NO. 278-A | MARCH 2006

Financial Accounting Series

Statement of Financial Accounting Standards No. 156

Accounting for Servicing of Financial Assets

an amendment of FASB Statement No. 140

Financial Accounting Standards Board
of the Financial Accounting Foundation

For additional copies of this Statement and information on applicable prices and discount rates contact:

Order Department
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, Connecticut 06856-5116

Please ask for our Product Code No. S156.

FINANCIAL ACCOUNTING SERIES (ISSN 0885-9051) is published monthly by the Financial Accounting Foundation. Periodicals—postage paid at Norwalk, CT and at additional mailing offices. The full subscription rate is $195 per year. POSTMASTER: Send address changes to Financial Accounting Standards Board, 401 Merritt 7, PO Box 5116, Norwalk, CT 06856-5116.

Summary

This Statement amends FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities,* with respect to the accounting for separately recognized servicing assets and servicing liabilities. This Statement:

1. Requires an entity to recognize a servicing asset or servicing liability each time it undertakes an obligation to service a financial asset by entering into a servicing contract in any of the following situations:
   a. A transfer of the servicer's financial assets that meets the requirements for sale accounting
   b. A transfer of the servicer's financial assets to a qualifying special-purpose entity in a guaranteed mortgage securitization in which the transferor retains all of the resulting securities and classifies them as either available-for-sale securities or trading securities in accordance with FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*
   c. An acquisition or assumption of an obligation to service a financial asset that does not relate to financial assets of the servicer or its consolidated affiliates.
2. Requires all separately recognized servicing assets and servicing liabilities to be initially measured at fair value, if practicable.
3. Permits an entity to choose either of the following subsequent measurement methods for each class of separately recognized servicing assets and servicing liabilities:
   a. *Amortization method*—Amortize servicing assets or servicing liabilities in proportion to and over the period of estimated net servicing income or net servicing loss and assess servicing assets or servicing liabilities for impairment or increased obligation based on fair value at each reporting date.
   b. *Fair value measurement method*—Measure servicing assets or servicing liabilities at fair value at each reporting date and report changes in fair value in earnings in the period in which the changes occur.
4. At its initial adoption, permits a one-time reclassification of available-for-sale securities to trading securities by entities with recognized servicing rights, without calling into question the treatment of other available-for-sale securities under Statement 115, provided that the available-for-sale securities are identified in some manner as offsetting the entity's exposure to changes in fair value of servicing assets or servicing liabilities that a servicer elects to subsequently measure at fair value.

5. Requires separate presentation of servicing assets and servicing liabilities subsequently measured at fair value in the statement of financial position and additional disclosures for all separately recognized servicing assets and servicing liabilities.

Reasons for Issuing This Statement

The Board added this project to its agenda because constituents asked the Board to reconsider Statement 140's requirements for accounting for mortgage servicing assets and servicing liabilities. The Board decided to broaden the scope of the project to include all servicing assets and servicing liabilities. Servicing assets and servicing liabilities may be subject to significant interest rate and prepayment risks, and many entities use financial instruments to mitigate those risks. Currently, servicing assets and servicing liabilities are amortized over the expected period of estimated net servicing income or loss and assessed for impairment or increased obligation at each reporting date. The Board acknowledged that the application of the lower of carrying amount or fair value measurement attribute to servicing assets results in asymmetrical recognition of economic events, because it requires recognition of all decreases in fair value but limits recognition of increases in fair value to the original carrying amount.

An entity may use derivative instruments to mitigate the risks inherent in its servicing assets and servicing liabilities. An entity that does not apply hedge accounting to these derivative instruments is exposed to income statement volatility that arises from the use of different measurement attributes for the servicing assets and servicing liabilities and the related derivative instruments. For example, in rising interest rate environments, decreases in the fair value of derivatives are reflected in the income statement, but increases in the fair value of related servicing assets are not reflected in the income statement to the extent that fair value exceeds the amortized carrying amount. Some constituents believe that meeting current hedge accounting criteria is burdensome and unduly restrictive and that the asymmetrical accounting for mortgage servicing assets and servicing liabilities and the related financial instruments used to mitigate the related risks does not appropriately reflect the economics of the hedging techniques employed.

When adding this project to its agenda, the Board also considered the complexity of application of the amortization method, such as the timing and characterization of impairment allowances versus write-downs, as well as the desire to simplify the accounting requirements for servicing assets and servicing liabilities.

How This Statement Improves Financial Reporting

This Statement requires that all separately recognized servicing assets and servicing liabilities be initially measured at fair value, if practicable. The Board concluded that fair value is the most relevant measurement attribute for the initial recognition of all servicing assets and servicing liabilities, because it represents the best measure of future cash flows. This Statement permits, but does not require, the subsequent measurement of servicing assets and servicing liabilities at fair value. An entity that uses derivative instruments to mitigate the risks inherent in servicing assets and servicing liabilities is required to account for those derivative instruments at fair value. Under this Statement, an entity can elect subsequent fair value measurement of its servicing assets and servicing liabilities by class, thus simplifying its accounting and providing for income statement recognition of the potential offsetting changes in fair value of the servicing assets, servicing liabilities, and related derivative instruments. An entity that elects to subsequently measure servicing assets and servicing liabilities at fair value is expected to recognize declines in fair value of the servicing assets and servicing liabilities more consistently than by reporting other-than-temporary impairments.

The Board decided to require additional disclosures and separate presentation in the statement of financial position of the carrying amounts of servicing assets and servicing liabilities that an entity elects to subsequently measure at fair value to address concerns about comparability that may result from the use of elective measurement methods.

Effective Date and Transition

An entity should adopt this Statement as of the beginning of its first fiscal year that begins after September 15, 2006. Earlier adoption is permitted as of the beginning of an entity's fiscal year, provided the entity has not yet issued financial statements, including interim financial statements, for any period of that fiscal year. The effective date of this Statement is the date an entity adopts the requirements of this Statement.

An entity should apply the requirements for recognition and initial measurement of servicing assets and servicing liabilities prospectively to all transactions after the effective date of this Statement.

An entity may elect to subsequently measure a class of separately recognized servicing assets and servicing liabilities at fair value as of the beginning of any fiscal year, beginning with the fiscal year in which the entity adopts this Statement. An entity that elects to subsequently measure a class of separately recognized servicing assets and servicing liabilities at fair value should apply that election prospectively to all new and existing separately recognized servicing assets and servicing liabilities within those classes that a servicer elects to subsequently measure at fair value. The effect of remeasuring an existing class of separately recognized servicing assets and servicing liabilities at fair value should be reported as a cumulative-effect adjustment to retained earnings as of the beginning of the fiscal year and should be separately disclosed.

This Statement permits an entity to reclassify certain available-for-sale securities to trading securities, regardless of the restriction in paragraph 15 of Statement 115, provided that those available-for-sale securities are identified in some manner as offsetting the entity's exposure to changes in fair value of servicing assets or servicing liabilities that a servicer elects to subsequently measure at fair value. This option is available only once, as of the beginning of the fiscal year in which the entity adopts this Statement. Any gains and losses associated with the reclassified securities that are included in accumulated other comprehensive income at the time of the reclassification should be reported as a cumulative-effect adjustment to retained earnings as of the beginning of the fiscal year that an entity adopts this Statement. The carrying amount of reclassified securities and the effect of that reclassification on the cumulative-effect adjustment should be separately disclosed.

Statement of Financial Accounting Standards No. 156

Accounting for Servicing of Financial Assets

an amendment of FASB Statement No. 140

March 2006

Financial Accounting Standards Board
of the Financial Accounting Foundation
401 MERRITT 7, PO BOX 5116, NORWALK, CONNECTICUT 06856-5116

Statement of Financial Accounting Standards No. 156

Accounting for Servicing of Financial Assets

an amendment of FASB Statement No. 140

March 2006

CONTENTS

Statement of Financial Accounting Standards No. 156

Accounting for Servicing of Financial Assets

an amendment of FASB Statement No. 140

March 2006

OBJECTIVE

1. FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities,* establishes, among other things, the accounting for all separately recognized servicing assets and servicing liabilities. This Statement amends Statement 140 to require that all separately recognized servicing assets and servicing liabilities be initially measured at fair value, if practicable. This Statement permits, but does not require, the subsequent measurement of separately recognized servicing assets and servicing liabilities at fair value. An entity that uses derivative instruments to mitigate the risks inherent in servicing assets and servicing liabilities is required to account for those derivative instruments at fair value. Under this Statement, an entity can elect subsequent fair value measurement to account for its separately recognized servicing assets and servicing liabilities. By electing that option, an entity may simplify its accounting because this Statement permits income statement recognition of the potential offsetting changes in fair value of those servicing assets and servicing liabilities and derivative instruments in the same accounting period.

STANDARDS OF FINANCIAL ACCOUNTING AND REPORTING

Scope

2. An entity shall apply this Statement to all separately recognized servicing assets and servicing liabilities. This Statement requires that an entity separately recognize a servicing asset or servicing liability when it undertakes an obligation to service a financial asset by entering into a servicing contract in connection with any of the following situations:

a. A transfer of the servicer's financial assets that meets the requirements for sale accounting
b. A transfer of the servicer's financial assets to a qualifying special-purpose entity in a guaranteed mortgage securitization in which the transferor retains all of the

resulting securities and classifies them as either available-for-sale securities or trading securities in accordance with FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*

c. An acquisition or assumption of an obligation to service a financial asset that does not relate to financial assets of the servicer or its consolidated affiliates.

An entity that transfers its financial assets to a qualifying special-purpose entity in a guaranteed mortgage securitization in which the transferor retains all of the resulting securities and classifies them as debt securities held-to-maturity in accordance with Statement 115 may either separately recognize its servicing assets or servicing liabilities or report those servicing assets or servicing liabilities together with the asset being serviced.

Key Terms

3. The following terms are used with the same meanings as in paragraph 364 of Statement 140 and are integral to understanding and applying this Statement.

a. **Adequate compensation**

   The amount of benefits of servicing that would fairly compensate a substitute servicer should one be required, which includes the profit that would be demanded in the marketplace.

b. **Contractually specified servicing fees**

   All amounts that, per contract, are due to the servicer in exchange for servicing the financial asset and would no longer be received by a servicer if the beneficial owners of the serviced assets (or their trustees or agents) were to exercise their actual or potential authority under the contract to shift the servicing to another servicer. Depending on the servicing contract, those fees may include some or all of the difference between the interest rate collectible on the asset being serviced and the rate to be paid to the beneficial owners of those assets.

c. **Fair value**

   See paragraphs 68–70 of Statement 140.

d. **Financial asset**

   Cash, evidence of an ownership interest in an entity, or a contract that conveys to a second entity a contractual right (1) to receive cash or another financial instrument from a first entity or (2) to exchange other financial instruments on potentially favorable terms with the first entity (Statement 107, paragraph 3(b)).

e. **Guaranteed mortgage securitization**
A securitization of mortgage loans that is within the scope of FASB Statement No. 65, *Accounting for Certain Mortgage Banking Activities,* as amended, and includes a substantive guarantee by a third party.

f. **Interest-only strip**
A contractual right to receive some or all of the interest due on a bond, mortgage loan, collateralized mortgage obligation, or other interest-bearing financial asset.

g. **Proceeds**
Cash, derivatives, or other assets that are obtained in a transfer of financial assets, less any liabilities incurred.

h. **Securitization**
The process by which financial assets are transformed into securities.

i. **Seller**
A transferor that relinquishes control over financial assets by transferring them to a transferee in exchange for consideration.

j. **Servicing asset**
A contract to service financial assets under which the estimated future revenues from contractually specified servicing fees, late charges, and other ancillary revenues are expected to more than adequately compensate the servicer for performing the servicing. A servicing contract is either (1) undertaken in conjunction with selling or securitizing the financial assets being serviced or (2) purchased or assumed separately.

k. **Servicing liability**
A contract to service financial assets under which the estimated future revenues from contractually specified servicing fees, late charges, and other ancillary revenues are not expected to adequately compensate the servicer for performing the servicing.

l. **Transfer**

The conveyance of a noncash financial asset by and to someone other than the issuer of that financial asset. Thus, a transfer includes selling a receivable, putting it into a securitization trust, or posting it as collateral but excludes the origination of that receivable, the settlement of that receivable, or the restructuring of that receivable into a security in a troubled debt restructuring.

m. **Undivided interest**

Partial legal or beneficial ownership of an asset as a tenant in common with others. The proportion owned may be pro rata, for example, the right to receive 50 percent of all cash flows from a security, or non–pro rata, for example, the right to receive the interest from a security while another has the right to the principal.

Amendments to Statement 140

4. Statement 140 is amended as follows: [Added text is underlined and deleted text is ~~struck out~~.]

a. Paragraph 4, as amended:

> This Statement does not address transfers of custody of financial assets for safekeeping, contributions,[2] transfers of ownership interests that are in substance sales of real estate, or investments by owners or distributions to owners of a business enterprise. This Statement does not address subsequent measurement of assets and liabilities, except for (a) **servicing assets** and **servicing liabilities** and (b) **interest-only strips,** securities, ~~retained~~ interests that continue to be held by a transferor in securitizations, loans, other receivables, or other financial assets that can contractually be prepaid or otherwise settled in such a way that the holder would not recover substantially all of its recorded investment and that are not within the scope of FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities.* This Statement does not change the accounting for employee benefits subject to the provisions of FASB Statement No. 87, *Employers' Accounting for Pensions,* No. 88, *Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits,* or No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions.* This Statement does not change the provisions relating to leveraged leases in FASB Statement No. 13, *Accounting for Leases,* or money-over-money and wrap lease transactions involving nonrecourse debt subject to the

provisions of FASB Technical Bulletin No. 88-1, *Issues Relating to Accounting for Leases.* This Statement does not address transfers of nonfinancial assets, for example, servicing assets, or transfers of unrecognized financial assets, for example, minimum lease payments to be received under operating leases.

b. Paragraph 5:

The Board concluded that an objective in accounting for transfers of financial assets is for each entity that is a party to the transaction to recognize only assets it controls and liabilities it has incurred, to **derecognize** assets only when control has been surrendered, and to derecognize liabilities only when they have been extinguished. Sales and other transfers frequently result in a disaggregation of financial assets and liabilities into components, which become separate assets and liabilities. For example, if an entity sells a portion of a financial asset it owns, the portion ~~retained~~that continues to be held by a transferor becomes an asset separate from the portion sold and from the assets obtained in exchange.

c. Paragraph 10:

Upon completion of any transfer of financial assets, the transferor shall:

~~a. Continue to carry in its statement of financial position any retained interest in the transferred assets, including, if applicable, servicing assets (paragraphs 61-67), beneficial interests in assets transferred to a qualifying SPE in a **securitization** (paragraphs 73–84), and retained **undivided interests** (paragraphs 58 and 59)~~

a. Initially recognize and measure at **fair value,** if practicable (paragraph 71), servicing assets and servicing liabilities that require recognition under the provisions of paragraph 13

b. Allocate the previous carrying amount between the assets sold, if any, and the ~~retained~~ interests that continue to be held by the transferor, if any, based on their relative fair values at the date of transfer (paragraphs 56–60)~~.~~

c. Continue to carry in its statement of financial position any interest it continues to hold in the transferred assets, including, if applicable, beneficial interests in assets transferred to a qualifying SPE in a **securitization** (paragraphs 73–84), and any **undivided interests** (paragraphs 58 and 59).

d. Paragraph 11:

> Upon completion[3] of a transfer of financial assets that satisfies the conditions to be accounted for as a sale (paragraph 9), the transferor (**seller**) shall:
>
> a. Derecognize all assets sold
> b. Recognize all assets obtained and liabilities incurred in consideration as **proceeds** of the sale, including cash, put or call options held or written (for example, guarantee or recourse obligations), forward commitments (for example, commitments to deliver additional receivables during the revolving periods of some securitizations), swaps (for example, provisions that convert interest rates from fixed to variable), and servicing assets and servicing liabilities, if applicable (paragraphs 56, 57, and 61–67)
> c. Initially measure at fair value assets obtained and liabilities incurred in a sale (paragraphs 68–70) or, if it is not practicable to estimate the fair value of an asset or a liability, apply alternative measures (paragraphs 71 and 72)
> d. Recognize in earnings any gain or loss on the sale.
>
> The transferee shall recognize all assets obtained and any liabilities incurred and initially measure them at fair value (in aggregate, presumptively the price paid).

e. Paragraph 13:

> ~~Each time an entity undertakes an obligation to service financial assets it shall recognize either a servicing asset or a servicing liability for that servicing contract, unless it transfers the assets to a qualifying SPE in a **guaranteed mortgage securitization,** retains all of the resulting securities, and classifies them as debt securities held-to-maturity in accordance with FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. If the servicing asset or liability was purchased or assumed rather than undertaken in a sale or securitization of the financial assets being serviced, it shall be measured initially at its fair value, presumptively the price paid. A servicing asset or liability shall be amortized in proportion to and over the period of estimated net servicing income (if servicing revenues exceed servicing costs) or net servicing loss (if servicing costs exceed servicing revenues). A servicing asset or liability shall be assessed for impairment or increased obligation based on its fair value (paragraphs 61–64).~~

An entity shall recognize and initially measure at fair value, if practicable, a servicing asset or servicing liability each time it undertakes an obligation to service a financial asset by entering into a servicing contract in any of the following situations:

a. A transfer of the servicer's financial assets that meets the requirements for sale accounting
b. A transfer of the servicer's financial assets to a qualifying SPE in a **guaranteed mortgage securitization** in which the transferor retains all of the resulting securities and classifies them as either available-for-sale securities or trading securities in accordance with FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*
c. An acquisition or assumption of a servicing obligation that does not relate to financial assets of the servicer or its consolidated affiliates.

An entity that transfers its financial assets to a qualifying SPE in a guaranteed mortgage securitization in which the transferor retains all of the resulting securities and classifies them as debt securities held-to-maturity in accordance with Statement 115 may either separately recognize its servicing assets or servicing liabilities or report those servicing assets or servicing liabilities together with the asset being serviced.

f. Paragraphs 13A and 13B are added as follows:

13A. An entity shall subsequently measure each class of servicing assets and servicing liabilities using one of the following methods:

a. *Amortization method:* Amortize servicing assets or servicing liabilities in proportion to and over the period of estimated net servicing income (if servicing revenues exceed servicing costs) or net servicing loss (if servicing costs exceed servicing revenues), and assess servicing assets or servicing liabilities for impairment or increased obligation based on fair value at each reporting date
b. *Fair value measurement method:* Measure servicing assets or servicing liabilities at fair value at each reporting date and report changes in fair value of servicing assets and servicing liabilities in earnings in the period in which the changes occur.

The election described in this paragraph shall be made separately for each class of servicing assets and servicing liabilities. An entity shall apply the same subsequent measurement method to each servicing asset and servicing liability in a class. Classes of servicing assets and servicing liabilities shall be identified based on (a) the availability of market inputs used in determining the fair value of servicing assets or servicing liabilities, (b) an entity's method for managing the risks of its servicing assets or servicing liabilities, or (c) both. Once an entity elects the fair value measurement method for a class of servicing assets and servicing liabilities, that election shall not be reversed (paragraph 63). If it is not practicable to initially measure a servicing asset or servicing liability at fair value, an entity shall initially recognize the servicing asset or servicing liability in accordance with paragraph 71 and shall include it in a class subsequently measured using the amortization method.

