

EITF ABSTRACTS

Issue No. 90-21

Title: Balance Sheet Treatment of a Sale of Mortgage Servicing Rights with a Subservicing Agreement

Dates Discussed: November 8, 1990; May 9, 1991; July 11, 1991; September 12, 1991

References: FASB Statement No. 13, *Accounting for Leases*
FASB Statement No. 65, *Accounting for Certain Mortgage Banking Activities*
FASB Statement No. 77, *Reporting by Transferors for Transfers of Receivables with Recourse*
FASB Statement No. 98, *Accounting for Leases: Sale-Leaseback Transactions Involving Real Estate, Sales-Type Leases of Real Estate, Definition of the Lease Term, and Initial Direct Costs of Direct Financing Leases*
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 Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*
SEC Staff Accounting Bulletin No. 30, *Accounting for Divestiture of a Subsidiary or Other Business Operation*
SEC Staff Accounting Bulletin No. 82, *Certain Transfers of Nonperforming Assets*

ISSUE

In Issue No. 87-34, "Sale of Mortgage Servicing Rights with a Subservicing Agreement," the Task Force reached a consensus that income should not be recognized immediately as a result of the sale of mortgage servicing rights with a subservicing agreement. However, 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 did not address whether the transaction should be accounted for as a financing or as a sale with the gain deferred.

This Issue addresses whether the transaction described in Issue 87-34 should be accounted for as a financing or as a sale with the gain deferred.

EITF DISCUSSION

The Task Force reached a consensus 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. [Note: See STATUS section.]

The SEC Observer noted that, in the view of the SEC staff, a transaction that, in substance, transfers only a portion of the servicing revenues does not result in transfer of substantially all of the risks and rewards of ownership and the accounting for those transactions should be guided by the consensus in Issue No. 88-18, "Sales of Future Revenues."

In addition, the Task Force reached a consensus that substantially all the risks and rewards inherent in owning the mortgage servicing rights have not been transferred to the buyer and, therefore, the transaction should be accounted for as a financing if one or more of the following factors are present:

1. The seller/subservicer directly or indirectly guarantees a yield to the buyer. For example, the seller/subservicer guarantees prepayment speeds or maximum loan default ratios to the buyer.
2. The seller/subservicer is obligated to advance a portion or all of the servicing fees on a nonrecoverable basis to the buyer prior to receipt of the loan payment from the mortgagor.
3. The seller/subservicer indemnifies the buyer for damages due to causes other than failure to perform its duties under the terms of the subservicing agreement.
4. The seller/subservicer absorbs losses on mortgage loan foreclosures not covered by FHA, VA, or other guarantors, if any, including absorption of foreclosure costs and costs of managing foreclosed property.
5. Title to the servicing rights is retained by the seller/subservicer.

The Task Force also reached a consensus that the presence of the following factors creates a rebuttable presumption that substantially all the risks and rewards inherent in owning the mortgage servicing rights have not been transferred to the buyer and that the transaction should be accounted for as a financing:

1. The seller/subservicer directly or indirectly provides financing or guarantees the buyer's financing. Nonrecourse financing, for example, would indicate that risks have not been transferred to the buyer.
2. The terms of the subservicing agreement unduly limit the buyer's ability to exercise ownership control over the servicing rights or result in the seller's retaining some of the risks and rewards of ownership. For example, if the buyer cannot cancel or decline to renew the subservicing agreement after a reasonable period of time, the buyer is precluded from exercising certain rights of ownership. Conversely, if the seller cannot cancel the subservicing agreement after a reasonable period of time, the seller has not transferred substantially all of the risks of ownership.
3. The buyer is a special-purpose entity without substantive capital at risk.

Some Task Force members observed that there may be factors other than those noted above that might also indicate that substantially all the risks and rewards inherent in owning the mortgage servicing rights have not been transferred to the buyer. [Note: See STATUS section.]

STATUS

A related issue was discussed 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."

Interpretation 45, which was issued in November 2002, requires a guarantor to recognize, at inception of the guarantee, a liability for the obligation undertaken in issuing the guarantee. The Interpretation also elaborates on the disclosures to be made by a guarantor.

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 and servicing liabilities subsequently measured at fair value are 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 sale date included in earnings at that time.

No further EITF discussion is planned.