantially all the risks and rewards inherent in owning the mortgage servicing rights have been effectively transferred to the buyer. The risks and rewards associated with a seller performing purely administrative functions under a subservicing agreement would not necessarily preclude sales treatment.

Statement 156, issued in March 2006, amends Statement 140 with respect to the accounting for separately recognized servicing assets and servicing liabilities. Statement 156 does not modify the consensus reached on this Issue. However, changes in the fair value of servicing assets or servicing liabilities subsequently measured at fair value should be included in earnings in the period in which those changes occur, with any additional change in fair value from the last measurement date to the date of the transaction included in earnings at that time. An assumption of a servicing obligation does not result in separate recognition of a servicing asset or servicing liability unless substantially all the risks and rewards inherent in owning the servicing asset or servicing liability have been effectively transferred (as discussed in Issue 90-21).