13B. An entity shall report recognized servicing assets and servicing liabilities that are subsequently measured using the fair value measurement method in a manner that separates those carrying amounts on the face of the statement of financial position from the carrying amounts for separately recognized servicing assets and servicing liabilities that are subsequently measured using the amortization method. To accomplish that separate reporting, an entity may either (a) display separate line items for the amounts that are subsequently measured using the fair value measurement method and amounts that are subsequently measured using the amortization method or (b) present the aggregate of those amounts that are subsequently measured at fair value and those amounts that are subsequently measured using the amortization method (paragraph 63) and disclose parenthetically the amount that is subsequently measured at fair value that is included in the aggregate amount.

g. Paragraph 14:

Interest-only strips, other~~retained~~ interests that continue to be held by a transferor in securitizations, loans, other receivables, or other financial assets that can contractually be prepaid or otherwise settled in such a way that the holder would not recover substantially all of its recorded investment, except for instruments that are within the scope of Statement 133, shall be subsequently measured like investments in debt securities classified as available-for-sale or trading under Statement 115, as amended (paragraph 362).

h. Paragraph 17:

An entity shall disclose the following:

a. For collateral:
   (1) If the entity has entered into repurchase agreements or securities lending transactions, its policy for requiring collateral or other security
   (2) If the entity has pledged any of its assets as collateral that are not reclassified and separately reported in the statement of financial position pursuant to paragraph 15(a), the carrying amount and classification of those assets as of the date of the latest statement of financial position presented
   (3) If the entity has accepted collateral that it is permitted by contract or custom to sell or repledge, the fair value as of the date of each statement of financial position presented of that collateral and of the portion of that collateral that it has sold or repledged, and information about the sources and uses of that collateral.
b. If debt was considered to be extinguished by in-substance defeasance under the provisions of FASB Statement No. 76, *Extinguishment of Debt,* prior to the effective date of Statement 125,[6] a general description of the transaction and the amount of debt that is considered extinguished at the end of the period so long as that debt remains outstanding.
c. If assets are set aside after the effective date of Statement 125 solely for satisfying scheduled payments of a specific obligation, a description of the nature of restrictions placed on those assets.
d. If it is not practicable to estimate the fair value of certain assets obtained or liabilities incurred in transfers of financial assets during the period, a description of those items and the reasons why it is not practicable to estimate their fair value.
~~e. For all servicing assets and servicing liabilities:~~
   ~~(1) The amounts of servicing assets or liabilities recognized and amortized during the period~~
   ~~(2) The fair value of recognized servicing assets and liabilities for which it is practicable to estimate that value and the method and significant assumptions used to estimate the fair value~~
   ~~(3) The risk characteristics of the underlying financial assets used to stratify recognized servicing assets for purposes of measuring impairment in accordance with paragraph 63~~
   ~~(4) The activity in any valuation allowance for impairment of recognized servicing assets—including beginning and ending balances, aggregate~~

~~additions charged and reductions credited to operations, and aggregate direct write-downs charged against the allowances—for each period for which results of operations are presented.~~

e. For all servicing assets and servicing liabilities:
   (1) Management's basis for determining its classes of servicing assets and servicing liabilities (paragraph 13A)
   (2) A description of the risks inherent in servicing assets and servicing liabilities and, if applicable, the instruments used to mitigate the income statement effect of changes in fair value of the servicing assets and servicing liabilities. (Disclosure of quantitative information about the instruments used to manage the risks inherent in servicing assets and servicing liabilities, including the fair value of those instruments at the beginning and end of the period, is encouraged but not required.)
   (3) The amount of contractually specified servicing fees (as defined in the glossary), late fees, and ancillary fees earned for each period for which results of operations are presented, including a description of where each amount is reported in the statement of income.

f. For servicing assets and servicing liabilities subsequently measured at fair value:
   (1) For each class of servicing assets and servicing liabilities, the activity in the balance of servicing assets and the activity in the balance of servicing liabilities (including a description of where changes in fair value are reported in the statement of income for each period for which results of operations are presented), including, but not limited to, the following:
      (a) The beginning and ending balances
      (b) Additions (through purchases of servicing assets, assumptions of servicing obligations, and servicing obligations that result from transfers of financial assets)
      (c) Disposals
      (d) Changes in fair value during the period resulting from:
         (i) Changes in valuation inputs or assumptions used in the valuation model
         (ii) Other changes in fair value and a description of those changes
      (e) Other changes that affect the balance and a description of those changes
   (2) A description of the valuation techniques or other methods used to estimate the fair value of servicing assets and servicing liabilities. If a valuation model is used, the description shall include the method-

ology and model validation procedures, as well as quantitative and qualitative information about the assumptions used in the valuation model (for example, discount rates and prepayment speeds). (An entity that provides quantitative information about the instruments used to manage the risks inherent in the servicing assets and servicing liabilities, as encouraged by paragraph 17(e)(2), is also encouraged, but not required, to disclose a description of the valuation techniques, as well as quantitative and qualitative information about the assumptions used to estimate the fair value of those instruments.)

g. For servicing assets and servicing liabilities subsequently amortized in proportion to and over the period of estimated net servicing income or loss and assessed for impairment or increased obligation:

(1) For each class of servicing assets and servicing liabilities, the activity in the balance of servicing assets and the activity in the balance of servicing liabilities (including a description of where changes in the carrying amount are reported in the statement of income for each period for which results of operations are presented), including, but not limited to, the following:

(a) The beginning and ending balances

(b) Additions (through purchases of servicing assets, assumption of servicing obligations, and servicing obligations that result from transfers of financial assets)

(c) Disposals

(d) Amortization

(e) Application of valuation allowance to adjust carrying value of servicing assets

(f) Other-than-temporary impairments

(g) Other changes that affect the balance and a description of those changes

(2) For each class of servicing assets and servicing liabilities, the fair value of recognized servicing assets and servicing liabilities at the beginning and end of the period if it is practicable to estimate the value

(3) A description of the valuation techniques or other methods used to estimate fair value of the servicing assets and servicing liabilities. If a valuation model is used, the description shall include the methodology and model validation procedures, as well as quantitative and qualitative information about the assumptions used in the valuation model (for example, discount rates and prepayment speeds). (An entity that provides quantitative information about the instruments used to manage the risks inherent in the servicing assets and servicing

liabilities, as encouraged by paragraph 17(e)(2), is also encouraged, but not required, to disclose a description of the valuation techniques as well as quantitative and qualitative information about the assumptions used to estimate the fair value of those instruments.)

(4) The risk characteristics of the underlying financial assets used to stratify recognized servicing assets for purposes of measuring impairment in accordance with paragraph 63

(5) The activity by class in any valuation allowance for impairment of recognized servicing assets—including beginning and ending balances, aggregate additions charged and recoveries credited to operations, and aggregate write-downs charged against the allowance—for each period for which results of operations are presented.

h~~f~~. If the entity has securitized financial assets during any period presented and accounts for that transfer as a sale, for each major asset type (for example, mortgage loans, credit card receivables, and automobile loans):

(1) Its accounting policies for initially measuring the ~~retained~~ interests that continue to be held by the transferor, if any, and servicing assets or servicing liabilities, if any, including the methodology (whether quoted market price, prices based on sales of similar assets and liabilities, or prices based on valuation techniques) used in determining their fair value (paragraphs 68–70)

(2) The characteristics of securitizations (a description of the transferor's continuing involvement with the transferred assets, including, but not limited to, servicing, recourse, and restrictions on ~~retained~~ interests that continue to be held by the transferor) and the gain or loss from sale of financial assets in securitizations

(3) The key assumptions[7] used in measuring the fair value of ~~retained~~ interests that continue to be held by the transferor and servicing assets or servicing liabilities, if any, at the time of securitization (including, at a minimum, quantitative information about discount rates, expected prepayments including the expected weighted-average life of prepayable financial assets,[8] and anticipated credit losses, if applicable)

(4) Cash flows between the securitization SPE and the transferor, unless reported separately elsewhere in the financial statements or notes (including proceeds from new securitizations, proceeds from collections reinvested in revolving-period securitizations, purchases of delinquent or foreclosed loans, servicing fees, and cash flows received on interests that continue to be held by the transferor~~retained~~).

i~~g~~. If the entity has ~~retained~~ interests that continue to be held by the transferor in ~~securitized~~ financial assets that it has securitized or servicing assets or servicing liabilities relating to assets that it has securitized, at the date of the latest statement of financial position presented, for each major asset type (for example, mortgage loans, credit card receivables, and automobile loans):

(1) Its accounting policies for subsequently measuring those ~~retained~~ interests, including the methodology (whether quoted market price, prices based on sales of similar assets and liabilities, or prices based on valuation techniques) used in determining their fair value (paragraphs 68–70)

(2) The key assumptions used in subsequently measuring the fair value of those interests (including, at a minimum, quantitative information about discount rates, expected prepayments including the expected weighted-average life of prepayable financial assets, and anticipated credit losses, including expected static pool losses,[9] if applicable)

(3) A sensitivity analysis or stress test showing the hypothetical effect on the fair value of those interests (including any servicing assets or servicing liabilities) of two or more unfavorable variations from the expected levels for each key assumption that is reported under (2) above independently from any change in another key assumption, and a description of the objectives, methodology, and limitations of the sensitivity analysis or stress test

(4) For the securitized assets and any other financial assets that it manages together with them:[10]

  (a) The total principal amount outstanding, the portion that has been derecognized, and the portion that continues to be recognized in each category reported in the statement of financial position, at the end of the period

  (b) Delinquencies at the end of the period

  (c) Credit losses, net of recoveries, during the period

  (Disclosure of average balances during the period is encouraged, but not required.)

i. Footnote 17 to paragraph 36:

An effect of that provision, in conjunction with paragraph 46, is that mortgage-backed securities ~~retained~~that continue to be held by a transferor in a guaranteed mortgage securitization in which the SPE meets all conditions for being a qualifying SPE are classified in the financial statements of the transferor as securities that are subsequently measured under Statement 115.

j. Paragraph 56:

> The proceeds from a sale of financial assets consist of the cash and any other assets obtained, including separately recognized servicing assets, in the transfer less any liabilities incurred, including separately recognized servicing liabilities. Any asset obtained that is not an interest in the transferred asset is part of the proceeds from the sale. Any liability incurred, even if it is related to the transferred assets, is a reduction of the proceeds. Any derivative financial instrument entered into concurrently with a transfer of financial assets is either an asset obtained or a liability incurred and part of the proceeds received in the transfer. All proceeds and reductions of proceeds from a sale shall be initially measured at fair value, if practicable.

k. Paragraph 57:

> Company A sells loans with a fair value of $1,100 and a carrying amount of $1,000. Company A ~~retains~~undertakes no servicing responsibilities but obtains an option to purchase from the transferee loans similar to the loans sold (which are readily obtainable in the marketplace) and assumes a limited recourse obligation to repurchase delinquent loans. Company A agrees to provide the transferee a return at a floating rate of interest even though the contractual terms of the loan are fixed rate in nature (that provision is effectively an interest rate swap).
>
> **Note: The table in this illustration is not reproduced here because there are no changes to that portion of this paragraph.**

l. Paragraph 58 and the heading preceding it:

> **~~Retained~~ Interests That Continue to Be Held by a Transferor**
>
> Other interests in transferred assets—those that are not part of the proceeds of a transfer—are ~~retained~~ interests that continue to be held by a transferor over which a transferor has not relinquished control. Interests that continue to be held by a transferor~~They~~ shall be measured at the date of the transfer by allocating the previous carrying amount between the assets sold, if any, and the ~~retained~~ interests that continue to be held by a transferor, based on their relative fair values. Allocation procedures shall be applied to all transfers in which interests ~~are~~continue to be held by a transferor ~~retained~~, even those that do not qualify as sales. Examples of ~~retained~~interests that continue to be held by a transferor include securities backed by the transferred assets, undivided

interests, ~~servicing assets,~~ and cash reserve accounts and residual interests in securitization trusts. If a transferor cannot determine whether an asset is an ~~retained~~ interest that continues to be held by a transferor or proceeds from the sale, the asset shall be treated as proceeds from the sale and accounted for in accordance with paragraph 56.

m. Paragraph 59:

If the ~~retained~~ interests that continue to be held by a transferor are subordinate~~d~~ to more senior interests held by others, that subordination may concentrate most of the risks inherent in the transferred assets into the ~~retained~~ interests that continue to be held by a transferor~~most of the risks inherent in the transferred assets~~ and shall be taken into consideration in estimating the fair value of those~~the retained~~ interests. For example, if the amount of the gain recognized, after allocation, on a securitization with a subordinated ~~retained~~ interest that continues to be held by the transferor is greater than the gain that would have been recognized had the entire asset been sold, the transferor needs to be able to identify why that can occur. Otherwise, it is likely that the effect~~impact~~ of subordination~~the retained interest being subordinate~~ to a senior interest has not been adequately considered in the determination of the fair value of the subordinated ~~retained~~ interest that continues to be held by a transferor.

n. Paragraph 60:

Company B sells a pro rata nine-tenths interest in loans with a fair value of $1,100 and a carrying amount of $1,000. There is no servicing asset or liability, because Company B estimates that the **benefits of servicing** are just adequate to compensate it for its servicing responsibilities.

Fair Values

Cash proceeds for nine-tenths interest sold	$990
One-tenth interest ~~retained~~that continues to be held by the transferor [($990 ÷ 9/10) × 1/10]	110

Carrying Amount Based on Relative Fair Values

	Fair Value	Percentage of Total Fair Value	Allocated Carrying Amount
Nine-tenths interest sold	$ 990	90	$ 900
One-tenth interest ~~retained~~that continues to be held by the transferor	110	10	100
Total	$1,100	100	$1,000

Gain on Sale

Net proceeds	$990
Carrying amount of loans sold	900
Gain on sale	$ 90

Journal Entry

Cash	990	
Loans		900
Gain on sale		90
To record transfer		

o. Paragraph 61:

Servicing of mortgage loans, credit card receivables, or other financial assets commonly includes, but is not limited to, collecting principal, interest, and escrow payments from borrowers; paying taxes and insurance from escrowed funds; monitoring delinquencies; executing foreclosure if necessary; temporarily investing funds pending distribution; remitting fees to guarantors, trustees, and others providing services; and accounting for and remitting principal and interest payments to the holders of beneficial interests in the financial assets. Servicing is inherent in all financial assets; it becomes a distinct asset or liability ~~only when contractually separated from the underlying assets by sale or securitization of the assets with servicing retained or separate purchase or assumption of the servicing~~for accounting purposes only in the circumstances described in paragraph 62.

p. Paragraph 62:

An entity that undertakes a contract to service financial assets shall recognize either a servicing asset or a servicing liability each time it undertakes an obligation to service a financial asset that (a) results from a transfer of the servicer's financial assets that meets the requirements for sale accounting, (b) results from a transfer of the servicer's financial assets to a qualifying SPE in a guaranteed mortgage securitization in which the transferor retains all of the resulting securities and classifies them as either available-for-sale securities or trading securities in accordance with Statement 115, or (c) is acquired or assumed and the servicing obligation does not relate to financial assets of the servicer or its consolidated affiliates.~~, with only one exception. (That exception is~~ However, if the transferor transfers the assets in a guaranteed mortgage securitization, retains all of the resulting securities, and classifies them as debt securities held-to-maturity in accordance with Statement 115, ~~in which case~~ the servicing asset or servicing liability may be reported together with the asset being serviced and not recognized separately.~~) Each sale or securitization with servicing retained or separate purchase or assumption of servicing results in a servicing contract.~~ A servicer of financial assets commonly receives the benefits of servicing—revenues from contractually specified servicing fees, a portion of the interest from the financial assets, late charges, and other ancillary sources, including "float," all of which it is entitled to receive only if it performs the servicing—and incurs the costs of servicing the assets. ~~Each servicing contract results in a servicing asset or servicing liability.~~ Typically, the benefits of servicing are expected to be more than **adequate compensation** to a servicer for performing the servicing, and the contract results in a servicing asset. However, if the benefits of servicing are not expected to adequately compensate a servicer for performing the servicing, the contract results in a servicing liability. (A servicing asset may become a servicing liability, or vice versa, if circumstances change, and the initial measure for servicing may be zero if the benefits of servicing are just adequate to compensate the servicer for its servicing responsibilities.) A servicer would account for its servicing contract that qualifies for separate recognition as a servicing asset or a servicing liability initially measured at its fair value regardless of whether explicit consideration was exchanged.

q. Paragraph 62A is added as follows:

62A. A servicer that transfers or securitizes financial assets in a transaction that does not meet the requirements for sale accounting and is accounted for as a secured borrowing with the underlying assets remaining on the transferor's balance sheet shall not recognize a servicing asset or a servicing liability. However, if a transferor enters into a servicing contract when the transferor transfers mortgage loans in a guaranteed mortgage securitization, retains all the resulting securities, and classifies those securities as either available-for-sale securities or trading securities in accordance with Statement 115, the transferor shall separately recognize a servicing asset or a servicing liability.

r. Paragraph 63:

A servicer that recognizes a servicing asset or servicing liability shall account for the contract to service financial assets separately from those financial assets, as follows:

a. Report servicing assets separately from servicing liabilities in the statement of financial position (paragraph 13B).
b. Initially measure servicing assets and servicing liabilities~~retained in a sale or securitization of the assets being serviced~~ at fair value~~their allocated previous carrying amount based on relative fair values~~, if practicable~~, at the date of the sale or securitization~~ (paragraphs 10, 11(b), 11(c), ~~58–60,~~ and 68–72).
~~c. Initially measure servicing assets purchased or servicing liabilities assumed at fair value (paragraph 13).~~
~~d. Initially measure servicing liabilities undertaken in a sale or securitization at fair value, if practicable (paragraphs 11(b), 11(c), and 68–72).~~
c~~e~~. Account separately for rights to future interest income from the serviced assets that exceed~~s~~ contractually specified servicing fees. Those rights are not servicing assets; they are financial assets, effectively interest-only strips to be accounted for in accordance with paragraph 14 of this Statement.
d. Identify classes of servicing assets and servicing liabilities based on (1) the availability of market inputs used in determining the fair value of servicing assets and servicing liabilities, (2) an entity's method for managing the risks of its servicing assets and servicing liabilities, or (3) both.
e~~f~~. Subsequently measure each class of separately recognized servicing assets and servicing liabilities either at fair value or by amortizing the amount recognized in proportion to and over the period of estimated net servicing income for assets—(the excess of servicing revenues over servicing costs) or the period of estimated net servicing loss for servicing liabilities (the excess of servicing costs over servicing revenues). Different elections can be made for different classes of servicing assets and servicing liabilities. An entity may make an irrevocable decision to

subsequently measure a class of servicing assets and servicing liabilities at fair value at the beginning of any fiscal year. Once a servicing asset or a servicing liability is reported in a class of servicing assets and servicing liabilities that an entity elects to subsequently measure at fair value, that servicing asset or servicing liability cannot be placed in a class of servicing assets and servicing liabilities that is subsequently measured using the amortization method. Changes in fair value should be reported in earnings for servicing assets and servicing liabilities subsequently measured at fair value (paragraph 13A(b)).

f~~g~~. Subsequently evaluate and measure impairment of each class of separately recognized servicing assets that are subsequently measured using the amortization method described in paragraph 13A(a) as follows:

(1) Stratify servicing assets within a class based on one or more of the predominant risk characteristics of the underlying financial assets. Those characteristics may include financial asset type,[19] size, interest rate, date of origination, term, and geographic location.

(2) Recognize impairment through a valuation allowance for an individual stratum. The amount of impairment recognized separately shall be the amount by which the carrying amount of servicing assets for a stratum exceeds their fair value. The fair value of servicing assets that have not been recognized shall not be used in the evaluation of impairment.

(3) Adjust the valuation allowance to reflect changes in the measurement of impairment subsequent to the initial measurement of impairment. Fair value in excess of the carrying amount of servicing assets for that stratum, however, shall not be recognized. This Statement does not address when an entity should record a direct write-down of recognized servicing assets~~ (paragraph 13)~~.

g~~h~~. ~~Subsequently measure servicing liabilities by amortizing the amount recognized in proportion to and over the period of estimated net servicing loss—the excess of servicing costs over servicing revenues. However,~~For servicing liabilities subsequently measured using the amortization method, if subsequent events have increased the fair value of the liability above the carrying amount, for example, because of significant changes in the amount or timing of actual or expected future cash flows ~~from~~relative to the cash flows previously projected, the servicer shall revise its earlier estimates and recognize the increased obligation as a loss in earnings (paragraph 13).

s. Paragraph 65 and the heading preceding it:

Illustration—Sale of Receivables with Servicing ~~Retained~~Obtained

Company C originates $1,000 of loans that yield 10 percent interest income for their estimated lives of 9 years. Company C sells the $1,000 principal plus the right to receive interest income of 8 percent to another entity for $1,000. Company C will continue to service the loans, and the contract stipulates that its compensation for performing the servicing is the right to receive half of the interest income not sold. The remaining half of the interest income not sold is considered an interest-only strip receivable that Company C classifies as an available-for-sale security. At the date of the transfer, the fair value of the loans~~, including servicing,~~ is $1,100. The fair values of the servicing asset and the interest-only strip receivable are~~is~~ $40 and $60, respectively.

Fair Values	
Cash proceeds	$1,000
Servicing asset	40
Interest-only strip receivable	60

Net Proceeds	
Cash proceeds	$1,000
Servicing asset	40
Net proceeds	$1,040

Carrying Amount Based on Relative Fair Values

	~~Fair Value~~	~~Percentage of Total Fair Value~~	~~Allocated Carrying Amount~~
~~Loans sold~~	~~$1,000~~	~~91.0~~	~~$ 910~~
~~Servicing asset~~	~~40~~	~~3.6~~	~~36~~
~~Interest-only strip receivable~~	~~60~~	~~5.4~~	~~54~~
~~Total~~	~~$1,100~~	~~100.0~~	~~$1,000~~

	Fair Value	Percentage of Total Fair Value	Allocated Carrying Amount
Loans sold	$1,040	94.55	$ 945.50
Interest-only strip receivable	60	5.45	54.50
Total	$1,100	100.00	$1,000.00

Gain on Sale

Net proceeds	$1,040.00~~1,000~~
Less: Carrying amount of loans sold	945.50~~910~~
Gain on sale	$ 94.50~~90~~

Journal Entries

Cash	1,000.00	
Interest-only strip receivable	54.50	
Servicing asset	40.00	
Loans		1,000.00~~910~~
Gain on sale		94.50~~90~~
To record transfer and to recognize interest-only strip receivable and servicing asset		
~~Servicing asset~~	~~36~~	
~~Interest-only strip receivable~~	~~54~~	
~~Loans~~		~~90~~
~~To record servicing asset and interest-only strip receivable~~		
Interest-only strip receivable	5.50~~6~~	
~~Equity~~Other comprehensive income		5.50~~6~~
To begin to subsequently measure interest-only strip receivable like an available-for-sale security (paragraph 14)		

t. Paragraph 66:

The previous illustration demonstrates how a transferor would account for a simple sale ~~or securitization~~ in which servicing is ~~retained~~obtained. Company C might instead transfer the financial assets to a corporation or a trust that is a qualifying SPE. The qualifying SPE then securitizes the loans by selling beneficial interests to the public. The qualifying SPE pays the cash proceeds to the original transferor, which accounts for the transfer as a sale and derecognizes the financial assets assuming that the criteria in paragraph 9 are met. Securitizations often combine the elements shown in paragraphs 57, 60, and 65, as illustrated below.

u. Paragraph 67:

Company D originates $1,000 of prepayable loans that yield 10 percent interest income for their 9-year expected lives. Company D sells nine-tenths of the principal plus interest of 8 percent to another entity. Company D will continue to service the loans, and the contract stipulates that its compensation for performing the servicing is the 2 percent of the interest income not sold. Company D obtains an option to purchase from the transferee loans similar to the loans sold (which are readily obtainable in the marketplace) and incurs a limited recourse obligation to repurchase delinquent loans. At the date of transfer, the fair value of the loans is $1,100.

Fair Values

Cash proceeds	$900
Call option	70
Recourse obligation	(60)
Servicing asset	90
One-tenth interest ~~retained~~that continues to be held by the transferor	100

Net Proceeds

Cash received	$ 900
Plus: Servicing asset	90
Plus: Call option	70
Less: Recourse obligation	(60)
Net proceeds	$1,000~~910~~

Carrying Amount Based on Relative Fair Values

	~~Fair Value~~	~~Percentage of Total Fair Value~~	~~Allocated Carrying Amount~~
~~Interest sold~~	~~$ 910~~	~~83~~	~~$ 830~~
~~Servicing asset~~	~~90~~	~~8~~	~~80~~
~~One-tenth interest retained~~	~~100~~	~~9~~	~~90~~
~~Total~~	~~$1,100~~	~~100~~	~~$1,000~~

	Fair Value	Percentage of Total Fair Value	Allocated Carrying Amount
Interest sold	$1,000	90.9	$ 909
One-tenth interest that continues to be held by the transferor	100	9.1	91
Total	$1,100	100.0	$1,000

Gain on Sale

Net proceeds	$1,000 ~~910~~
Less: Carrying amount of loans sold	(909) ~~830~~
Gain on sale	$ 91 ~~80~~

Loans Sold

Carrying amount of loans	$1,000
Less: Allocated carrying amount of interest that continues to be held by the transferor	(91)
Loans sold	$ 909

Journal Entries

Cash	900	
Call option	70	
Servicing asset	90	
Loans		909~~830~~
Recourse obligation		60
Gain on sale		91~~80~~
To record transfer and to recognize servicing asset, call option, and recourse obligation		
~~Servicing asset~~	~~80~~	
~~Loans~~		~~80~~
~~To record servicing asset~~		

~~At the time of the transfer, Company D reports its one-tenth retained interest in the loans at its allocated carrying amount of $90.~~

v. Footnotes 20 and 21 to paragraph 69:

[20]FASB Concepts Statement No. 7, *Using Cash Flow Information and Present Value in Accounting Measurements,* discusses the use of present value techniques in measuring the fair value of an asset (or liability) in paragraphs 42–54 and 75–88. The Board believes that an expected present value technique is superior to traditional "best estimate" techniques, especially in situations in which the timing or amount of estimated cash flows is uncertain, as is often the case for ~~retained~~ interests that continue to be held by a transferor in transferred financial assets. Concepts Statement 7 also discusses in paragraph 44 the steps needed to complete a proper search for the "rate commensurate with the risk" in applying the traditional technique.

[21]The timing and amount of future cash flows for ~~retained~~ interests in securitizations that continue to be held by a transferor are commonly uncertain, especially if those interests are subordinate to more senior beneficial interests. Applying the present value approach depends heavily on assumptions about default and prepayment of all the assets securitized, because of the implicit credit or prepayment risk enhancement arising from the subordination.

w. Paragraph 72:

Company E sells loans with a carrying amount of $1,000 to another entity for cash proceeds of $1,050 plus a call option to purchase loans similar to the loans sold (which are readily obtainable in the marketplace) and incurs a limited recourse obligation to repurchase any delinquent loans. Company E undertakes an obligation to service the transferred assets for the other entity. In Case 1, Company E finds it impracticable to estimate the fair value of the servicing contract, although it is confident that servicing revenues will be more than adequate compensation for performing the servicing. In Case 2, Company E finds it impracticable to estimate the fair value of the recourse obligation.

Fair Values	**Case 1**	**Case 2**
Cash proceeds	$1,050	$1,050
Servicing asset	XX*	40
Call option	70	70
Recourse obligation	(60)	XX*
Fair value of loans transferred	1,100	1,100

*Not practicable to estimate fair value.

Net Proceeds	**Case 1**	**Case 2**
Cash received	$1,050	$1,050
Plus: Servicing asset	XX*	40
Plus: Call option	70	70
Less: Recourse obligation	(60)	XX†
Net proceeds	$1,060	$1,160~~1,120~~

~~**Carrying Amount Based on Relative Fair Values (Case 1)**~~

	~~**Fair Value**~~	~~**Percentage of Total Fair Value**~~	~~**Allocated Carrying Amount**~~
~~Loans sold~~	~~$1,060~~	~~100~~	~~$1,000~~
~~Servicing asset~~	~~0~~	~~0~~	~~0~~
~~Total~~	~~$1,060~~	~~100~~	~~$1,000~~

~~**Carrying Amount Based on Relative Fair Values (Case 2)**~~

	~~**Fair Value**~~	~~**Percentage of Total Fair Value**~~	~~**Allocated Carrying Amount**~~
~~Loans sold~~	~~$1,120~~	~~97~~	~~$ 970~~
~~Servicing asset~~	~~40~~	~~3~~	~~30~~
~~Total~~	~~$1,160~~	~~100~~	~~$1,000~~

Gain on Sale	**Case 1**	**Case 2**
Net proceeds	$1,060	$1,160
Carrying amount of loans	1,000	1,000
Less: Recourse obligation	0	(160)†
Gain on sale	$ 60	$ 0

Journal Entries	**Case 1**		**Case 2**	
Cash	1,050		1,050	
Servicing asset	0*		40~~30~~	
Call option	70		70	
Loans		1,000		1,000
Recourse obligation		60		160~~150~~†
Gain on sale		60		0
To record transfer				

*Assets shall be recorded at zero if an estimate of the fair value of the assets is not practicable.

†The amount recorded as a liability in this example equals the sum of the known assets less the fair value of the known liabilities, that is, the amount that results in no gain or loss.

x. Paragraph 76:

Pass-through, pay-through, and revolving-period securitizations that meet the criteria in paragraph 9 qualify for sale accounting under this Statement. All financial assets obtained or ~~retained~~that continue to be held by a transferor and liabilities incurred by the originator of a securitization that qualifies as a sale shall be recognized and measured as provided in paragraphs 10 and 11; that includes the implicit forward contract to sell new receivables during a revolving period, which may become valuable or onerous to the transferor as interest rates and other market conditions change.

y. Paragraph 82:

> In other securitizations, a similar corporation transfers financial assets to an SPE in exchange for cash and beneficial interests in the transferred assets. That entity raises the cash by issuing to investors commercial paper that gives them a senior interest in cash received from the financial assets. The beneficial interests ~~retained~~that continue to be held by the transferring corporation represent a junior interest to be reduced by any credit losses on the financial assets in trust. The commercial paper interests are highly rated by credit rating agencies only if both (a) the credit enhancement from the junior interest is sufficient and (b) the transferor is highly rated. Depending on facts and circumstances, the Board understands that those "single-step" securitizations often would be judged in the United States as not having isolated the assets, because the nature of the continuing involvement may make it difficult to obtain reasonable assurance that the transfer would be found to be a true sale at law that places the assets beyond the reach of the transferor and its creditors in U.S. bankruptcy (paragraph 113). If the transferor fell into bankruptcy and the transfer was found not to be a true sale at law, investors in the transferred assets might be subjected to an automatic stay that would delay payments due them, and they might have to share in bankruptcy expenses and suffer further losses if the transfer was recharacterized as a secured loan.

z. Paragraph 83(b):

> Second, the special-purpose corporation transfers the assets to a trust or other legal vehicle with a sufficient increase in the credit or yield protection on the second transfer (provided by a junior ~~retained~~ beneficial interest that continues to be held by the transferor or other means) to merit the high credit rating sought by third-party investors who buy senior beneficial interests in the trust. Because of that aspect of its design, that second transfer might not be judged to be a true sale at law and, thus, the transferred assets could at least in theory be reached by a bankruptcy trustee for the special-purpose corporation.

aa. Paragraph 87(a):

> A ROAP for random removal of excess assets, if the ROAP is sufficiently limited so that the transferor cannot remove specific transferred assets, for

example, by limiting removals to the amount of the ~~transferor's retained~~ interests that continue to be held by the transferor and to one removal per month

bb. Paragraph 343:

The first example illustrates the disclosure of accounting policies for ~~retained~~ interests that continue to be held by the transferor. In particular, it describes the accounting policies for (a) initial measurement (paragraph 17(~~f~~h)(1)) and (b) subsequent measurement (paragraph 17(~~g~~i)(1)), including determination of fair value.

NOTE X—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Receivable Sales

When the Company sells receivables in securitizations of automobile loans, credit card loans, and residential mortgage loans, it may hold~~retains~~ interest-only strips, one or more subordinated tranches, ~~servicing rights,~~ and in some cases a cash reserve account, all of which are ~~retained~~ interests that continue to be held by the transferor in the securitized receivables. It may also obtain servicing assets or assume servicing liabilities that are initially measured at fair value. Gain or loss on sale of the receivables depends in part on both (a) the previous carrying amount of the financial assets involved in the transfer, allocated between the assets sold and the ~~retained~~ interests that continue to be held by the transferor based on their relative fair value at the date of transfer, and (b) the proceeds received. To obtain fair values, quoted market prices are used if available. However, quotes are generally not available for ~~retained~~ interests that continue to be held by the transferor, so the Company generally estimates fair value based on the present value of future expected cash flows estimated using management's best estimates of the key assumptions—credit losses, prepayment speeds, forward yield curves, and discount rates commensurate with the risks involved.

cc. Paragraph 344:

In addition to the disclosure of assumptions used in determining the values of ~~retained~~ interests that continue to be held by the transferor at the time of securitization that are presented in paragraph 343, this Statement also requires similar disclosures at the end of the latest period being presented. The following example illustrates disclosures about the characteristics of securitizations and gain or loss from securitizations and other sales by major type of asset (paragraph 17(~~f~~h)(2)).

NOTE Y—SALES OF RECEIVABLES

During 20X2 and 20X1, the Company sold automobile loans, residential mortgage loans, and credit card loans in securitization transactions. In all those securitizations, the Company ~~retained~~obtained servicing responsibilities and subordinated interests. The Company receives annual servicing fees approximating 0.5 percent (for mortgage loans), 2 percent (for credit card loans), and 1.5 percent (for automobile loans) of the outstanding balance and rights to future cash flows arising after the investors in the securitization trust have received the return for which they contracted. The investors and the securitization trusts have no recourse to the Company's other assets for failure of debtors to pay when due. The ~~Company's retained~~ interests that continue to be held by the Company are subordinate to investor's interests. Their value is subject to credit, prepayment, and interest rate risks on the transferred financial assets.

In 20X2, the Company recognized pretax gains of $22.3 million on the securitization of the automobile loans, $30.2 million on the securitization of credit card loans, and $25.6 million on the securitization of residential mortgage loans.

In 20X1, the Company recognized pretax gains of $16.9, $21.4, and $15.0 million on the securitization of the automobile loans, credit card loans, and residential mortgage loans, respectively.

dd. Paragraph 345:

The following is an illustration of the quantitative information about key assumptions used in measuring ~~retained~~ interests that continue to be held by the transferor at the date of sale or securitization for each financial period presented (paragraph 17(~~f~~h)(3)).

Key economic assumptions used in measuring the ~~retained~~ interests that continue to be held by the transferor at the date of securitization resulting from securitizations completed during the year were as follows (rates* per annum):

Note: The table in this illustration is not reproduced here because there are no changes to that portion of this paragraph.

ee. Paragraph 346 and its related footnote:

The following is an illustration that combines disclosure of the key assumptions used in valuing ~~retained~~ interests that continue to be held by the transferor at the end of the latest period (paragraph 17(~~g~~i)(2)) and the hypothetical effect on current fair value of two or more pessimistic variations from the expected levels for each of the key assumptions (paragraph 17(~~g~~i)(3)).

At December 31, 20X2, key economic assumptions and the sensitivity of the current fair value of residual cash flows to immediate 10 percent and 20 percent adverse changes in those assumptions are as follows ($ in millions):

			Residential Mortgage Loans	
	Automobile Loans	Credit Card Loans	Fixed-Rate	Adjustable
Carrying amount/fair value of ~~retained~~ interests that continue to be held by the transferor	$15.6	$21.25	$12.0	$13.3
Weighted-average life (in years)[34]	1.7	0.4	6.5	6.1
Prepayment speed assumption (annual rate)	**1.3%**	**15.0%**	**11.5%**	**9.3%**
Impact on fair value of 10% adverse change	*$0.3*	*$1.6*	*$3.3*	*$2.6*
Impact on fair value of 20% adverse change	*$0.7*	*$3.0*	*$7.8*	*$6.0*
Expected credit losses (annual rate)	**3.0%**	**6.1%**	**0.9%**	**1.8%**
Impact on fair value of 10% adverse change	*$4.2*	*$3.2*	*$1.1*	*$1.2*
Impact on fair value of 20% adverse change	*$8.4*	*$6.5*	*$2.2*	*$3.0*
Residual cash flows discount rate (annual)	**14.0%**	**14.0%**	**12.0%**	**9.0%**
Impact on fair value of 10% adverse change	*$1.0*	*$0.1*	*$0.6*	*$0.5*
Impact on fair value of 20% adverse change	*$1.8*	*$0.1*	*$0.9*	*$0.9*
Interest rates on variable and adjustable contracts	**Forward Eurodollar yield curve plus contracted spread**			
Impact on fair value of 10% adverse change	*$1.5*	*$4.0*	*$0.4*	*$1.5*
Impact on fair value of 20% adverse change	*$2.5*	*$8.1*	*$0.7*	*$3.8*

These sensitivities are hypothetical and should be used with caution. As the figures indicate, changes in fair value based on a 10 percent variation in assumptions generally cannot be extrapolated because the relationship of the change in assumption to the change in fair value may not be linear. Also, in this table, the effect of a variation in a particular assumption on the fair value of the ~~retained~~ interest that continues to be held by the transferor is calculated without changing any other assumption; in reality, changes in one factor may result in changes in another (for example, increases in market interest rates may result in lower prepayments and increased credit losses), which might magnify or counteract the sensitivities.

[34]Footnote 8, paragraph 17(~~f~~h)(3), describes how weighted-average life can be calculated.

ff. Paragraph 347:

The following is an illustration of disclosure of expected static pool credit losses (paragraph 17(~~g~~i)(2)).

Note: The table in this illustration is not reproduced here because there are no changes to that portion of this paragraph.

gg. Paragraph 348 and note * to paragraph 348:

The following is an illustration of the disclosure of cash flows between the securitization SPE and the transferor (paragraph 17(~~f~~h)(4)).

The table below summarizes certain cash flows received from and paid to securitization trusts ($ in millions):

	Year Ended December 31	
	20X2	**20X1**
Proceeds from new securitizations	$1,413	$ 971
Proceeds from collections reinvested in previous credit card securitizations	3,150	2,565
Servicing fees received	23	19
Other cash flows received on ~~retained~~ interests that continue to be held by the transferor*	81	52
Purchases of delinquent or foreclosed assets	(45)	(25)
Servicing advances	(102)	(73)
Repayments of servicing advances	90	63

Note:

*This amount represents total cash flows received from ~~retained~~ interests that continue to be held by the transferor ~~other than servicing fees~~. Other cash flows include, for example, all cash flows from interest-only strips and cash above the minimum required level in cash collateral accounts.

hh. Note § to paragraph 349:

Represents the principal amount of the loan. Interest-only strips (or other interests that continue to be held by a transferor) and servicing assets and servicing liabilities~~rights (or other retained interests)~~ held for securitized assets are excluded from this table because they are recognized separately.

ii. Paragraph 349A is added as follows:

349A. The following is an illustration of disclosures related to the activity in the balance of servicing assets and servicing liabilities by class (paragraphs 17(f)(1) and 17(g)(1)):

(This page intentionally left blank.)

Tabular Disclosure of Changes in Servicing Assets and Servicing Liabilities Subsequently Measured Using the Fair Value Measurement Method

	Class 1		Class 2		
Balance Sheet Disclosures	**Servicing Asset**	**Servicing Liability**	**Servicing Asset**	**Servicing Liability**	**Reference**
Fair value as of the beginning of the period	XX	XX	XX	XX	17(f)(1)(a)
Additions:					17(f)(1)(b)
Purchases of servicing assets	XX	N/A	XX	N/A	
Assumption of servicing obligations	XX	XX	XX	XX	
Servicing obligations that result from transfers of financial assets	XX	XX	XX	XX	
Subtractions:					
Disposals	(XX)	(XX)	(XX)	(XX)	17(f)(1)(c)
Changes in fair value:					17(f)(1)(d)
Due to change in valuation inputs or assumptions used in the valuation model	XX/(XX)	XX/(XX)	XX/(XX)	XX/(XX)	
Other changes in fair value	XX/(XX)	XX/(XX)	XX/(XX)	XX/(XX)	
Other changes that affect the balance	XX/(XX)	XX/(XX)	XX/(XX)	XX/(XX)	17(f)(1)(e)
Fair value as of the end of the period	XX	XX	XX	XX	17(f)(1)(a)

Tabular Disclosure of Changes in Servicing Assets and Servicing Liabilities Subsequently Measured Using the Amortization Method

	Class 3		Class 4		
Balance Sheet Disclosures	**Servicing Asset**	**Servicing Liability**	**Servicing Asset**	**Servicing Liability**	**Reference**
Carrying amount as of the beginning of the period	XX	XX	XX	XX	17(g)(1)(a)
Additions:					17(g)(1)(b)
Purchases of servicing assets	XX	N/A	XX	N/A	
Assumption of servicing obligations	XX	XX	XX	XX	
Servicing obligations that result from transfers of financial assets	XX	XX	XX	XX	
Subtractions:					
Disposals	(XX)	(XX)	(XX)	(XX)	17(g)(1)(c)
Amortization	(XX)	(XX)	(XX)	(XX)	17(g)(1)(d)
Application of valuation allowance to adjust carrying values of servicing assets	XX/(XX)	N/A	XX/(XX)	N/A	17(g)(1)(e)
Other-than-temporary impairments	(XX)	(XX)	(XX)	(XX)	17(g)(1)(f)
Other changes that affect the balance	XX/(XX)	XX/(XX)	XX/(XX)	XX/(XX)	17(g)(1)(g)
Carrying amount before valuation allowance	XX	XX	XX	XX	

Valuation allowance for servicing assets:					17(g)(5)
Beginning balance	XX	N/A	XX	N/A	
Provisions/recoveries	XX/(XX)	N/A	XX/(XX)	N/A	
Other-than-temporary impairments	(XX)	N/A	(XX)	N/A	17(g)(1)(f)
Sales and disposals	(XX)	N/A	(XX)	N/A	
Ending balance	XX/(XX)	N/A	XX/(XX)	N/A	
Carrying amount as of the end of the period	XX	XX	XX	XX	17(g)(1)(a)

Fair Value Disclosures

Fair value as of the beginning of the period	XX	XX	XX	XX	17(g)(2)
Fair value as of the end of the period	XX	XX	XX	XX	17(g)(2)

Amendments to Other Existing Pronouncements

5. FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities,* is amended as follows:

a. Footnote 9 to paragraph 21:

> Mortgage bankers and other servicers of financial assets that designate a hedged portfolio by aggregating servicing rights within one or more risk strata used under paragraph 63~~(g)~~(f) of Statement 140 would not necessarily comply with the requirement in this paragraph for portfolios of similar assets. The risk ~~stratum~~strata under paragraph 63~~(g)~~(f) of Statement 140 can be based on any predominant risk characteristic, including date of origination or geographic location.

b. Paragraph 56, as amended:

> At the date of initial application, mortgage bankers and other servicers of financial assets may choose to restratify their servicing rights pursuant to paragraph 63~~(g)~~(f) of Statement 140 in a manner that would enable individual strata to comply with the requirements of this Statement regarding what constitutes "a portfolio of similar assets." As noted in footnote 9 of this Statement, mortgage bankers and other servicers of financial assets that designate a hedged portfolio by aggregating servicing rights within one or more risk strata used under paragraph 63~~(g)~~(f) of Statement 140 would not necessarily comply with the requirement in paragraph 21(a) of this Statement for portfolios of similar assets, since the risk stratum under paragraph 63~~(g)~~(f) of Statement 140 can be based on any predominant risk characteristic, including date of origination or geographic location. The restratification of servicing rights is a change in the application of an accounting principle, and the effect of that change as of the initial application of this Statement shall be reported as part of the cumulative-effect-type adjustment for the transition adjustments.

6. FASB Technical Bulletin No. 87-3, *Accounting for Mortgage Servicing Fees and Rights,* is amended as follows:

a. Paragraph 9, as amended:

> An enterprise should~~may acquire~~ separately recognize either a servicing asset~~s~~ or a servicing liability~~liabilities~~ each time that it undertakes an

obligation to service a financial asset by entering into a servicing contract in any of the following situations:~~by purchasing or originating financial assets with servicing rights retained or by purchasing the servicing rights separately.~~

a. A transfer of the servicer's financial assets that meets the requirements for sale accounting
b. A transfer of the servicer's financial assets to a qualifying special-purpose entity (SPE) in a guaranteed mortgage securitization in which the transferor retains all of the resulting securities and classifies them as either available-for-sale securities or trading securities in accordance with FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*
c. An acquisition or assumption of a servicing obligation that does not relate to financial assets of the servicer or its consolidated affiliates.

Servicing assets ~~and liabilities~~that are subsequently measured using the amortization method are amortized in proportion to, and over the period of, estimated net servicing income—the excess of servicing revenues over servicing costs. Servicing liabilities that are subsequently measured using the amortization method are amortized in proportion to, and over the period of, estimated net servicing loss—the excess of servicing costs over servicing revenues. For servicing assets and servicing liabilities that are subsequently measured using the fair value measurement method, changes in fair value of servicing assets and liabilities shall be reported in earnings in the period in which the changes occur. An entity that transfers its financial assets to a qualifying SPE in a guaranteed mortgage securitization in which the transferor retains all of the resulting debt securities and classifies them as held-to-maturity in accordance with Statement 115 either may separately recognize its servicing assets or servicing liabilities or may report those servicing assets or servicing liabilities together with the asset being serviced.

b. Paragraph 10:

No. The mortgage servicing right represents a contractual relationship between the servicer and the investor in the loan, not between the servicer and the borrower. The cost of ~~the~~a mortgage servicing right that is subsequently measured using the amortization method may require adjustment as a result of the refinancing transaction depending on the servicer's assumptions in recording the servicing asset. If the refinancing transaction represents prepayment activity anticipated by the servicer when the servicing asset was recorded, an adjustment would not be necessary. However, if actual prepayments differ from anticipated prepayments, an adjustment to the servicing asset would be required. If the servicing rights (assets or liabilities) are subsequently measured using the fair value measurement method, the entity would recognize any adjustment as a result of the refinancing transaction directly in earnings.

Effective Date and Transition

7. An entity shall adopt this Statement as of the beginning of its first fiscal year that begins after September 15, 2006. Earlier adoption is permitted as of the beginning of an entity's fiscal year, provided the entity has not yet issued financial statements, including interim financial statements, for any period of that fiscal year. The effective date of this Statement is the date that an entity adopts the requirements of this Statement.

Initial Recognition and Measurement of Servicing Assets and Servicing Liabilities

8. The guidance on initial recognition and measurement of servicing assets and servicing liabilities shall be applied prospectively to transactions occurring after the effective date of this Statement. The related disclosure requirements in paragraphs 17(e)–17(g) of Statement 140 shall also be applied prospectively to periods ending after the effective date of this Statement.

Subsequent Measurement at Fair Value upon Adoption of This Statement

9. The option, if elected, to subsequently measure separately recognized servicing assets and servicing liabilities at fair value shall be applied to existing servicing assets and servicing liabilities as of the beginning of the fiscal year that an entity adopts this Statement, provided the entity has not yet issued financial statements, including interim financial statements, for any period of that fiscal year. This Statement enables entities to make an irrevocable election to subsequently measure each class of separately recognized servicing assets and servicing liabilities at fair value. The subsequent measurement of a class of separately recognized servicing assets and servicing liabilities at fair value shall be applied prospectively to all new and existing separately recognized servicing assets and servicing liabilities within that class. The difference between the fair value and the carrying amount, net of any related valuation allowance, of separately recognized servicing assets and servicing liabilities existing at the date of initial application of the subsequent fair value measurement shall be recorded as a cumulative-effect adjustment to retained earnings as of the beginning of the fiscal year and shall be separately disclosed.

10. Upon adoption of this Statement, an entity with recognized servicing rights may make an irrevocable election to reclassify available-for-sale securities to trading securities as of the beginning of the fiscal year in which its adopts this Statement without regard to the restriction in paragraph 15 of Statement 115, provided that those securities are identified in some manner as offsetting the entity's exposure to changes in fair value of servicing assets or servicing liabilities that the entity elects to subsequently measure at fair value. The amount of gains and losses in accumulated other comprehensive income related to the reclassified securities shall be reported as a separate cumulative-effect adjustment to beginning retained earnings. The carrying amount of reclassified securities and the effect of that reclassification on the cumulative-effect adjustment shall be separately disclosed.

Subsequent Measurement at Fair Value after Adoption of This Statement

11. An entity also may make an irrevocable decision to subsequently measure a class of separately recognized servicing assets and servicing liabilities at fair value as of the beginning of any fiscal year that begins subsequent to the initial adoption of this Statement. Transferring servicing assets and servicing liabilities from a class subsequently measured using the amortization method to a class subsequently measured at fair value is permitted as of the beginning of any fiscal year. The subsequent measurement of servicing assets and servicing liabilities at fair value shall be applied prospectively with a cumulative-effect adjustment to retained earnings as of the beginning of the fiscal year to reflect the difference between the fair value and the carrying amount, net of any related valuation allowance, of the servicing assets and servicing liabilities that exist at the beginning of the fiscal year in which the entity makes the fair value election. The amount of the cumulative-effect adjustment shall be separately disclosed.

Subsequent Measurement at Fair Value for a New Class of Servicing Assets and Servicing Liabilities

12. If, after the initial adoption of this Statement, an entity recognizes a new class of servicing assets and servicing liabilities, and no servicing assets and servicing liabilities that would belong to this class had previously been recognized by the entity, the entity may elect to subsequently measure that new class of servicing assets and servicing liabilities at fair value at the date of initial recognition of those servicing assets and servicing liabilities.

The provisions of this Statement need not be applied to immaterial items.

This Statement was adopted by the affirmative votes of six members of the Financial Accounting Standards Board. Ms. Schipper dissented.

Ms. Schipper dissents from the issuance of this Statement because, by permitting free choice between two different subsequent measurement attributes for servicing rights, the provisions of this Statement impair comparability and consistency, two desirable qualitative characteristics of financial information in the Board's conceptual framework. She believes that the impairment of comparability and consistency cannot be justified by a cost-benefit analysis. Ms. Schipper agrees with the Board's conclusion, as described in paragraph A10, that fair value is the most relevant measurement attribute for servicing rights because of the similarities between those rights and financial instruments, and the Board's conclusion, as described in paragraph A2, that the lower of fair value or carrying amount is a suboptimal measurement attribute. Therefore, she would require that servicing rights be initially and subsequently measured at fair value in the statement of financial position, with changes in fair value reported in earnings.

Ms. Schipper believes that treatment alternatives, such as the one provided in this Statement, are inherently undesirable because they impair comparability, a desirable qualitative characteristic of financial information in the Board's conceptual framework. The Board acknowledges, in paragraph A20 of this Statement, that comparability between entities will be impaired to the extent that different entities that hold servicing rights apply different measurement attributes. In addition, because the treatment alternative is applied class by class within an entity, it will probably result in different measurement attributes for different classes of servicing rights within an entity. Ms. Schipper believes that the detailed disclosures that are required by this Statement, with the objective of rectifying the noncomparability in measurements, are not a substitute for consistent and comparable measurement of similar items. The requirement in this Statement that fair values of servicing rights be disclosed, if practicable, by entities that elect not to apply fair value measurement for recognition purposes could imply that the Board believes that disclosure of fair value measurements is a substitute for recognition (that is, initial and subsequent measurement in the financial statements) at fair value, an idea that she rejects.

With regard to the cost-benefit criterion of the Board's conceptual framework, Ms. Schipper notes that the incremental burden that would be imposed on preparers by a requirement to measure all servicing rights initially and subsequently at fair value would not be large, given the requirements of existing accounting guidance and the disclosure requirements of this Statement. Specifically, the existing accounting guidance already requires certain fair value measurements (as part of recording servicing rights at the lower of fair value or carrying amount). Thus, as acknowledged in paragraph A11 of this Statement, the ability to measure servicing rights at fair value should already be in place. Ms. Schipper acknowledges that the existing requirement is less burdensome than a fair value remeasurement at every reporting date, but rejects the idea that the incremental burden would be sufficient to justify the noncomparability permitted by this Statement. With regard to disclosure, this Statement requires that entities that do not elect fair value measurement for recognition purposes shall nonetheless disclose those fair value amounts, if practicable. She believes that compliance with the existing accounting requirements to measure servicing rights at the lower of fair value or carrying amount means that this disclosure would be practicable for entities. Therefore, fair value measurements of servicing rights will have to be prepared by entities for disclosure purposes under the requirements of this Statement (that is, it will be practicable for entities to do so), and there would be no incremental preparation burden imposed by requiring those measurements in the financial statements.

Ms. Schipper acknowledges that some holders of servicing rights use instruments to hedge the risks, such as interest rate risk, inherent in those rights while others do not. She also acknowledges the conclusion in paragraph A12 that some entities do not consider servicing rights to be similar to financial instruments and believe that fair value measurement for those rights would create a new source of earnings volatility that those entities do not view as representationally faithful. However, Ms. Schipper believes that the choice of measurement attributes should be predicated on the nature of the item being measured and not on management intent (in this case, to hedge or not to hedge the risks inherent in those rights) and that, regardless of management's intent in holding servicing rights, changes in fair values of those rights represent economic changes that should be included in earnings.

Members of the Financial Accounting Standards Board:

Robert H. Herz, *Chairman*
George J. Batavick
G. Michael Crooch
Katherine Schipper
Leslie F. Seidman
Edward W. Trott
Donald M. Young

Appendix A

BACKGROUND INFORMATION AND BASIS FOR CONCLUSIONS

CONTENTS

Appendix A

BACKGROUND INFORMATION AND BASIS FOR CONCLUSIONS

Introduction and Background

A1. This appendix summarizes considerations that Board members deemed significant in reaching the conclusions in this Statement. It includes reasons for accepting certain views and rejecting others. Individual Board members gave greater weight to some factors than to others.

A2. The scarcity of over-the-counter derivative instruments whose changes in fair value closely track the changes in fair value of servicing assets and servicing liabilities makes it difficult for entities that acquire derivative instruments for the purpose of offsetting changes in fair value of servicing assets and servicing liabilities to comply with the hedge effectiveness requirements in FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*. Because servicing assets and servicing liabilities are not measured at fair value and derivative instruments are, the income statements of some entities reflect volatility that is partly due to those differences in accounting requirements. Constituents requested that the Board permit entities to subsequently measure servicing assets and servicing liabilities at fair value to achieve an income statement presentation that is similar to the application of hedge accounting, without meeting the hedge effectiveness requirements of Statement 133. The Board also considered the lower of fair value or carrying amount as a suboptimal measurement attribute when it decided to add this project to its agenda.

A3. Differences exist in whether and how entities choose to offset risks using derivatives and in whether those entities qualify for and apply special hedge accounting permitted under Statement 133. For example, an entity that applies hedge accounting would typically be able to adjust the balance of servicing assets and servicing liabilities for the changes in fair value associated with the risk being hedged, whereas an entity that does not apply hedge accounting would report servicing assets and servicing liabilities at the lower of allocated carrying amount or fair value. The differences in how entities value, amortize, and assess servicing assets and servicing liabilities for impairment can result in different amounts reflected in the servicing assets' and servicing liabilities' balances at the end of each reporting period. To address those factors that affect comparability, some constituents requested that servicing assets and servicing liabilities be recorded at fair value by all entities.

A4. Although the initial request for the project focused on accounting for mortgage servicing assets and servicing liabilities under Statement 140, this Statement applies to all servicing assets and servicing liabilities that are separately recognized, that is, to servicing assets and servicing liabilities recognized as assets or liabilities apart from the assets being serviced. That scope is clarified in this Statement.

A5. In August 2005, the Board issued the Exposure Draft, *Accounting for Servicing of Financial Assets*. Twenty-six organizations and individuals commented on that Exposure Draft. The majority of those respondents noted that the proposed Statement would improve financial reporting but suggested that certain modifications be made to the final Statement. The Board considered the comments and suggestions provided by respondents during its redeliberations in November and December 2005 on the issues addressed by the Exposure Draft.

A6. Based on comments received on the Exposure Draft, the Board decided to clarify the scope of the servicing assets and servicing liabilities provisions of Statement 140. Respondents asked the Board to provide additional guidance on whether the servicing provisions of Statement 140 should be applied to:

a. A servicing contract that a transferor enters into in a transfer of its financial assets that does not meet the requirements for sale accounting
b. A servicing contract that a servicer enters into that does not involve financial assets that it owned, transferred, or securitized.

Amendments to Statement 140

Amendments Related to the Scope of Servicing Assets and Servicing Liabilities

A7. The Board first considered whether it was appropriate to separately recognize servicing assets and servicing liabilities that arise from transfers or securitizations of the servicer's own assets that do not meet the requirements for sale accounting and that are treated as secured borrowings. The Board decided that transfers that do not give rise to a sale should not create a separately recognized servicing asset or servicing liability. The Board does not believe it is appropriate for a servicer to recognize a servicing asset or servicing liability for a servicing contract that relates only to its own assets. However, Statement 140 permits or requires separate recognition of servicing assets or servicing liabilities in a guaranteed mortgage securitization (depending on the classification of the resulting securities) because that type of securitization changes the legal form of the assets and may create a servicing asset or servicing liability that should be separately recognized even though the transaction does not qualify for sale accounting under Statement 140. The Board did not amend the exception for servicing assets and servicing liabilities created in a guaranteed mortgage securitization.

A8. The Board also considered whether to clarify whether a servicer should separately recognize a servicing asset or servicing liability if it entered into a servicing contract that did not involve assets that it owned, transferred, or securitized. The Board decided to clarify that a servicer should separately recognize servicing assets and servicing liabilities any time the servicer enters into a servicing contract that does not relate to financial assets of the servicer or its consolidated affiliates.

Amendments Related to Initial Measurement of Servicing Assets and Servicing Liabilities

A9. The current requirements for initial measurement of servicing assets and servicing liabilities vary depending on whether they are purchased separately, assumed, or obtained in a sale or securitization transaction, as well as whether they are assets or liabilities. The Board concluded that recognized servicing assets and servicing liabilities should be accounted for similarly, regardless of how they are obtained.

A10. The Board concluded that all servicing assets and servicing liabilities that are required to be separately recognized should be initially measured at fair value. The Board previously concluded that fair value is the most relevant measurement attribute for financial instruments. Because servicing assets and servicing liabilities have characteristics similar to financial instruments, that conclusion logically applies to them as well. Constituents have told the Board that fair value measurements for servicing assets and servicing liabilities are sufficiently reliable to be used in financial statements and that some entities are currently using those values to manage their daily operations. The Board decided to include separately recognized servicing assets as part of proceeds of a sale to simplify the application of the guidance and provide consistency between servicing assets and servicing liabilities obtained in a transfer of financial assets that meets the requirements for sale accounting. Prior to the issuance of this Statement, separately recognized servicing assets were included as part of retained interests. References to *retained interests* have been changed to *interests that continue to be held by a transferor* to clarify that servicing assets are no longer deemed retained interests.

Amendments Related to Subsequent Measurement of Servicing Assets and Servicing Liabilities

A11. Preparers of financial statements have developed techniques to reliably measure servicing assets and servicing liabilities at fair value to comply with Statement 140, which requires that servicing assets and servicing liabilities be assessed for impairment or increased obligation at each reporting date based on their fair values. Subsequent measurement of servicing assets and servicing liabilities at fair value would improve the representational faithfulness of reporting (a) risk management activities associated with such servicing assets and servicing liabilities and (b) declines in the fair value of servicing assets and servicing liabilities. Subsequent measurement of servicing assets and servicing liabilities at fair value would eliminate the necessity for entities that manage the risks inherent in servicing assets and servicing liabilities with derivatives to qualify for hedge accounting treatment to avoid certain income statement effects that result from the use of accounting standards that require different measurement attributes for derivatives and for servicing assets and servicing liabilities. Subsequent measurement of servicing assets and servicing liabilities at fair value would also eliminate diversity in the characterization of declines in fair value as impairments or direct write-downs, which affects the subsequent accounting for the remaining balance of servicing assets and servicing liabilities.

A12. However, some entities use financial instruments other than derivatives, such as available-for-sale securities, to offset risks inherent in servicing assets and servicing liabilities and to avoid the income statement volatility associated with the use of derivatives. Other entities do not attempt to mitigate the risks inherent in servicing assets and servicing liabilities and do not consider servicing assets and servicing liabilities to be similar to financial instruments but consider servicing assets and servicing liabilities to be contracts to provide services. For those entities, subsequent measurement of servicing assets and servicing liabilities at fair value would result in a new source of income statement volatility, which they view as not representationally faithful of their performance.

A13. The Board decided to permit an entity to elect either fair value measurement with changes in fair value reflected in earnings or the amortization and impairment requirements of Statement 140 for subsequent measurement. The election would be made by class of servicing assets and servicing liabilities and would be made at the beginning of a fiscal year. The Board also decided that if an entity chooses fair value measurement for a class of servicing assets and servicing liabilities, that entity cannot decide later to adopt the amortization method for that class or for any servicing asset or servicing liability in that class.

A14. The Board is aware that entities use financial instruments such as derivatives to offset the risks inherent in only certain classes of servicing assets and servicing liabilities. The Board initially believed that application of the fair value measurement election by broad class of servicing assets and servicing liabilities identified by major asset type, similar to the identification of asset classes in paragraph 17(f) of Statement 140 (now 17(h) of Statement 140 as amended), would improve comparability. Many respondents to the Exposure Draft opposed the Board's initial approach to apply the fair value election based on major asset type for several reasons. One reason is that the availability of market-observable inputs used in determining the fair value of servicing assets and servicing liabilities may vary significantly within a broad asset class. Another reason is that entities manage the risks in servicing assets and servicing liabilities with differing risk characteristics differently within major asset types.

A15. Factors such as the nature of the collateral, fixed or floating interest rates, commercial or consumer loans, credit quality, tenor, expected variation in customer prepayment rates, and other factors affect a servicer's decision as to whether and how it manages its risk exposure for its servicing assets and servicing liabilities. Some respondents to the Exposure Draft supported a more finely disaggregated approach to identify classes and recommended that a servicer be permitted to take into account the different valuation and risk characteristics of the underlying assets within a broad asset class as well as the manner in which an entity manages the economic risks for various groups of servicing assets or servicing liabilities when establishing the classes for the election for subsequent measurement.

A16. The Board decided to require a servicer to define its classes of servicing assets and servicing liabilities for the subsequent measurement election based on one or both of the following:

a. The availability of market inputs used to determine the fair value of servicing assets and servicing liabilities
b. An entity's method for managing the risks of its servicing assets and servicing liabilities.

The Board concluded that the additional disclosures required for each class of servicing assets and servicing liabilities would provide meaningful information to users of financial statements. The Board acknowledges that a servicer may or may not consider the major asset type of the underlying financial asset being serviced when identifying its classes of separately recognized servicing assets and servicing liabilities under this approach. Further, the Board believes that this approach is not analogous to the stratification guidance to determine impairment of servicing assets or servicing liabilities that are subsequently measured using the amortization method. An entity must first identify its classes of separately recognized servicing assets and servicing liabilities under this approach. For any class subsequently measured using the amortization method, an entity must then stratify that class to determine if impairment has occurred.

One-Time Option to Reclassify Available-for-Sale Securities

A17. Many servicers purchase securities to partially offset their exposure to certain risks associated with their servicing assets and servicing liabilities. Servicers often classify those securities as available-for-sale securities, which are reported at fair value with unrealized changes in fair value reported in other comprehensive income in accordance with Statement 115. Servicers sell those securities in periods in which the servicing assets are impaired (or servicing liabilities are assessed for increased obligation) to offset the effect of recognizing impairment or increased obligation in the income statement. If a servicer elects to subsequently measure a servicing asset or servicing liability at fair value upon adoption of this Statement, that election may cause such available-for-sale securities to be subsequently measured at fair value through other comprehensive income, while the related servicing asset or servicing liability would be subsequently measured at fair value through earnings. This is not an issue for new servicing assets and servicing liabilities because the servicer has the option to classify newly purchased securities as trading securities, which are reported at fair value with changes in fair value reported in earnings consistent with the manner in which the related servicing asset or servicing liability would be reported if fair value is elected. However, for existing available-for-sale securities, paragraph 15 of Statement 115 states that ". . . transfers into or from the trading category also should be rare." Constituents told the Board that as a result of paragraph 15, servicers that hold available-for-sale securities to offset changes in the fair value of existing servicing assets and servicing liabilities would be unlikely to elect to subsequently measure those servicing assets and servicing liabilities at fair value unless they were permitted to reclassify the related available-for-sale securities to trading securities.

A18. The Board agreed with constituent concerns and tentatively decided to permit a one-time election for servicers to reclassify available-for-sale securities to trading securities without questioning the treatment of those securities under Statement 115. Similar special reclassification elections were permitted in other Statements, most recently in Statement 133. However, the Board was concerned about permitting an unrestricted election, because that election could involve a large number of securities that are unrelated to servicing assets or servicing liabilities. The Board asked respondents in the notice for recipients of the Exposure Draft whether a servicer that uses available-for-sale securities to offset the income statement effect of changes in fair value of servicing assets and servicing liabilities would be able to identify specific available-for-sale securities held for that purpose. Respondents stated that servicers that held such available-for-sale securities would generally be able to identify both the securities and the related servicing assets and servicing liabilities. Based on that information, the Board decided to permit a one-time election to reclassify available-for-sale securities to trading securities but limited that election to those available-for-sale securities that are intended to offset the income statement effect of changes in the fair value of servicing assets and servicing liabilities that a servicer elects to subsequently measure at fair value. The Board discussed whether prior documentation of the relationship between each available-for-sale security and specific servicing assets or servicing liabilities would be required to reclassify a particular available-for-sale security in this election. The Board concluded that requiring that a servicer provide specific identification retroactively would be impracticable.

A19. The Board considered whether the effect of the reclassification of securities on accumulated other comprehensive income should be reported through earnings, as described in paragraph 15 of Statement 115, or through retained earnings as a cumulative-effect adjustment. The Board also considered whether the reclassification election should be a one-time election at adoption of this Statement or whether it should be allowed each time a servicer elects to subsequently measure a class of servicing assets and servicing liabilities at fair value. The Board decided to limit the reclassification to a one-time election at adoption of this Statement. It also decided to require that the effect of the reclassification on accumulated other comprehensive income be reported as part of the cumulative-effect adjustment to retained earnings with the effect of the reclassification disclosed separately from the effect of the election to subsequently measure servicing assets and servicing liabilities at fair value. The Board decided to adopt that approach because it believes that approach would provide sufficient information in one place to users of financial statements about the effect of adopting this Statement. The Board decided to permit the one-time reclassification only upon adoption of this Statement because it believes that those who intended to offset the income statement effect of changes in the fair value of their servicing assets and servicing liabilities would elect to use fair value for subsequent measurement more quickly.

Amendments Related to Financial Statement Presentation and Disclosures for Servicing Assets and Servicing Liabilities

A20. The Board was concerned that permitting alternative methods for subsequent measurement would reduce the comparability of financial statements. As a result, the Board considered whether special display guidance for the statement of financial position and additional disclosures would be needed to address the comparability issues that may arise from the use of alternative measurement methods. The Board also considered this issue during its deliberations on the fair value option project in which it tentatively decided to require separate presentation of carrying amounts in the statement of financial position when an entity elects to use fair value measurement for certain assets and liabilities but not for other similar assets and liabilities. The Board decided in this project to require that servicing assets and servicing liabilities subsequently measured at fair value be presented in the statement of financial position separately from servicing assets and servicing liabilities that are subsequently measured using the amortization method. The Board decided that an entity may meet the separate reporting requirement by either:

a. Displaying separate line items for servicing assets or servicing liabilities subsequently measured using the fair value measurement method and those that are subsequently measured using the amortization method; or
b. Presenting the aggregate amounts for both servicing assets or servicing liabilities that are subsequently measured at fair value and those that are subsequently measured using the amortization method provided that the amounts of servicing assets or servicing liabilities that are subsequently measured using the fair value measurement method included in the aggregate amount are disclosed parenthetically on the face of the statement.

A21. The Board also decided to require the additional disclosures described in paragraph 4(h) of this Statement to mitigate concerns about comparability. Those additional disclosures are intended to provide users with information about the classes of servicing assets and servicing liabilities that an entity holds and management's basis for identifying its classes of servicing assets and servicing liabilities.

A22. To enable users to better understand the sources of changes in servicing assets and servicing liabilities during the periods presented, this Statement requires that the activity by class in the balance of servicing assets and in the balance of servicing liabilities be disclosed, regardless of whether the class is subsequently measured at fair value or using the amortization method. To improve comparability among classes of servicing assets and servicing liabilities within an entity as well as among different entities, this Statement requires disclosure of the fair values of servicing assets and the fair values of servicing liabilities by class at the beginning and end of each period presented, including those classes using the amortization method, if it is practicable to do so.

A23. Given the diversity in techniques used to measure servicing assets and servicing liabilities at fair value, the Board decided to require an entity to describe the valuation techniques used to estimate fair values of the servicing assets and servicing liabilities. It also encouraged similar disclosures of the valuation techniques used to estimate fair values for instruments used to manage the risks inherent in servicing assets and servicing liabilities, to the extent that those disclosures are not required under existing generally accepted accounting principles. The Board believes that those disclosures will provide insight into how an entity measures the fair value of servicing assets and servicing liabilities when no market quotes are available.

A24. The Board also decided to require an entity to disclose qualitative information about instruments used to manage the risks inherent in servicing assets and servicing liabilities. The Board decided to encourage, rather than require, quantitative information about those instruments as part of this Statement because such quantitative disclosures are generally not required for those instruments that are used to manage other risks, unless those instruments are subject to special hedge accounting requirements. Those disclosures that are required under other accounting guidance continue to be required.

A25. The Board considered but decided not to require a separate sensitivity analysis for classes of servicing assets and servicing liabilities because the costs to prepare that analysis would outweigh the benefits in most cases. However, servicing assets and servicing liabilities obtained by a transferor in a securitization must be included in the sensitivity analysis required by paragraph 17(i) of Statement 140.

A26. This Statement requires disclosure of the activity in the valuation allowance for impairment of recognized servicing assets, if any, for each class of servicing assets and servicing liabilities using the amortization method. This requirement ensures that users understand the reasons for changes in the valuation allowance account.

Effective Date and Transition

A27. The Board decided that the effective date of this Statement should be consistent with the effective date for FASB Statement No. 155, *Accounting for Certain Hybrid Financial Instruments*. The Board understands that the ability to subsequently measure separately recognized servicing assets and servicing liabilities and certain hybrid financial instruments at fair value was supported by many financial institutions and that the application of fair value would not be burdensome, given the existing requirements of Statement 140. Therefore, the Board permitted early adoption of this Statement as well as Statement 155. An entity must adopt this Statement as of the beginning of its first fiscal year that begins after September 15, 2006, with earlier adoption permitted as of the beginning of an entity's fiscal year, provided that the entity has not yet issued financial statements, including any interim financial statements, for that fiscal year.

A28. The Board decided to clarify the requirements for the initial recognition of separate servicing assets and servicing liabilities. The Board is aware that under previous guidance, servicers may have recognized separate servicing assets or separate servicing liabilities that are no longer permitted to be separately recognized under the requirements of this Statement. The Board decided that any servicing assets or servicing liabilities previously recognized by an entity in a securitization transaction that was accounted for as a financing transaction should continue to be recognized after the adoption of this Statement.

A29. The Board decided to provide transition for the provisions related to initial measurement of servicing assets and servicing liabilities separately from those related to subsequent measurement. The Board decided that the requirement to initially measure servicing assets and servicing liabilities at fair value should be applied on a prospective basis for new servicing assets and servicing liabilities. The Board considered the relative merits of applying this Statement to both new assets and existing assets or applying it retrospectively. The Board acknowledged that the difference between initial measurement at fair value and initial measurement at the allocated carrying amount is likely to be minimal for certain servicing assets and servicing liabilities. The Board also acknowledged that the application of initial fair value to existing servicing assets and servicing liabilities would require modifications to the application of the amortization method from the date the servicing asset or servicing liability was separately recognized through the date of adoption of this Statement. The Board concluded that the comparability that would be achieved from either retrospective application or a cumulative-effect adjustment for existing servicing assets and servicing liabilities would be insufficient to justify the cost.

A30. The Board decided that the irrevocable option to subsequently measure servicing assets and servicing liabilities at fair value should be applied on a prospective basis for each class of servicing assets and servicing liabilities, with a cumulative-effect adjustment to retained earnings recorded to reflect the adjustment for existing servicing assets and servicing liabilities to fair value as of the beginning of the fiscal year that the election is made.

A31. To ensure that all servicing assets and servicing liabilities in a class of servicing assets and servicing liabilities would be measured using the same subsequent measurement attribute, the Board decided to allow existing servicing assets and servicing liabilities to be subsequently measured at fair value along with new servicing assets and servicing liabilities. The Board recognized that a prospective application of the subsequent measurement of existing servicing assets and servicing liabilities at fair value would cause entities electing to subsequently measure servicing assets and servicing liabilities at fair value to reflect the unrealized gain or loss of the servicing assets and servicing liabilities on the date the fair value election is made. The Board determined that recognition of a cumulative-effect adjustment to the beginning balance of the existing servicing assets and servicing liabilities would be appropriate because this adjustment would enable preparers to measure and present all of the servicing assets and servicing liabilities in a class in the same manner. The Board decided not to require retrospective application of this election to existing servicing assets and servicing liabilities because the cost of that requirement would outweigh the limited benefits to users in interpreting this information for prior periods presented.

A32. In analyzing the application of the fair value election at a date subsequent to initial adoption, the Board considered the same factors that it considered in determining the transition requirements for making the election upon adoption, as well as FASB Statement No. 154, *Accounting Changes and Error Corrections.* The Board believes that a subsequent fair value election would be considered a voluntary action by the entity and would require use of the retrospective transition method under Statement 154, unless the Board explicitly provided for a different transition method. In evaluating whether a different transition method should be required in this Statement, the Board reasoned that in the first few years of applying this Statement, the application of the retrospective transition provisions would be impracticable as it would require consideration of prior-period servicing assets and servicing liabilities as part of classes that may not be previously identified. The Board decided that the election to subsequently measure a class of servicing assets and servicing liabilities at fair value could be made only at the beginning of a fiscal year because allowing the election to be made at any other time would require recordkeeping that is not presently required and would impair consistency. The Board considered all of the disclosures related to accounting changes in Statement 154 and amended the disclosures in paragraph 17 of Statement 140 to include those disclosures that it believes are necessary. The Board decided not to require disclosure of the direct and indirect effects of electing the fair value subsequent measurement method because those disclosures would require an entity to maintain two sets of accounting records.

Benefits and Costs

A33. The mission of the FASB is to establish and improve standards of financial accounting and reporting for the guidance and education of the public, including preparers, auditors, and users of financial information. In fulfilling that mission, the Board endeavors to determine that a proposed standard will fill a significant need and that the costs imposed to meet that standard, as compared with other alternatives, are justified in relation to the overall benefits of the resulting information. Although the costs to implement a new standard may not be borne evenly, investors and creditors—both present and potential—and other users of financial information benefit from improvements in financial reporting, thereby facilitating the functioning of markets for capital and credit and the efficient allocation of resources in the economy.

A34. The Board's assessment of the benefits and costs of amending Statement 140 with respect to the accounting for servicing assets and servicing liabilities was based on discussions with preparers, users, and auditors of financial statements. The Board considered the costs associated with decreased comparability as a result of allowing a choice between the amortization method and the fair value measurement method for separately recognized servicing assets and servicing liabilities. The Board also considered the benefits arising from (a) permitting entities to use the same measurement attribute for both separately recognized servicing assets and servicing liabilities and the derivatives held to manage risks inherent in those rights and (b) reducing diversity among entities that apply the amortization method and recognize impairment on separately recognized servicing assets and servicing liabilities. The Board concluded that the financial reporting benefits would outweigh the costs of noncomparability, particularly since the improved disclosures that are required by this Statement would enable users to compare entities that make different decisions about subsequent measurement of servicing assets and servicing liabilities.

Appendix B

EFFECT ON RELATED AUTHORITATIVE LITERATURE

B1. This appendix addresses the effect of this Statement on authoritative accounting literature included in categories (b)–(d) in the GAAP hierarchy discussed in AICPA Statement on Auditing Standards No. 69, *The Meaning of* Present Fairly in Conformity With Generally Accepted Accounting Principles. Any authoritative literature affected by the issuance of Statement 156 solely due to the replacement of the term *retained interests* with the term *interests that continue to be held by a transferor* has been excluded from this appendix.

EITF Issues

B2. The following table lists EITF Issues and Topic relating to servicing rights and indicates (a) the status of that literature after issuance of this Statement and (b) the effect of this Statement on that literature (if any) or the reasons that the literature is beyond the scope of this Statement. (**Note:** The *EITF Abstracts* that have been affected by this Statement will be updated on the FASB website upon issuance of this Statement.)

Status Legend	
Language revised by this Statement	References and/or language in this Issue have been revised for amendments to Statement 140 by this Statement.
The guidance in this Issue is unaffected by this Statement	The guidance in this Issue is unaffected by this Statement.
Nullified	This Statement provides guidance on this matter. As a result, this Issue has been nullified.

Issue Number/ Question	Title	Status	Description/Effect of Statement 156
EITF Issues			
Issue 85-13	Sale of Mortgage Service Rights on Mortgages Owned by Others	**The guidance in this Issue is unaffected by this Statement**	**Description—**This Issue addresses whether a gain should be recorded on the sale of mortgage servicing rights when the sale is for a participation in a future interest income stream and, if a gain is recognized, how that gain should be measured. Issue 85-13 states that gain recognition is appropriate at the sale date. **Effect of Statement 156—**This Statement does not modify the consensus reached on this Issue. However, changes in the fair value of servicing assets or servicing liabilities that are 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 sale date included in earnings at that time.

Issue Number/ Question	Title	Status	Description/Effect of Statement 156
Issue 87-34	Sale of Mortgage Servicing Rights with a Subservicing Agreement	**The guidance in this Issue is unaffected by this Statement**	**Description—**This Issue addresses whether the transfer of mortgage servicing rights and the simultaneous agreement to provide subservicing should be reported by the transferor as a sale or as a financing and, if reported as a sale, how the sale should be recognized. The Task Force reached a consensus on this Issue that income should not be recognized immediately as a result of the transaction and that a loss on the transaction 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. **Effect of Statement 156—**This Statement does not modify the consensus reached on this Issue. However, changes in the fair value of servicing assets or servicing liabilities that are 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.

Issue 88-11	Allocation of Recorded Investment When a Loan or Part of a Loan Is Sold	**Nullified**	**Description—**This Issue addresses how an entity's recorded investment in a loan should be allocated between the portion of the loan sold (for purposes of determining the gain or loss on the sale) and the portion retained (for purposes of determining the remaining recorded investment) and states that the allocation should be based on the relative fair values of those portions. **Effect of Statement 156—**Paragraph 10 of Statement 140 (as amended by Statement 156) requires that upon initial recognition, servicing assets and servicing liabilities be measured at fair value. Paragraph 10 also describes the allocation method that the transferor is required to follow upon completion of any transfer of financial assets. Statement 125 and Statement 140 (as amended by Statement 156) nullify Issue 88-11.

Issue Number/ Question	Title	Status	Description/Effect of Statement 156
Issue 90-21	Balance Sheet Treatment of a Sale of Mortgage Servicing Rights with a Subservicing Agreement	**The guidance in this Issue is unaffected by this Statement**	**Description—**This Issue addresses whether a transaction described in Issue 87-34 (discussed above) should be accounted for as a financing or as a sale with the gain deferred. The Task Force reached a consensus on this Issue 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 sale accounting treatment. **Effect of Statement 156—**This Statement does not modify the consensus reached on this Issue. However, changes in the fair value of servicing assets or servicing liabilities 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 sale date included in earnings at that time.

Issue 02-9	Accounting for Changes That Result in a Transferor Regaining Control of Financial Assets Sold	**Language revised by this Statement**	**Description—**This Issue addresses the application of the guidance in paragraph 55 of Statement 140 when transferred assets previously accounted for as sold are subsequently repurchased by the transferor. **Effect of Statement 156—**The Application Section of this Issue has been revised to initially measure separately recognized servicing assets at fair value.
Topic D-69	Gain Recognition on Transfers of Financial Assets under FASB Statement No. 125	**Language revised by this Statement**	**Description—**Paragraph 1 of Topic D-69 summarizes the requirements in paragraph 11 of Statement 140 for determining gain or loss on a sale of financial assets. Topic D-69 also summarizes guidance to be used when estimating the fair value of interests that continue to be held by a transferor and new interests obtained and requirements to disclose significant assumptions used in estimating the fair value of those interests. **Effect of Statement 156—**This Topic has been revised to: a. Refer to additional disclosures required by Statement 140 (as amended by Statement 156) b. Update references to relevant guidance in Statement 140 (as amended by Statement 156).

FASB Special Report, ***A Guide to Implementation of Statement 140 on Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*** **(Q&A)**

B3. The following table lists Q&As relating to servicing assets and servicing liabilities and indicates (a) the status of that literature upon issuance of this Statement and (b) the effect of this Statement on that literature. **Note: Questions 1–57, 59–70, 72, 74–80, 83–89, 91, 93, 98, 102–106, and 108–123 have not been affected by this Statement and therefore are not included herein. In addition, the actual text of questions and answers are not included in this Statement. The revised text can be found in the FASB Special Report,** ***A Guide to Implementation of Statement 140 on Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities.*** (**Note:** The Statement 140 Q&A will be updated on the FASB website upon issuance of this Statement.)

Status Legend	
Modified	Guidance provided by the Statement 140 implementation guide is modified by this Statement.
Language revised by this Statement	References and/or language in this Q&A have been revised for amendments to Statement 140 by this Statement.
Nullified	This question has been nullified because this Statement provides specific guidance that addresses this question.

Issue Number/ Question	Status	Description/Effect of Statement 156
Q&A		
58	**Modified**	**Description—**This question addresses how transferred components of financial assets and interests that continue to be held by a transferor should be accounted for upon completion of a transfer. **Effect of Statement 156—**The answer to this question has been modified to: a. Provide the new language in paragraph 10 of Statement 140 (as amended by Statement 156), which, in part, requires that separately recognized servicing assets and servicing liabilities be initially measured at fair value b. Note the new language in paragraphs 13 and 13A of Statement 140 (as amended by Statement 156) relating to initial and subsequent measurement of servicing assets and servicing liabilities.

71	**Language revised by this Statement**	**Description—**This question addresses whether an asset or liability for which it is not practicable to estimate the fair value at the date of a transfer should be remeasured at a later date if the transferor can estimate the fair value (that is, it becomes practicable). **Effect of Statement 156—**The answer has not been affected by this Statement. Paragraph 13A of Statement 140 (as amended by Statement 156) requires that if it is not practicable to measure a separately recognized servicing asset or servicing liability at fair value at the time of transfer, an entity shall initially recognize the servicing asset or servicing liability in accordance with paragraph 71 of Statement 140 (as amended by Statement 156) and shall include it in a class subsequently measured using the amortization method.
73	**Language revised by this Statement**	**Description—**This question addresses disclosures about the assumptions used to estimate fair values of interests that continue to be held by a transferor in securitized financial assets or of assets obtained and liabilities incurred as proceeds in a transfer. **Effect of Statement 156—**This Statement does not amend those disclosure requirements and requires additional disclosures for all servicing rights. Paragraph references have been updated.

Issue Number/ Question	Status	Description/Effect of Statement 156
81	**Language revised by this Statement**	**Description—**This question addresses how to determine the fair value of the servicing asset. The answer states that the unsolicited bid from the third party represents a quoted market price, which represents the fair value of the servicing asset. **Effect of Statement 156—**While this Statement does not amend the answer noted above, the question and the answer have been revised to reflect this Statement's requirement to initially measure all separately recognized servicing assets and servicing liabilities at fair value (paragraphs 13 and 62).
82	**Language revised by this Statement**	**Description—**This question addresses how to determine the value of a servicing asset. The answer states that an estimate of fair value (that is not a bid) from a single third party in an inactive or shallow market does not constitute a quoted market price but raises questions about the reasonableness of a transferor's estimate of zero for fair value. **Effect of Statement 156—**While this Statement does not amend the answer noted above, the question and the answer have been revised to reflect this Statement's requirement to initially measure all separately recognized servicing assets and servicing liabilities at fair value (paragraphs 13 and 62).

90	**Modified**	**Description—**This question addresses whether Statement 140 includes any requirement to adjust the recorded servicing asset or servicing liability if market rates for servicing a specific type of asset change subsequent to the initial recognition of a servicing asset or servicing liability. **Effect of Statement 156—**This Statement permits an entity to subsequently measure classes of servicing assets and servicing liabilities using either the fair value measurement method or the amortization method (paragraph 13A). If an entity elects to subsequently measure a class of servicing assets and servicing liabilities using the amortization method, then the answer to the question remains appropriate. If an entity elects to subsequently measure a class of servicing assets and servicing liabilities using the fair value measurement method, any change in fair value would be recognized in earnings.
92	**Nullified**	**Description—**This question addresses whether an entity should recognize a servicing asset or servicing liability when it transfers the assets to a qualifying SPE in a guaranteed mortgage securitization, retains all of the resulting securities, and classifies them as debt securities held-to-maturity in accordance with Statement 115. **Effect of Statement 156—**This question was nullified because this Statement provides specific guidance that addresses this question in paragraph 13 of Statement 140 (as amended by Statement 156).

Issue Number/ Question	Status	Description/Effect of Statement 156
94	**Language revised by this Statement**	**Description—**This question addresses whether a loss should be recognized if a servicing fee that is equal to or greater than adequate compensation is to be received but the servicer's anticipated cost of servicing would exceed the fee. **Effect of Statement 156—**This Statement does not affect the answer to this question. However, the excerpt from paragraph 62 of Statement 140 (as amended by Statement 156) has been modified to reflect changes to that paragraph. References to certain paragraphs have been updated.
95	**Language revised by this Statement**	**Description—**This question addresses whether an entity should recognize a servicing liability when the transferor-servicer will not receive a contractually specified fee. **Effect of Statement 156—**Paragraph 13 requires that all separately recognized servicing assets or servicing liabilities be initially measured at fair value, if practicable. This Statement also changes the requirements for separate recognition of a servicing asset or servicing liability (paragraph 13 of Statement 140 [as amended by Statement 156]).
96	**Language revised by this Statement**	**Description—**This question addresses whether an entity that sells a portion of a loan under a loan participation agreement and continues to service the loan is required to recognize a servicing asset. **Effect of Statement 156—**This Statement does not affect the answer to this question. However, references to certain paragraphs have been updated.

97	**Language revised by this Statement**	**Description—**This question addresses how an entity should account for the obligation to service a financial asset when it subcontracts that obligation to another servicer. **Effect of Statement 156—**This Statement does not affect the answer to this question. However, paragraphs 10 and 11 of Statement 140 (as amended by Statement 156) now require that upon recognition, servicing assets and servicing liabilities should be initially measured at fair value, if practicable.
99	**Modified**	**Description—**This question addresses whether servicing assets must be stratified based on more than one predominant risk characteristic of the underlying financial assets. **Effect of Statement 156—**This Statement permits an entity to subsequently measure classes of servicing assets and servicing liabilities at fair value (paragraph 13 of Statement 140 [as amended by Statement 156]). Classes subsequently measured at fair value will no longer be separately assessed for impairment or increased obligation. For classes of separately recognized servicing assets and servicing liabilities that an entity elects to subsequently measure using the amortization method, the answer still applies. References to certain paragraphs have been updated.

Issue Number/ Question	Status	Description/Effect of Statement 156
100	**Modified**	**Description—**This question addresses whether the strata selected by the servicer should be used consistently from period to period when evaluating and measuring impairment of servicing assets. **Effect of Statement 156—**This Statement permits an entity to subsequently measure a class of servicing assets and servicing liabilities at fair value (paragraph 13 of Statement 140 [as amended by Statement 156]). If an entity makes this election for one or more classes of servicing assets and servicing liabilities, those classes subsequently measured at fair value will no longer be separately assessed for impairment or increased obligation, and any changes in fair value would be reported in earnings in the period in which the changes occur. For classes of separately recognized servicing assets and servicing liabilities that an entity elects to subsequently measure using the amortization method, the answer still applies. References to certain paragraphs have been updated.

101	**Modified**	**Description—**This question addresses how an entity should recognize subsequent increases in a previously recognized servicing liability. **Effect of Statement 156—**This Statement permits an entity to subsequently measure a class of servicing assets and servicing liabilities at fair value and requires any changes in fair value to be reported in earnings in the period in which the changes occur. If an entity does make this election for one or more classes of servicing assets and servicing liabilities, those classes subsequently measured at fair value will not be separately assessed for impairment or increased obligation. For classes of separately recognized servicing assets and servicing liabilities that an entity elects to subsequently measure using the amortization method, the answer still applies. References to certain paragraphs have been updated.
107	**Language revised by this Statement**	**Description—**This question addresses how to account for the servicing asset or servicing liability when the transferor subcontracts its servicing obligation to a third party. **Effect of Statement 156—**This Statement does not affect the answer to this question. However, paragraphs 10 and 11 of Statement 140 (as amended by Statement 156) now require that separately recognized servicing assets and servicing liabilities be initially measured at fair value.

Statement 133 Implementation Issues

B4. The following table addresses the effect of this Statement on the answers to Statement 133 Implementation Issues relating to servicing rights.

Status Legend	
Modified	Guidance provided in the Issue is modified by this Statement.

Issue Number/ Question	Title	Status	Description/Effect of Statement 156
Statement 133 Implementation Issues			
F1	Stratification of Servicing Assets	**Modified**	**Description—**This Issue addresses whether an entity is permitted to use different stratification criteria for the impairment test for servicing assets and to group similar assets to be designated as a hedged portfolio in a fair value hedge. **Effect of Statement 156—**This Statement permits an entity to subsequently measure classes of servicing assets and servicing liabilities using either the fair value measurement method or the amortization method (paragraph 13A). If an entity elects to subsequently measure a class of servicing assets and servicing liabilities using the amortization method, then the answer to the question remains appropriate. Classes that an entity elects to subsequently measure at fair value will not be separately assessed for impairment or increased obligation. References to certain paragraphs have been updated.

Issue Number/ Question	Title	Status	Description/Effect of Statement 156
F8	Hedging Mortgage Servicing Right Assets Using Preset Hedge Coverage Ratios	**Modified**	**Description—**This Issue addresses whether, in a fair value hedge of a portion of a recognized servicing asset or servicing liability, an entity may designate the hedged item at the inception of the hedge by initially specifying a series of possible percentages of the servicing asset or servicing liability that each correspond to a specified independent variable. **Effect of Statement 156—**This Statement permits an entity to subsequently measure classes of servicing assets and servicing liabilities at fair value (paragraph 13 of Statement 140 [as amended by Statement 156]). Thus, an entity may mitigate its income statement volatility that arises from the use of different measurement attributes for its servicing assets or servicing liabilities and related derivative instruments without applying hedge accounting to those instruments. Classes of servicing assets and servicing liabilities that are subsequently measured at fair value will no longer be separately assessed for impairment or increased obligation, and any changes in fair value would be reported in earnings. For classes of separately recognized servicing assets and servicing liabilities that an entity elects to subsequently measure using the amortization method, the answer still applies.

AICPA Literature

B5. The following table lists guidance issued by the AICPA or its staff that may be affected by the decisions made by the Board in this Statement. This information is presented for informational purposes only. Decisions about whether to amend AICPA guidance are made by the FASB in conjunction with the AICPA prior to issuing a final pronouncement.

Status Legend	
Language revised by this Statement	References and/or language in the Statements of Position/Accounting and Audit Guides have been revised for amendments to Statement 140 by this Statement.

Reference	Title	Status	Description/Effect of Statement 156
AICPA Literature			
SOP 01-06	Accounting by Certain Entities (Including Entities With Trade Receivables) That Lend to or Finance the Activities of Others	**Language revised by this Statement**	**Description—**Paragraph .08(h) states that sales of servicing assets and servicing liabilities relating to loans that are retained should be recognized in income on the date of the sale and the carrying amount should be allocated between the servicing assets and servicing liabilities and the loans retained using the relative fair values of each in a manner consistent with paragraph 10(b) of Statement 140. **Effect of Statement 156—**This Statement revises the guidance in paragraph 10 of Statement 140. This Statement does not address sales of servicing assets or servicing liabilities. As a result, the language in paragraph .08(h) will be revised to remove the reference to paragraph 10(b) of Statement 140 and to specify the amended method for allocating the carrying amount between the retained loans and the sold servicing assets or servicing liabilities.

Reference	Title	Status	Description/Effect of Statement 156
Audit and Accounting Guide	Depository and Lending Institutions: Banks and Savings Institutions, Credit Unions, Finance Companies and Mortgage Companies	**Language revised by this Statement**	**Description—**Paragraphs 7.83–7.85 describe the accounting guidance for transfers of financial assets, specifically quoting paragraphs 9–11 of Statement 140. **Effect of Statement 156—**This Statement amends paragraphs 10 and 11 of Statement 140 and makes significant changes to paragraphs 58–59, 61–63, and 65–67. Specifically, this Statement provides new guidance for the disclosure of and accounting for servicing assets and servicing liabilities. Paragraphs 7.83–7.85 will be revised as follows: (a) any reference to servicing assets as retained interests will be removed, (b) the term *retained interests* will be replaced with *interests that continue to be held by a transferor,* and (c) the language quoted from paragraphs 10 and 11 of Statement 140 (as amended by Statement 156) will be revised accordingly.

Audit and Accounting Guide	Depository and Lending Institutions: Banks and Savings Institutions, Credit Unions, Finance Companies and Mortgage Companies	**Language revised by this Statement**	**Description—**Paragraph 7.87 details the recognition and measurement of servicing assets and servicing liabilities as described in paragraph 13 of Statement 140. **Effect of Statement 156—**This Statement amends paragraph 13 of Statement 140 to require that an entity measure a servicing asset or servicing liability initially at fair value if it meets the requirements found therein for recognition. It adds paragraph 13A to require that an entity subsequently measure each class of servicing assets and servicing liabilities using either the fair value measurement method or the amortization method. As a result of the amendments to Statement 140, paragraph 7.87 will be revised to reflect the language in paragraphs 13 and 13A of Statement 140 (as amended by Statement 156).
Audit and Accounting Guide	Depository and Lending Institutions: Banks and Savings Institutions, Credit Unions, Finance Companies and Mortgage Companies	**Language revised by this Statement**	**Description—**Paragraph 7.103 references the required disclosures detailed in paragraph 17 of Statement 140. **Effect of Statement 156—**This Statement adds to and amends the required disclosures found in paragraph 17 of Statement 140. As a result of the amendments to Statement 140, paragraph 7.103 will be revised to reflect the language in paragraph 17 of Statement 140 (as amended by Statement 156).

Reference	Title	Status	Description/Effect of Statement 156
Audit and Accounting Guide	Depository and Lending Institutions: Banks and Savings Institutions, Credit Unions, Finance Companies and Mortgage Companies	**Language revised by this Statement**	**Description—**Paragraph 10.22 references the accounting guidance found in paragraphs 13 and 61–67 of Statement 140. **Effect of Statement 156—**This Statement amends paragraph 13 of Statement 140 to require that an entity initially measure a servicing asset or servicing liability at fair value, if practicable, if it meets the revised requirements found therein for recognition. It adds paragraph 13A to require that an entity subsequently measure each class of servicing assets and servicing liabilities using either the fair value measurement method or the amortization method. As a result of the amendments to Statement 140, paragraph 10.22 will be revised to reflect the language in paragraphs 13 and 13A of Statement 140 (as amended by Statement 156).
Audit and Accounting Guide	Depository and Lending Institutions: Banks and Savings Institutions, Credit Unions, Finance Companies and Mortgage Companies	**Language revised by this Statement**	**Description—**Paragraph 10.23 references paragraphs 61–67 of Statement 140, which specify the accounting for a contract to service financial assets separately from those assets. **Effect of Statement 156—**This Statement amends those referenced paragraphs. As a result of the amendments to Statement 140, paragraph 10.23 will be revised to reflect the language in paragraphs 61–67 of Statement 140 (as amended by Statement 156).

Audit and Accounting Guide	Depository and Lending Institutions: Banks and Savings Institutions, Credit Unions, Finance Companies and Mortgage Companies	**Language revised by this Statement**	**Description—**Paragraphs 10.35 and 10.36 reference the disclosure requirements found in paragraphs 17(d) and 17(e) of Statement 140. **Effect of Statement 156—**This Statement amends those disclosure requirements. Certain references to paragraph 17 will be updated.

Appendix C

STATEMENT 140 MARKED TO SHOW CHANGES THAT WOULD BE MADE BY THE COMBINATION OF FASB STATEMENT NO. 155, *ACCOUNTING FOR CERTAIN HYBRID FINANCIAL INSTRUMENTS*, AND THIS STATEMENT

C1. Statement 140 has been amended by FASB Statement No. 155, *Accounting for Certain Hybrid Financial Instruments,* and this Statement. This appendix contains the following sections of Statement 140 as originally issued, marked to integrate changes from Statement 155 and this amendment: introduction and scope, standard, selected sections of the implementation guidance, and the glossary. It does not contain the summary, Appendix B (background information and basis for conclusions), and Appendix D (amendments to existing pronouncements).

[Added text is underlined and deleted text is ~~struck out~~.]

INTRODUCTION AND SCOPE

1. The Board added a project on financial instruments and off-balance-sheet financing to its agenda in May 1986. The project is intended to develop standards to aid in resolving existing financial accounting and reporting issues and other issues likely to arise in the future about various financial instruments and related transactions. The November 1991 FASB Discussion Memorandum, *Recognition and Measurement of Financial Instruments,* describes the issues to be considered. This Statement focuses on the issues of accounting for **transfers**[1] and servicing of **financial assets** and extinguishments of liabilities.

2. Transfers of financial assets take many forms. Accounting for transfers in which the **transferor** has no continuing involvement with the transferred assets or with the **transferee** has not been controversial. However, transfers of financial assets often occur in which the transferor has some continuing involvement either with the assets transferred or with the transferee. Examples of continuing involvement are **recourse,** servicing, agreements to reacquire, options written or held, and pledges of **collateral.** Transfers of financial assets with continuing involvement raise issues about the circumstances under which the transfers should be considered as sales of all or part of

[1]Terms defined in Appendix E, the glossary, are set in **boldface type** the first time they appear.

the assets or as secured borrowings and about how transferors and transferees should account for sales and secured borrowings. This Statement establishes standards for resolving those issues.

3. An entity may settle a liability by transferring assets to the creditor or otherwise obtaining an unconditional release. Alternatively, an entity may enter into other arrangements designed to set aside assets dedicated to eventually settling a liability. Accounting for those arrangements has raised issues about when a liability should be considered extinguished. This Statement establishes standards for resolving those issues.

4. This Statement does not address transfers of custody of financial assets for safekeeping, contributions,[2] transfers of ownership interests that are in substance sales of real estate, or investments by owners or distributions to owners of a business enterprise. This Statement does not address subsequent measurement of assets and liabilities, except for (a) **servicing assets** and **servicing liabilities** and (b) **interest-only strips,** securities, ~~retained~~ interests that continue to be held by a transferor in securitizations, loans, other receivables, or other financial assets that can contractually be prepaid or otherwise settled in such a way that the holder would not recover substantially all of its recorded investment and that are not within the scope of FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*. This Statement does not change the accounting for employee benefits subject to the provisions of FASB Statement No. 87, *Employers' Accounting for Pensions*, No. 88, *Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits,* or No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*. This Statement does not change the provisions relating to leveraged leases in FASB Statement No. 13, *Accounting for Leases,* or money-over-money and wrap lease transactions involving nonrecourse debt subject to the provisions of FASB Technical Bulletin No. 88-1, *Issues Relating to Accounting for Leases*. This Statement does not address transfers of nonfinancial assets, for example, servicing assets, or transfers of unrecognized financial assets, for example, minimum lease payments to be received under operating leases.

5. The Board concluded that an objective in accounting for transfers of financial assets is for each entity that is a party to the transaction to recognize only assets it controls and liabilities it has incurred, to **derecognize** assets only when control has been surrendered, and to derecognize liabilities only when they have been extinguished. Sales and other transfers frequently result in a disaggregation of financial assets and liabilities into

---

[2]Contributions—unconditional nonreciprocal transfers of assets—are addressed in FASB Statement No. 116, *Accounting for Contributions Received and Contributions Made.*

components, which become separate assets and liabilities. For example, if an entity sells a portion of a financial asset it owns, the portion ~~retained~~that continues to be held by a transferor becomes an asset separate from the portion sold and from the assets obtained in exchange.

6. The Board concluded that another objective is that recognition of financial assets and liabilities should not be affected by the sequence of transactions that result in their acquisition or incurrence unless the effect of those transactions is to maintain effective control over a transferred financial asset. For example, if a transferor sells financial assets it owns and at the same time writes an "at-the-money" put option (such as a guarantee or recourse obligation) on those assets, it should recognize the put obligation in the same manner as would another unrelated entity that writes an identical put option on assets it never owned. Similarly, a creditor may release a debtor on the condition that a third party assumes the obligation and that the original debtor becomes secondarily liable. In those circumstances, the original debtor becomes a guarantor and should recognize a guarantee obligation in the same manner as would a third-party guarantor that had never been primarily liable to that creditor, whether or not explicit consideration was paid for that guarantee. However, certain agreements to repurchase or redeem transferred assets maintain effective control over those assets and should therefore be accounted for differently than agreements to acquire assets never owned.

7. Before FASB Statement No. 125, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities,* accounting standards generally required that a transferor account for financial assets transferred as an inseparable unit that had been either entirely sold or entirely retained. Those standards were difficult to apply and produced inconsistent and arbitrary results. For example, whether a transfer "purported to be a sale" was sufficient to determine whether the transfer was accounted for and reported as a sale of receivables under one accounting standard or as a secured borrowing under another. After studying many of the complex developments that have occurred in financial markets during recent years, the Board concluded that previous approaches that viewed each financial asset as an indivisible unit do not provide an appropriate basis for developing consistent and operational standards for dealing with transfers and servicing of financial assets and extinguishments of liabilities. To address those issues adequately and consistently, the Board decided to adopt as the basis for this Statement a *financial-components approach* that focuses on control and recognizes that financial assets and liabilities can be divided into a variety of components.

8. The Board issued Statement 125 in June 1996. After the issuance of that Statement, several parties called for reconsideration or clarification of certain provisions. Matters the Board was asked to reconsider or clarify included:

a. Circumstances in which a special-purpose entity (SPE) can be considered qualifying
b. Circumstances in which the assets held by a qualifying SPE should appear in the consolidated financial statements of the transferor
c. Whether sale accounting is precluded if the transferor holds a right to repurchase transferred assets that is attached to, is embedded in, or is otherwise transferable with the financial assets
d. Circumstances in which sale accounting is precluded if transferred financial assets can be removed from an SPE by the transferor (for example, under a removal-of-accounts provision (ROAP))
e. Whether arrangements that obligate, but do not entitle, a transferor to repurchase or redeem transferred financial assets should affect the accounting for those transfers
f. The impact of the powers of the Federal Deposit Insurance Corporation (FDIC) on isolation of assets transferred by financial institutions
g. Whether transfers of financial assets measured using the equity method of accounting should continue to be included in the scope of Statement 125
h. Whether disclosures should be enhanced to provide more information about assumptions used to determine the fair value of retained interests and the gain or loss on financial assets sold in securitizations
i. The accounting for and disclosure about collateral that can be sold or repledged.

The Board concluded that those requests to reconsider certain provisions of Statement 125 were appropriate and added a project to amend Statement 125 to its agenda in March 1997. This Statement is the result. To present the amended accounting standards for transfers of financial assets more clearly, this Statement replaces Statement 125. However, most of the provisions of Statement 125 have been carried forward without reconsideration.

STANDARDS OF FINANCIAL ACCOUNTING AND REPORTING

Accounting for Transfers and Servicing of Financial Assets

9. A transfer of financial assets (or all or a portion of a financial asset) in which the transferor surrenders control over those financial assets shall be accounted for as a sale to the extent that consideration other than **beneficial interests** in the transferred assets is received in exchange. The transferor has surrendered control over transferred assets if and only if *all of the following conditions* are met:

a. The transferred assets have been isolated from the transferor—put presumptively beyond the reach of the transferor and its creditors, even in bankruptcy or other receivership (paragraphs 27 and 28).
b. Each transferee (or, if the transferee is a qualifying SPE (paragraph 35), each holder of its beneficial interests) has the right to pledge or exchange the assets (or beneficial interests) it received, and no condition both constrains the transferee (or holder) from taking advantage of its right to pledge or exchange and provides more than a trivial benefit to the transferor (paragraphs 29–34).
c. The transferor does not maintain effective control over the transferred assets through either (1) an agreement that both entitles and obligates the transferor to repurchase or redeem them before their maturity (paragraphs 47–49) or (2) the ability to unilaterally cause the holder to return specific assets, other than through a **cleanup call** (paragraphs 50–54).

10. Upon completion of any transfer of financial assets, the transferor shall:

~~a. Continue to carry in its statement of financial position any retained interest in the transferred assets, including, if applicable, servicing assets (paragraphs 61-67), beneficial interests in assets transferred to a qualifying SPE in a **securitization** (paragraphs 73–84), and retained **undivided interests** (paragraphs 58 and 59)~~

a. Initially recognize and measure at **fair value,** if practicable (paragraph 71), servicing assets and servicing liabilities that require recognition under the provisions of paragraph 13

b. Allocate the previous carrying amount between the assets sold, if any, and the ~~retained~~ interests that continue to be held by the transferor, if any, based on their relative fair values at the date of transfer (paragraphs 56–60)~~.~~

c. Continue to carry in its statement of financial position any interest it continues to hold in the transferred assets, including, if applicable, beneficial interests in assets transferred to a qualifying SPE in a **securitization** (paragraphs 73–84), and any **undivided interests** (paragraphs 58 and 59).

11. Upon completion[3] of a transfer of financial assets that satisfies the conditions to be accounted for as a sale (paragraph 9), the transferor (**seller**) shall:

a. Derecognize all assets sold
b. Recognize all assets obtained and liabilities incurred in consideration as **proceeds** of the sale, including cash, put or call options held or written (for example, guarantee or recourse obligations), forward commitments (for example, commitments to deliver additional receivables during the revolving periods of some securitizations), swaps (for example, provisions that convert interest rates from fixed to variable), and servicing assets and servicing liabilities, if applicable (paragraphs 56, 57, and 61–67)
c. Initially measure at fair value assets obtained and liabilities incurred in a sale (paragraphs 68–70) or, if it is not practicable to estimate the fair value of an asset or a liability, apply alternative measures (paragraphs 71 and 72)
d. Recognize in earnings any gain or loss on the sale.

The transferee shall recognize all assets obtained and any liabilities incurred and initially measure them at fair value (in aggregate, presumptively the price paid).

12. If a transfer of financial assets in exchange for cash or other consideration (other than beneficial interests in the transferred assets) does not meet the criteria for a sale in paragraph 9, the transferor and transferee shall account for the transfer as a secured borrowing with pledge of collateral (paragraph 15).

Recognition and Measurement of Servicing Assets and Liabilities

~~13. Each time an entity undertakes an obligation to service financial assets it shall recognize either a servicing asset or a servicing liability for that servicing contract, unless it transfers the assets to a qualifying SPE in a **guaranteed mortgage securitization,** retains all of the resulting securities, and classifies them as debt securities held-to-maturity in accordance with FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. If the servicing asset or liability was purchased or assumed rather than undertaken in a sale or securitization of the financial assets being serviced, it shall be measured initially at its fair value, presumptively the price paid. A servicing asset or liability shall be amortized in~~

[3]Although a transfer of securities may not be considered to have reached completion until the settlement date, this Statement does not modify other generally accepted accounting principles, including FASB Statement No. 35, *Accounting and Reporting by Defined Benefit Pension Plans,* and AICPA Statements of Position and audit and accounting Guides for certain industries, that require accounting at the trade date for certain contracts to purchase or sell securities.

~~proportion to and over the period of estimated net servicing income (if servicing revenues exceed servicing costs) or net servicing loss (if servicing costs exceed servicing revenues). A servicing asset or liability shall be assessed for impairment or increased obligation based on its fair value (paragraphs 61–64).~~

An entity shall recognize and initially measure at fair value, if practicable, a servicing asset or servicing liability each time it undertakes an obligation to service a financial asset by entering into a servicing contract in any of the following situations:

a. A transfer of the servicer's financial assets that meets the requirements for sale accounting
b. A transfer of the servicer's financial assets to a qualifying SPE in a **guaranteed mortgage securitization** in which the transferor retains all of the resulting securities and classifies them as either available-for-sale securities or trading securities in accordance with FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*
c. An acquisition or assumption of a servicing obligation that does not relate to financial assets of the servicer or its consolidated affiliates.

An entity that transfers its financial assets to a qualifying SPE in a guaranteed mortgage securitization in which the transferor retains all of the resulting securities and classifies them as debt securities held-to-maturity in accordance with Statement 115 may either separately recognize its servicing assets or servicing liabilities or report those servicing assets or servicing liabilities together with the asset being serviced.

13A. An entity shall subsequently measure each class of servicing assets and servicing liabilities using one of the following methods:

a. *Amortization method:* Amortize servicing assets or servicing liabilities in proportion to and over the period of estimated net servicing income (if servicing revenues exceed servicing costs) or net servicing loss (if servicing costs exceed servicing revenues), and assess servicing assets or servicing liabilities for impairment or increased obligation based on fair value at each reporting date
b. *Fair value measurement method:* Measure servicing assets or servicing liabilities at fair value at each reporting date and report changes in fair value of servicing assets and servicing liabilities in earnings in the period in which the changes occur.

The election described in this paragraph shall be made separately for each class of servicing assets and servicing liabilities. An entity shall apply the same subsequent measurement method to each servicing asset and servicing liability in a class. Classes of servicing assets and servicing liabilities shall be identified based on (a) the availability of market inputs used in determining the fair value of servicing assets or servicing liabilities, (b) an entity's method for managing the risks of its servicing assets or servicing liabilities, or (c) both. Once an entity elects the fair value measurement method for a class of servicing assets and servicing liabilities, that election shall not be reversed (paragraph 63). If it is not practicable to initially measure a servicing asset or servicing liability at fair value, an entity shall initially recognize the servicing asset or servicing liability in accordance with paragraph 71 and shall include it in a class subsequently measured using the amortization method.

13B. An entity shall report recognized servicing assets and servicing liabilities that are subsequently measured using the fair value measurement method in a manner that separates those carrying amounts on the face of the statement of financial position from the carrying amounts for separately recognized servicing assets and servicing liabilities that are subsequently measured using the amortization method. To accomplish that separate reporting, an entity may either (a) display separate line items for the amounts that are subsequently measured using the fair value measurement method and amounts that are subsequently measured using the amortization method or (b) present the aggregate of those amounts that are subsequently measured at fair value and those amounts that are subsequently measured using the amortization method (paragraph 63) and disclose parenthetically the amount that is subsequently measured at fair value that is included in the aggregate amount.

Financial Assets Subject to Prepayment

14. Interest-only strips, other~~retained~~ interests that continue to be held by a transferor in securitizations, loans, other receivables, or other financial assets that can contractually be prepaid or otherwise settled in such a way that the holder would not recover substantially all of its recorded investment, except for instruments that are within the scope of Statement 133, shall be subsequently measured like investments in debt securities classified as available-for-sale or trading under Statement 115, as amended (paragraph 362).

Secured Borrowings and Collateral

15. A debtor may grant a **security interest** in certain assets to a lender (the secured party) to serve as collateral for its obligation under a borrowing, with or without recourse to other assets of the debtor. An obligor under other kinds of current or potential obligations, for example, interest rate swaps, also may grant a security interest in certain assets to a secured party. If collateral is transferred to the secured party, the custodial arrangement is commonly referred to as a pledge. Secured parties sometimes are permitted to sell or repledge (or otherwise transfer) collateral held under a pledge.

The same relationships occur, under different names, in transfers documented as sales that are accounted for as secured borrowings (paragraph 12). The accounting for noncash[4] collateral by the debtor (or obligor) and the secured party depends on whether the secured party has the right to sell or repledge the collateral and on whether the debtor has defaulted.

a. If the secured party (transferee) has the right by contract or custom to sell or repledge the collateral, then the debtor (transferor) shall reclassify that asset and report that asset in its statement of financial position separately (for example, as security pledged to creditors) from other assets not so encumbered.
b. If the secured party (transferee) sells collateral pledged to it, it shall recognize the proceeds from the sale and its obligation to return the collateral. The sale of the collateral is a transfer subject to the provisions of this Statement.
c. If the debtor (transferor) defaults under the terms of the secured contract and is no longer entitled to redeem the pledged asset, it shall derecognize the pledged asset, and the secured party (transferee) shall recognize the collateral as its asset initially measured at fair value or, if it has already sold the collateral, derecognize its obligation to return the collateral.
d. Except as provided in paragraph 15(c), the debtor (transferor) shall continue to carry the collateral as its asset, and the secured party (transferee) shall not recognize the pledged asset.

Extinguishments of Liabilities

16. A debtor shall derecognize a liability if and only if it has been extinguished. A liability has been extinguished if either of the following conditions is met:

a. The debtor pays the creditor and is relieved of its obligation for the liability. Paying the creditor includes delivery of cash, other financial assets, goods, or services or reacquisition by the debtor of its outstanding debt securities whether the securities are canceled or held as so-called treasury bonds.
b. The debtor is legally released[5] from being the primary obligor under the liability, either judicially or by the creditor.

---

[4]Cash "collateral," sometimes used, for example, in securities lending transactions (paragraphs 91–95), shall be derecognized by the payer and recognized by the recipient, not as collateral, but rather as proceeds of either a sale or a borrowing.

[5]If nonrecourse debt (such as certain mortgage loans) is assumed by a third party in conjunction with the sale of an asset that serves as sole collateral for that debt, the sale and related assumption effectively accomplish a legal release of the seller-debtor for purposes of applying this Statement.

Disclosures

17. An entity shall disclose the following:

a. For collateral:
   (1) If the entity has entered into repurchase agreements or securities lending transactions, its policy for requiring collateral or other security
   (2) If the entity has pledged any of its assets as collateral that are not reclassified and separately reported in the statement of financial position pursuant to paragraph 15(a), the carrying amount and classification of those assets as of the date of the latest statement of financial position presented
   (3) If the entity has accepted collateral that it is permitted by contract or custom to sell or repledge, the fair value as of the date of each statement of financial position presented of that collateral and of the portion of that collateral that it has sold or repledged, and information about the sources and uses of that collateral

b. If debt was considered to be extinguished by in-substance defeasance under the provisions of FASB Statement No. 76, *Extinguishment of Debt,* prior to the effective date of Statement 125,[6] a general description of the transaction and the amount of debt that is considered extinguished at the end of the period so long as that debt remains outstanding.

c. If assets are set aside after the effective date of Statement 125 solely for satisfying scheduled payments of a specific obligation, a description of the nature of restrictions placed on those assets.

d. If it is not practicable to estimate the fair value of certain assets obtained or liabilities incurred in transfers of financial assets during the period, a description of those items and the reasons why it is not practicable to estimate their fair value.

~~e. For all servicing assets and servicing liabilities:~~
   ~~(1) The amounts of servicing assets or liabilities recognized and amortized during the period~~
   ~~(2) The fair value of recognized servicing assets and liabilities for which it is practicable to estimate that value and the method and significant assumptions used to estimate the fair value~~
   ~~(3) The risk characteristics of the underlying financial assets used to stratify recognized servicing assets for purposes of measuring impairment in accordance with paragraph 63~~

[6]Refer to footnote 11 to paragraph 19.

~~(4) The activity in any valuation allowance for impairment of recognized servicing assets—including beginning and ending balances, aggregate additions charged and reductions credited to operations, and aggregate direct write-downs charged against the allowances—for each period for which results of operations are presented.~~

e. For all servicing assets and servicing liabilities:
   (1) Management's basis for determining its classes of servicing assets and servicing liabilities (paragraph 13A)
   (2) A description of the risks inherent in servicing assets and servicing liabilities and, if applicable, the instruments used to mitigate the income statement effect of changes in fair value of the servicing assets and servicing liabilities. (Disclosure of quantitative information about the instruments used to manage the risks inherent in servicing assets and servicing liabilities, including the fair value of those instruments at the beginning and end of the period, is encouraged but not required.)
   (3) The amount of contractually specified servicing fees (as defined in the glossary), late fees, and ancillary fees earned for each period for which results of operations are presented, including a description of where each amount is reported in the statement of income.

f. For servicing assets and servicing liabilities subsequently measured at fair value:
   (1) For each class of servicing assets and servicing liabilities, the activity in the balance of servicing assets and the activity in the balance of servicing liabilities (including a description of where changes in fair value are reported in the statement of income for each period for which results of operations are presented), including, but not limited to, the following:
      (a) The beginning and ending balances
      (b) Additions (through purchases of servicing assets, assumptions of servicing obligations, and servicing obligations that result from transfers of financial assets)
      (c) Disposals
      (d) Changes in fair value during the period resulting from:
         (i) Changes in valuation inputs or assumptions used in the valuation model
         (ii) Other changes in fair value and a description of those changes
      (e) Other changes that affect the balance and a description of those changes
   (2) A description of the valuation techniques or other methods used to estimate the fair value of servicing assets and servicing liabilities. If a valuation model is used, the description shall include the methodology and model validation procedures, as well as quantitative and qualitative

information about the assumptions used in the valuation model (for example, discount rates and prepayment speeds). (An entity that provides quantitative information about the instruments used to manage the risks inherent in the servicing assets and servicing liabilities, as encouraged by paragraph 17(e)(2), is also encouraged, but not required, to disclose a description of the valuation techniques, as well as quantitative and qualitative information about the assumptions used to estimate the fair value of those instruments.)

g. For servicing assets and servicing liabilities subsequently amortized in proportion to and over the period of estimated net servicing income or loss and assessed for impairment or increased obligation:
   (1) For each class of servicing assets and servicing liabilities, the activity in the balance of servicing assets and the activity in the balance of servicing liabilities (including a description of where changes in the carrying amount are reported in the statement of income for each period for which results of operations are presented), including, but not limited to, the following:
      (a) The beginning and ending balances
      (b) Additions (through purchases of servicing assets, assumption of servicing obligations, and servicing obligations that result from transfers of financial assets)
      (c) Disposals
      (d) Amortization
      (e) Application of valuation allowance to adjust carrying value of servicing assets
      (f) Other-than-temporary impairments
      (g) Other changes that affect the balance and a description of those changes
   (2) For each class of servicing assets and servicing liabilities, the fair value of recognized servicing assets and servicing liabilities at the beginning and end of the period if it is practicable to estimate the value
   (3) A description of the valuation techniques or other methods used to estimate fair value of the servicing assets and servicing liabilities. If a valuation model is used, the description shall include the methodology and model validation procedures, as well as quantitative and qualitative information about the assumptions used in the valuation model (for example, discount rates and prepayment speeds). (An entity that provides quantitative information about the instruments used to manage the risks inherent in the servicing assets and servicing liabilities, as encouraged by paragraph 17(e)(2), is also encouraged, but not required, to disclose a description of the valuation techniques as well as quantitative and

qualitative information about the assumptions used to estimate the fair value of those instruments.)

(4) The risk characteristics of the underlying financial assets used to stratify recognized servicing assets for purposes of measuring impairment in accordance with paragraph 63

(5) The activity by class in any valuation allowance for impairment of recognized servicing assets—including beginning and ending balances, aggregate additions charged and recoveries credited to operations, and aggregate write-downs charged against the allowance—for each period for which results of operations are presented.

h~~f~~. If the entity has securitized financial assets during any period presented and accounts for that transfer as a sale, for each major asset type (for example, mortgage loans, credit card receivables, and automobile loans):

(1) Its accounting policies for initially measuring the ~~retained~~ interests that continue to be held by the transferor, if any, and servicing assets or servicing liabilities, if any, including the methodology (whether quoted market price, prices based on sales of similar assets and liabilities, or prices based on valuation techniques) used in determining their fair value (paragraphs 68–70)

(2) The characteristics of securitizations (a description of the transferor's continuing involvement with the transferred assets, including, but not limited to, servicing, recourse, and restrictions on ~~retained~~ interests that continue to be held by the transferor) and the gain or loss from sale of financial assets in securitizations

(3) The key assumptions[7] used in measuring the fair value of ~~retained~~ interests that continue to be held by the transferor and servicing assets or servicing liabilities, if any, at the time of securitization (including, at a minimum, quantitative information about discount rates, expected prepayments including the expected weighted-average life of prepayable financial assets,[8] and anticipated credit losses, if applicable)

(4) Cash flows between the securitization SPE and the transferor, unless reported separately elsewhere in the financial statements or notes (including proceeds from new securitizations, proceeds from collections reinvested in revolving-period securitizations, purchases of delinquent or foreclosed loans, servicing fees, and cash flows received on interests that continue to be held by the transferor~~retained~~).

---

[7]If an entity has made multiple securitizations of the same major asset type during a period, it may disclose the range of assumptions.

[8]The weighted-average life of prepayable assets in periods (for example, months or years) can be calculated by multiplying the principal collections expected in each future period by the number of periods until that future period, summing those products, and dividing the sum by the initial principal balance.

i~~g~~. If the entity has ~~retained~~ interests that continue to be held by the transferor in ~~securitized~~ financial assets that it has securitized or servicing assets or servicing liabilities relating to assets that it has securitized, at the date of the latest statement of financial position presented, for each major asset type (for example, mortgage loans, credit card receivables, and automobile loans):

- (1) Its accounting policies for subsequently measuring those ~~retained~~ interests, including the methodology (whether quoted market price, prices based on sales of similar assets and liabilities, or prices based on valuation techniques) used in determining their fair value (paragraphs 68–70)
- (2) The key assumptions used in subsequently measuring the fair value of those interests (including, at a minimum, quantitative information about discount rates, expected prepayments including the expected weighted-average life of prepayable financial assets, and anticipated credit losses, including expected static pool losses,[9] if applicable)
- (3) A sensitivity analysis or stress test showing the hypothetical effect on the fair value of those interests (including any servicing assets or servicing liabilities) of two or more unfavorable variations from the expected levels for each key assumption that is reported under (2) above independently from any change in another key assumption, and a description of the objectives, methodology, and limitations of the sensitivity analysis or stress test
- (4) For the securitized assets and any other financial assets that it manages together with them:[10]
  - (a) The total principal amount outstanding, the portion that has been derecognized, and the portion that continues to be recognized in each category reported in the statement of financial position, at the end of the period
  - (b) Delinquencies at the end of the period
  - (c) Credit losses, net of recoveries, during the period

  (Disclosure of average balances during the period is encouraged, but not required.)

[9]Expected static pool losses can be calculated by summing the actual and projected future credit losses and dividing the sum by the original balance of the pool of assets.

[10]Excluding securitized assets that an entity continues to service but with which it has no other continuing involvement.

Implementation Guidance

18. Appendix A describes certain provisions of this Statement in more detail and describes their application to certain types of transactions. Appendix A is an integral part of the standards provided in this Statement.

Effective Date and Transition

[Paragraphs 19–25 have been omitted because the effective dates of those provisions in Statement 140 have passed. However, in July 2001, FASB Technical Bulletin No. 01-1, *Effective Date for Certain Financial Institutions of Certain Provisions of Statement 140 Related to the Isolation of Transferred Financial Assets,* was issued to provide certain financial institutions with an additional transition period to apply Statement 140. That transition period will end June 30, 2006.]

Appendix A

IMPLEMENTATION GUIDANCE

Introduction

26. This appendix describes certain provisions of this Statement in more detail and describes how they apply to certain types of transactions. This appendix discusses generalized situations. Facts and circumstances and specific contracts need to be considered carefully in applying this Statement. This appendix is an integral part of the standards provided in this Statement.

Isolation beyond the Reach of the Transferor and Its Creditors

27. The nature and extent of supporting evidence required for an assertion in financial statements that transferred financial assets have been isolated—put presumptively beyond the reach of the transferor and its creditors, either by a single transaction or a series of transactions taken as a whole—depend on the facts and circumstances. All available evidence that either supports or questions an assertion shall be considered. That consideration includes making judgments about whether the contract or circumstances permit the transferor to revoke the transfer. It also may include making judgments about the kind of bankruptcy or other receivership into which a transferor or SPE might be placed, whether a transfer of financial assets would likely be deemed a true sale at law, whether the transferor is affiliated with the transferee, and other factors pertinent under applicable law. Derecognition of transferred assets is appropriate only

if the available evidence provides reasonable assurance that the transferred assets would be beyond the reach of the powers of a bankruptcy trustee or other receiver for the transferor or any **consolidated affiliate of the transferor** that is not a special-purpose corporation or other entity designed to make remote the possibility that it would enter bankruptcy or other receivership (paragraph 83(c)).

28. Whether securitizations isolate transferred assets may depend on such factors as whether the securitization is accomplished in one step or two steps (paragraphs 80–84). Many common financial transactions, for example, typical repurchase agreements and securities lending transactions, isolate transferred assets from the transferor, although they may not meet the other criteria for surrender of control.

Conditions That Constrain a Transferee

29. Sale accounting is allowed under paragraph 9(b) only if each transferee has the right to pledge, or the right to exchange, the transferred assets or beneficial interests it received, but constraints on that right also matter. Many transferor-imposed or other conditions on a transferee's right to pledge or exchange a transferred asset both constrain a transferee from pledging or exchanging the transferred assets and, through that constraint, provide more than a trivial benefit to the transferor. For example, a provision in the transfer contract that prohibits selling or pledging a transferred loan receivable not only constrains the transferee but also provides the transferor with the more-than-trivial benefits of knowing who has the asset, a prerequisite to repurchasing the asset, and of being able to block the asset from finding its way into the hands of a competitor for the loan customer's business or someone that the loan customer might consider an undesirable creditor. Transferor-imposed contractual constraints that narrowly limit timing or terms, for example, allowing a transferee to pledge only on the day assets are obtained or only on terms agreed with the transferor, also constrain the transferee and presumptively provide the transferor with more-than-trivial benefits.

30. However, some conditions do not constrain a transferee from pledging or exchanging the asset and therefore do not preclude a transfer subject to such a condition from being accounted for as a sale. For example, a transferor's right of first refusal on the occurrence of a bona fide offer to the transferee from a third party presumptively would not constrain a transferee, because that right in itself does not enable the transferor to compel the transferee to sell the assets and the transferee would be in a position to receive the sum offered by exchanging the asset, albeit possibly from the transferor rather than the third party. Further examples of conditions that presumptively would not constrain a transferee include (a) a requirement to obtain the transferor's permission to sell or pledge that is not to be unreasonably withheld, (b) a prohibition on sale to the transferor's competitor if other potential willing buyers exist, (c) a

regulatory limitation such as on the number or nature of eligible transferees (as in the case of securities issued under Securities Act Rule 144A or debt placed privately), and (d) illiquidity, for example, the absence of an active market. Judgment is required to assess the significance of some conditions. For example, a prohibition on sale to the transferor's competitor would be a significant constraint if that competitor were the only potential willing buyer other than the transferor.

31. A condition imposed by a transferor that constrains the transferee presumptively provides more than a trivial benefit to the transferor. A condition *not* imposed by the transferor that constrains the transferee may or may not provide more than a trivial benefit to the transferor. For example, if the transferor refrains from imposing its usual contractual constraint on a specific transfer because it knows an equivalent constraint is already imposed on the transferee by a third party, it presumptively benefits more than trivially from that constraint. However, the transferor cannot benefit from a constraint if it is unaware at the time of the transfer that the transferee is constrained.

Transferor's Rights or Obligations to Reacquire Transferred Assets

32. Some rights or obligations to reacquire transferred assets both constrain the transferee and provide more than a trivial benefit to the transferor, thus precluding sale accounting under paragraph 9(b). For example, a **freestanding call** option written by a transferee to the transferor benefits the transferor and, if the transferred assets are not readily obtainable in the marketplace, is likely to constrain a transferee because it might have to default if the call was exercised and it had exchanged or pledged the assets. A freestanding forward purchase-sale contract between the transferor and the transferee on transferred assets not readily obtainable in the marketplace would benefit the transferor and is likely to constrain a transferee in much the same manner. Judgment is necessary to assess constraint and benefit. For example, put options written to the transferee generally do not constrain it, but a put option on a not-readily-obtainable asset may benefit the transferor and effectively constrain the transferee if the option is sufficiently deep-in-the-money when it is written that it is probable that the transferee will exercise it and the transferor will reacquire the transferred asset. In contrast, a sufficiently out-of-the-money call option held by the transferor may not constrain a transferee if it is probable when the option is written that it will not be exercised. Freestanding rights to reacquire transferred assets that are readily obtainable presumptively do not constrain the transferee from exchanging or pledging them and thus do not preclude sale accounting under paragraph 9(b).

33. Other rights or obligations to reacquire transferred assets, regardless of whether they constrain the transferee, may result in the transferor's maintaining effective control over the transferred assets, as discussed in paragraphs 50–54, thus precluding sale accounting under paragraph 9(c)(2).[15]

Conditions That Constrain a Holder of Beneficial Interests in a Qualifying SPE

34. The considerations in paragraphs 29–32, about conditions that may or may not constrain a transferee that is not a qualifying SPE from pledging or exchanging the transferred assets, also extend to conditions that may or may not constrain a BIH from pledging or exchanging its beneficial interests in assets transferred to a qualifying SPE. For example, if BIHs agree to sell their beneficial interests in a qualifying SPE back to the transferor upon request at the price paid plus a stated return, that arrangement clearly conveys more than a trivial benefit to the transferor; sale accounting for the transfer to the qualifying SPE would be precluded if that agreement constrained a BIH from exchanging or pledging its beneficial interest.

Qualifying SPE

35. A qualifying SPE[16] is a trust or other legal vehicle that meets *all* of the following conditions:

a. It is demonstrably distinct from the transferor (paragraph 36).
b. Its permitted activities (1) are significantly limited, (2) were entirely specified in the legal documents that established the SPE or created the beneficial interests in the transferred assets that it holds, and (3) may be significantly changed only with the approval of the holders of at least a majority of the beneficial interests held by entities other than any transferor, its affiliates, and its agents (paragraphs 37 and 38).

---

[15]And it is necessary to consider the overall effect of related rights and obligations in assessing such matters as whether a transferee is constrained or a transferor has maintained effective control. For example, if the transferor or its affiliate or agent is the servicer for the transferred asset and is empowered to decide to put the asset up for sale, and has the right of first refusal, that combination would place the transferor in position to unilaterally cause the return of a specific transferred asset and thus maintain the transferor's effective control of the transferred asset as discussed in paragraphs 9(c)(2) and 50.

[16]The description of a qualifying SPE is restrictive. The accounting for qualifying SPEs and transfers of financial assets to them should not be extended to any entity that does not currently satisfy all of the conditions articulated in this paragraph.

c. It may hold only:
   (1) Financial assets transferred to it that are passive in nature (paragraph 39)
   (2) Passive **derivative financial instruments** that pertain to beneficial interests ~~(other than another derivative financial instrument)~~ issued or sold to parties other than the transferor, its affiliates, or its agents (paragraphs 39 and 40)
   (3) Financial assets (for example, guarantees or rights to collateral) that would reimburse it if others were to fail to adequately service financial assets transferred to it or to timely pay obligations due to it and that it entered into when it was established, when assets were transferred to it, or when beneficial interests (other than derivative financial instruments) were issued by the SPE
   (4) Servicing rights related to financial assets that it holds
   (5) Temporarily, nonfinancial assets obtained in connection with the collection of financial assets that it holds (paragraph 41)
   (6) Cash collected from assets that it holds and investments purchased with that cash pending distribution to holders of beneficial interests that are appropriate for that purpose (that is, money-market or other relatively risk-free instruments without options and with maturities no later than the expected distribution date).

d. If it can sell or otherwise dispose of noncash financial assets, it can do so only in automatic response to one of the following conditions:
   (1) Occurrence of an event or circumstance that (a) is specified in the legal documents that established the SPE or created the beneficial interests in the transferred assets that it holds; (b) is outside the control of the transferor, its affiliates, or its agents; and (c) causes, or is expected at the date of transfer to cause, the fair value of those financial assets to decline by a specified degree below the fair value of those assets when the SPE obtained them (paragraphs 42 and 43)
   (2) Exercise by a BIH (other than the transferor, its affiliates, or its agents) of a right to put that holder's beneficial interest back to the SPE (paragraph 44)
   (3) Exercise by the transferor of a call or ROAP specified in the legal documents that established the SPE, transferred assets to the SPE, or created the beneficial interests in the transferred assets that it holds (paragraphs 51–54 and 85–88)
   (4) Termination of the SPE or maturity of the beneficial interests in those financial assets on a fixed or determinable date that is specified at inception (paragraph 45).

Need to Be Demonstrably Distinct from the Transferor

36. A qualifying SPE is demonstrably distinct from the transferor only if it cannot be unilaterally dissolved by any transferor, its affiliates, or its agents and either (a) at least 10 percent of the fair value of its beneficial interests is held by parties other than any transferor, its affiliates, or its agents or (b) the transfer is a guaranteed mortgage securitization.[17] An ability to unilaterally dissolve an SPE can take many forms, including but not limited to holding sufficient beneficial interests to demand that the trustee dissolve the SPE, the right to call all the assets transferred to the SPE, and a right to call or a prepayment privilege on the beneficial interests held by other parties.

Limits on Permitted Activities

37. The powers of the SPE must be limited to those activities allowed by paragraph 35 for it to be a qualifying SPE. Many kinds of entities are not so limited. For example, any bank, insurance company, pension plan, or investment company has powers that cannot be sufficiently limited for it to be a qualifying SPE.

38. The BIHs other than any transferor, its affiliates, or its agents may have the ability to change the powers of a qualifying SPE. If the powers of a previously qualifying SPE are changed so that the SPE is no longer qualifying, unless the conditions in paragraph 9(b) are then met by the SPE itself and the conditions in paragraphs 9(a) and 9(c) continue to be met, that change would bring the transferred assets held in the SPE back under the control of the transferor (paragraph 55).

Limits on What a Qualifying SPE May Hold

39. A financial asset or derivative financial instrument is passive only if holding the asset or instrument does not involve its holder in making decisions other than the decisions inherent in servicing (paragraph 61). An equity instrument is not passive if the qualifying SPE can exercise the voting rights and is permitted to choose how to vote. Investments are not passive if through them, either in themselves or in combination with other investments or rights, the SPE or any related entity, such as the transferor, its affiliates, or its agents, is able to exercise control or significant influence (as defined in generally accepted accounting principles for consolidation policy and for the equity method, respectively) over the investee. A derivative financial instrument is not passive

[17]An effect of that provision, in conjunction with paragraph 46, is that mortgage-backed securities ~~retained~~that continue to be held by a transferor in a guaranteed mortgage securitization in which the SPE meets all conditions for being a qualifying SPE are classified in the financial statements of the transferor as securities that are subsequently measured under Statement 115.

if, for example, it includes an option allowing the SPE to choose to call or put other financial instruments; but other derivative financial instruments can be passive, for example, interest rate caps and swaps and forward contracts. Derivative financial instruments that result in liabilities, like other liabilities of a qualifying SPE, are a kind of beneficial interest in the qualifying SPE's assets.

40. A derivative financial instrument pertains to beneficial interests ~~(other than another derivative financial instrument)~~ issued only if it:

a. Is entered into (1) when the beneficial interests are issued by the qualifying SPE to parties other than the transferor, its affiliates, or its agents or sold to such other parties after being issued by the qualifying SPE to the transferor, its affiliates, or its agents or (2) when a passive derivative financial instrument needs to be replaced upon occurrence of an event or circumstance (specified in the legal documents that established the SPE or created the beneficial interests in the transferred assets that it holds) outside the control of the transferor, its affiliates, or its agents, for example, when the counterparty to the derivative defaults or is downgraded below a specified threshold
b. Has a notional amount that does not initially exceed the amount of those beneficial interests and is not expected to exceed them subsequently
c. Has characteristics that relate to, and partly or fully but not excessively counteract, some risk associated with those beneficial interests or the related transferred assets.

41. A qualifying SPE may hold nonfinancial assets other than servicing rights only temporarily and only if those nonfinancial assets result from collecting the transferred financial assets. For example, a qualifying SPE could be permitted to temporarily hold foreclosed nonfinancial collateral. In contrast, an entity cannot be a qualifying SPE if, for example, it receives from a transferor significant secured financial assets likely to default with the expectation that it will foreclose on and profitably manage the securing nonfinancial assets. A qualifying SPE also may hold the residual value of a sales-type or a direct financing lease only to the extent that it is guaranteed at the inception of the lease either by the lessee or by a third party financially capable of discharging the obligations that may arise from the guarantee (paragraph 89).

Limits on Sales or Other Dispositions of Assets

42. Examples of requirements to sell, exchange, put, or distribute (hereinafter referred to collectively as dispose of) noncash financial assets that *are* permitted activities of a qualifying SPE—because they respond automatically to the occurrence of an event or circumstance that (a) is specified in the legal documents that established the SPE or

created the beneficial interests in the transferred assets that it holds; (b) is outside the control of the transferor, its affiliates, or its agents; and (c) causes, or is expected to cause, the fair value of those assets to decline by a specified degree below the fair value of those assets when the qualifying SPE obtained them—include requirements to dispose of transferred assets in response to:

a. A failure to properly service transferred assets that could result in the loss of a substantial third-party credit guarantee
b. A default by the obligor
c. A downgrade by a major rating agency of the transferred assets or of the underlying obligor to a rating below a specified minimum rating
d. The involuntary insolvency of the transferor
e. A decline in the fair value of the transferred assets to a specified value less than their fair value at the time they were transferred to the SPE.

43. The following are examples of powers or requirements to dispose of noncash financial assets that *are not* permitted activities of a qualifying SPE, because they do not respond automatically to the occurrence of a specified event or circumstance outside the control of the transferor, its affiliates, or its agents that causes, or is expected to cause, the fair value of those transferred assets to decline by a specified degree below the fair value of those assets when the SPE obtained them:

a. A power that allows an SPE to choose to either dispose of transferred assets or hold them in response to a default, a downgrade, a decline in fair value, or a servicing failure
b. A requirement to dispose of marketable equity securities upon a specified decline from their "highest fair value" if that power could result in disposing of the asset in exchange for an amount that is more than the fair value of those assets at the time they were transferred to the SPE
c. A requirement to dispose of transferred assets in response to the violation of a nonsubstantive contractual provision (that is, a provision for which there is not a sufficiently large disincentive to ensure performance).

44. A qualifying SPE may dispose of transferred assets automatically to the extent necessary to comply with the exercise by a BIH (other than the transferor, its affiliates, or its agents) of its right to put beneficial interests back to the SPE in exchange for:

a. A full or partial distribution of those assets
b. Cash (which may require that the SPE dispose of those assets or issue beneficial interests to generate cash to fund settlement of the put)
c. New beneficial interests in those assets.

45. A qualifying SPE may have the power to dispose of assets to a party other than the transferor, its affiliate, or its agent on termination of the SPE or maturity of the beneficial interests, but only automatically on fixed or determinable dates that are specified at inception. For example, if an SPE is required to dispose of long-term mortgage loans and terminate itself at the earlier of (a) the specified maturity of beneficial interests in those mortgage loans or (b) the date of prepayment of a specified amount of the transferred mortgage loans, the termination date is a fixed or determinable date that was specified at inception. In contrast, if that SPE has the power to dispose of transferred assets on two specified dates and the SPE can decide which transferred assets to sell on each date, the termination date is *not* a fixed or determinable date that was specified at inception.

Qualifying SPEs and Consolidated Financial Statements

46. A qualifying SPE shall not be consolidated in the financial statements of a transferor or its affiliates.

Maintaining Effective Control over Transferred Assets

Agreement to Repurchase or Redeem Transferred Assets

47. An agreement that both entitles and obligates the transferor to repurchase or redeem transferred assets from the transferee maintains the transferor's effective control over those assets under paragraph 9(c)(1), and the transfer is therefore to be accounted for as a secured borrowing, if and only if all of the following conditions are met:

a. The assets to be repurchased or redeemed are the same or substantially the same as those transferred (paragraph 48).
b. The transferor is able to repurchase or redeem them on substantially the agreed terms, even in the event of default by the transferee (paragraph 49).
c. The agreement is to repurchase or redeem them before maturity, at a fixed or determinable price.
d. The agreement is entered into concurrently with the transfer.

48. To be substantially the same,[18] the asset that was transferred and the asset that is to be repurchased or redeemed need to have all of the following characteristics:

[18]In this Statement, the term *substantially the same* is used consistently with the usage of that term in the AICPA Statement of Position 90-3, *Definition of the Term Substantially the Same for Holders of Debt Instruments, as Used in Certain Audit Guides and a Statement of Position.*

a. The same primary obligor (except for debt guaranteed by a sovereign government, central bank, government-sponsored enterprise or agency thereof, in which case the guarantor and the terms of the guarantee must be the same)
b. Identical form and type so as to provide the same risks and rights
c. The same maturity (or in the case of mortgage-backed pass-through and pay-through securities, similar remaining weighted-average maturities that result in approximately the same market yield)
d. Identical contractual interest rates
e. Similar assets as collateral
f. The same aggregate unpaid principal amount or principal amounts within accepted "good delivery" standards for the type of security involved.

49. To be able to repurchase or redeem assets on substantially the agreed terms, even in the event of default by the transferee, a transferor must at all times during the contract term have obtained cash or other collateral sufficient to fund substantially all of the cost of purchasing replacement assets from others.

Ability to Unilaterally Cause the Return of Specific Transferred Assets

50. Some rights to reacquire transferred assets (or to acquire beneficial interests in transferred assets held by a qualifying SPE), regardless of whether they constrain the transferee, may result in the transferor's maintaining effective control over the transferred assets through the **unilateral ability** to cause the return of specific transferred assets. Such rights preclude sale accounting under paragraph 9(c)(2). For example, an **attached call** in itself would not constrain a transferee who is able, by exchanging or pledging the asset subject to that call, to obtain substantially all of its economic benefits. An attached call could result, however, in the transferor's maintaining effective control over the transferred asset(s) because the attached call gives the transferor the ability to unilaterally cause whoever holds that specific asset to return it. In contrast, transfers of financial assets subject to calls embedded by the issuers of the financial instruments, for example, callable bonds or prepayable mortgage loans, do not preclude sale accounting. Such an **embedded call** does not result in the transferor's maintaining effective control, because it is the issuer rather than the transferor who holds the call.

51. If the transferee is a qualifying SPE, it has met the conditions in paragraph 35(d) and therefore must be constrained from choosing to exchange or pledge the transferred assets. In that circumstance, any call held by the transferor is effectively attached to the assets and could—depending on the price and other terms of the call—maintain the transferor's effective control over transferred assets through the ability to unilaterally cause the transferee to return specific assets. For example, a transferor's unilateral

ability to cause a qualifying SPE to return to the transferor or otherwise dispose of specific transferred assets at will or, for example, in response to its decision to exit a market or a particular activity, could provide the transferor with effective control over the transferred assets.

52. A call that is attached to transferred assets maintains the transferor's effective control over those assets if, under its price and other terms, the call conveys more than a trivial benefit to the transferor. Similarly, any unilateral right to reclaim specific assets transferred to a qualifying SPE maintains the transferor's effective control over those assets if the right conveys more than a trivial benefit to the transferor. A call or other right conveys more than a trivial benefit if the price to be paid is fixed, determinable, or otherwise potentially advantageous, unless because that price is so far out of the money or for other reasons it is probable when the option is written that the transferor will not exercise it. Thus, for example, a call on specific assets transferred to a qualifying SPE at a price fixed at their principal amount maintains the transferor's effective control over the assets subject to that call. Effective control over transferred assets can be present even if the right to reclaim is indirect. For example, if an embedded call allows a transferor to buy back the beneficial interests of a qualifying SPE at a fixed price, then the transferor remains in effective control of the assets underlying those beneficial interests. A cleanup call, however, is permitted as an exception to that general principle.

53. A right to reclaim specific transferred assets by paying their fair value when reclaimed generally does not maintain effective control, because it does not convey a more than trivial benefit to the transferor. However, a transferor has maintained effective control if it has such a right and also holds the residual interest in the transferred assets. For example, if a transferor can reclaim such assets at termination of the qualifying SPE by purchasing them in an auction, and thus at what might appear to be fair value, then sale accounting for the assets it can reclaim would be precluded. Such circumstances provide the transferor with a more than trivial benefit and effective control over the assets, because it can pay any price it chooses in the auction and recover any excess paid over fair value through its residual interest.

54. A transferor that has a right to reacquire transferred assets from a qualifying SPE does not maintain effective control if the reclaimed assets would be randomly selected and the amount of the assets reacquired is sufficiently limited (paragraph 87(a)), because that would not be a right to reacquire *specific* assets. Nor does a transferor maintain effective control through an obligation to reacquire transferred assets from a qualifying SPE if the transfer could occur only after a specified failure of the servicer to properly service the transferred assets that could result in the loss of a third-party guarantee (paragraph 42(a)) or only after a BIH other than the transferor, its affiliate, or

its agent requires a qualifying SPE to repurchase that beneficial interest (paragraph 44(b)), because the transferor could not cause that reacquisition *unilaterally.*

Changes That Result in the Transferor's Regaining Control of Assets Sold

55. A change in law, status of the transferee as a qualifying SPE, or other circumstance may result in the transferor's regaining control of assets previously accounted for appropriately as having been sold, because one or more of the conditions in paragraph 9 are no longer met. Such a change, unless it arises solely from either the initial application of this Statement or a change in market prices (for example, an increase in price that moves into-the-money a freestanding call that was originally sufficiently out-of-the-money that it was judged not to constrain the transferee), is accounted for in the same manner as a purchase of the assets from the former transferee(s) in exchange for liabilities assumed (paragraph 11). After that change, the transferor recognizes in its financial statements those assets together with liabilities to the former transferee(s) or BIHs in those assets (paragraph 38). The transferor initially measures those assets and liabilities at fair value on the date of the change, as if the transferor purchased the assets and assumed the liabilities on that date. The former transferee would derecognize the assets on that date, as if it had sold the assets in exchange for a receivable from the transferor.

Measurement of Interests Held after a Transfer of Financial Assets

Assets Obtained and Liabilities Incurred as Proceeds

56. The proceeds from a sale of financial assets consist of the cash and any other assets obtained, including separately recognized servicing assets, in the transfer less any liabilities incurred, including separately recognized servicing liabilities. Any asset obtained that is not an interest in the transferred asset is part of the proceeds from the sale. Any liability incurred, even if it is related to the transferred assets, is a reduction of the proceeds. Any derivative financial instrument entered into concurrently with a transfer of financial assets is either an asset obtained or a liability incurred and part of the proceeds received in the transfer. All proceeds and reductions of proceeds from a sale shall be initially measured at fair value, if practicable.

Illustration—Recording Transfers with Proceeds of Cash, Derivatives, and Other Liabilities

57. Company A sells loans with a fair value of \$1,100 and a carrying amount of \$1,000. Company A ~~retains~~undertakes no servicing responsibilities but obtains an option to purchase from the transferee loans similar to the loans sold (which are readily obtainable in the marketplace) and assumes a limited recourse obligation to repurchase

delinquent loans. Company A agrees to provide the transferee a return at a floating rate of interest even though the contractual terms of the loan are fixed rate in nature (that provision is effectively an interest rate swap).

Fair Values

Cash proceeds	$1,050
Interest rate swap	40
Call option	70
Recourse obligation	60

Net Proceeds

Cash received	$1,050
Plus: Call option	70
Interest rate swap	40
Less: Recourse obligation	(60)
Net proceeds	$1,100

Gain on Sale

Net proceeds	$1,100
Carrying amount of loans sold	1,000
Gain on sale	$ 100

Journal Entry

Cash	1,050	
Interest rate swap	40	
Call option	70	
Loans		1,000
Recourse obligation		60
Gain on sale		100
To record transfer		

~~Retained~~ Interests That Continue to Be Held by a Transferor

58. Other interests in transferred assets—those that are not part of the proceeds of a transfer—are ~~retained~~ interests that continue to be held by a transferor over which a transferor has not relinquished control. Interests that continue to be held by a transferor~~They~~ shall be measured at the date of the transfer by allocating the previous carrying amount between the assets sold, if any, and the ~~retained~~ interests that continue to be held by a transferor, based on their relative fair values. Allocation procedures shall

be applied to all transfers in which interests ~~are~~continue to be held by a transferor~~retained~~, even those that do not qualify as sales. Examples of ~~retained~~ interests that continue to be held by a transferor include securities backed by the transferred assets, undivided interests, ~~servicing assets,~~ and cash reserve accounts and residual interests in securitization trusts. If a transferor cannot determine whether an asset is an ~~retained~~ interest that continues to be held by a transferor or proceeds from the sale, the asset shall be treated as proceeds from the sale and accounted for in accordance with paragraph 56.

59. If the ~~retained~~ interests that continue to be held by a transferor are subordinate~~d~~ to more senior interests held by others, that subordination may concentrate most of the risks inherent in the transferred assets into the ~~retained~~ interests that continue to be held by a transferor~~most of the risks inherent in the transferred assets~~ and shall be taken into consideration in estimating the fair value of those~~the retained~~ interests. For example, if the amount of the gain recognized, after allocation, on a securitization with a subordinated ~~retained~~ interest that continues to be held by the transferor is greater than the gain that would have been recognized had the entire asset been sold, the transferor needs to be able to identify why that can occur. Otherwise, it is likely that the effect~~impact~~ of subordination~~the retained interest being subordinate~~ to a senior interest has not been adequately considered in the determination of the fair value of the subordinated ~~retained~~ interest that continues to be held by a transferor.

Illustration—Recording Transfers of Partial Interests

60. Company B sells a pro rata nine-tenths interest in loans with a fair value of $1,100 and a carrying amount of $1,000. There is no servicing asset or liability, because Company B estimates that the **benefits of servicing** are just adequate to compensate it for its servicing responsibilities.

Fair Values	
Cash proceeds for nine-tenths interest sold	$990
One-tenth interest ~~retained~~that continues to be held by the transferor [($990 ÷ 9/10) × 1/10]	110

Carrying Amount Based on Relative Fair Values

	Fair Value	Percentage of Total Fair Value	Allocated Carrying Amount
Nine-tenths interest sold	$ 990	90	$ 900
One-tenth interest ~~retained~~that continues to be held by the transferor	110	10	100
Total	$1,100	100	$1,000

Gain on Sale

Net proceeds	$990
Carrying amount of loans sold	900
Gain on sale	$ 90

Journal Entry

Cash	990	
Loans		900
Gain on sale		90
To record transfer		

Servicing Assets and Liabilities

61. Servicing of mortgage loans, credit card receivables, or other financial assets commonly includes, but is not limited to, collecting principal, interest, and escrow payments from borrowers; paying taxes and insurance from escrowed funds; monitoring delinquencies; executing foreclosure if necessary; temporarily investing funds pending distribution; remitting fees to guarantors, trustees, and others providing services; and accounting for and remitting principal and interest payments to the holders of beneficial interests in the financial assets. Servicing is inherent in all financial assets; it becomes a distinct asset or liability ~~only when contractually separated from the underlying assets by sale or securitization of the assets with servicing retained or separate purchase or assumption of the servicing~~for accounting purposes only in the circumstances described in paragraph 62.

62. An entity that undertakes a contract to service financial assets shall recognize either a servicing asset or a servicing liability each time it undertakes an obligation to service a financial asset that (a) results from a transfer of the servicer's financial assets that meets the requirements for sale accounting, (b) results from a transfer of the servicer's

financial assets to a qualifying SPE in a guaranteed mortgage securitization in which the transferor retains all of the resulting securities and classifies them as either available-for-sale securities or trading securities in accordance with Statement 115, or (c) is acquired or assumed and the servicing obligation does not relate to financial assets of the servicer or its consolidated affiliates.~~, with only one exception. (That exception is~~ However, if the transferor transfers the assets in a guaranteed mortgage securitization, retains all of the resulting securities, and classifies them as debt securities held-to-maturity in accordance with Statement 115, ~~in which case~~ the servicing asset or servicing liability may be reported together with the asset being serviced and not recognized separately.~~) Each sale or securitization with servicing retained or separate purchase or assumption of servicing results in a servicing contract.~~ A servicer of financial assets commonly receives the benefits of servicing—revenues from contractually specified servicing fees, a portion of the interest from the financial assets, late charges, and other ancillary sources, including "float," all of which it is entitled to receive only if it performs the servicing—and incurs the costs of servicing the assets. ~~Each servicing contract results in a servicing asset or servicing liability.~~ Typically, the benefits of servicing are expected to be more than **adequate compensation** to a servicer for performing the servicing, and the contract results in a servicing asset. However, if the benefits of servicing are not expected to adequately compensate a servicer for performing the servicing, the contract results in a servicing liability. (A servicing asset may become a servicing liability, or vice versa, if circumstances change, and the initial measure for servicing may be zero if the benefits of servicing are just adequate to compensate the servicer for its servicing responsibilities.) A servicer would account for its servicing contract that qualifies for separate recognition as a servicing asset or a servicing liability initially measured at its fair value regardless of whether explicit consideration was exchanged.

62A. A servicer that transfers or securitizes financial assets in a transaction that does not meet the requirements for sale accounting and is accounted for as a secured borrowing with the underlying assets remaining on the transferor's balance sheet shall not recognize a servicing asset or a servicing liability. However, if a transferor enters into a servicing contract when the transferor transfers mortgage loans in a guaranteed mortgage securitization, retains all the resulting securities, and classifies those securities as either available-for-sale securities or trading securities in accordance with Statement 115, the transferor shall separately recognize a servicing asset or a servicing liability.

63. A servicer that recognizes a servicing asset or servicing liability shall account for the contract to service financial assets separately from those financial assets, as follows:

a. Report servicing assets separately from servicing liabilities in the statement of financial position (paragraph 13B).

b. Initially measure servicing assets and servicing liabilities~~retained in a sale or securitization of the assets being serviced~~ at fair value~~their allocated previous carrying amount based on relative fair values~~, if practicable~~, at the date of the sale or securitization~~ (paragraphs 10, 11(b), 11(c), ~~58–60,~~ and 68–72).

~~c. Initially measure servicing assets purchased or servicing liabilities assumed at fair value (paragraph 13).~~

~~d. Initially measure servicing liabilities undertaken in a sale or securitization at fair value, if practicable (paragraphs 11(b), 11(c), and 68–72).~~

c~~e~~. Account separately for rights to future interest income from the serviced assets that exceed~~s~~ contractually specified servicing fees. Those rights are not servicing assets; they are financial assets, effectively interest-only strips to be accounted for in accordance with paragraph 14 of this Statement.

d. Identify classes of servicing assets and servicing liabilities based on (1) the availability of market inputs used in determining the fair value of servicing assets and servicing liabilities, (2) an entity's method for managing the risks of its servicing assets and servicing liabilities, or (3) both.

e~~f~~. Subsequently measure each class of separately recognized servicing assets and servicing liabilities either at fair value or by amortizing the amount recognized in proportion to and over the period of estimated net servicing income for assets~~—~~(the excess of servicing revenues over servicing costs) or the period of estimated net servicing loss for servicing liabilities (the excess of servicing costs over servicing revenues). Different elections can be made for different classes of servicing assets and servicing liabilities. An entity may make an irrevocable decision to subsequently measure a class of servicing assets and servicing liabilities at fair value at the beginning of any fiscal year. Once a servicing asset or a servicing liability is reported in a class of servicing assets and servicing liabilities that an entity elects to subsequently measure at fair value, that servicing asset or servicing liability cannot be placed in a class of servicing assets and servicing liabilities that is subsequently measured using the amortization method. Changes in fair value should be reported in earnings for servicing assets and servicing liabilities subsequently measured at fair value (paragraph 13A(b)).

f~~g~~. Subsequently evaluate and measure impairment of each class of separately recognized servicing assets that are subsequently measured using the amortization method described in paragraph 13A(a) as follows:

(1) Stratify servicing assets within a class based on one or more of the predominant risk characteristics of the underlying financial assets. Those

characteristics may include financial asset type,[19] size, interest rate, date of origination, term, and geographic location.

(2) Recognize impairment through a valuation allowance for an individual stratum. The amount of impairment recognized separately shall be the amount by which the carrying amount of servicing assets for a stratum exceeds their fair value. The fair value of servicing assets that have not been recognized shall not be used in the evaluation of impairment.

(3) Adjust the valuation allowance to reflect changes in the measurement of impairment subsequent to the initial measurement of impairment. Fair value in excess of the carrying amount of servicing assets for that stratum, however, shall not be recognized. This Statement does not address when an entity should record a direct write-down of recognized servicing assets~~ (paragraph 13)~~.

g~~h~~. ~~Subsequently measure servicing liabilities by amortizing the amount recognized in proportion to and over the period of estimated net servicing loss—the excess of servicing costs over servicing revenues. However,~~For servicing liabilities subsequently measured using the amortization method, if subsequent events have increased the fair value of the liability above the carrying amount, for example, because of significant changes in the amount or timing of actual or expected future cash flows ~~from~~relative to the cash flows previously projected, the servicer shall revise its earlier estimates and recognize the increased obligation as a loss in earnings (paragraph 13).

64. As indicated above, transferors sometimes agree to take on servicing responsibilities when the future benefits of servicing are not expected to adequately compensate them for performing that servicing. In that circumstance, the result is a servicing liability rather than a servicing asset. For example, if in the transaction illustrated in paragraph 57 the transferor had agreed to service the loans without explicit compensation and it estimated the fair value of that servicing obligation at $50, net proceeds would be reduced to $1,050, gain on sale would be reduced to $50, and the transferor would report a servicing liability of $50.

Illustration—Sale of Receivables with Servicing ~~Retained~~Obtained

65. Company C originates $1,000 of loans that yield 10 percent interest income for their estimated lives of 9 years. Company C sells the $1,000 principal plus the right to receive interest income of 8 percent to another entity for $1,000. Company C will continue to service the loans, and the contract stipulates that its compensation for

[19]For example, for mortgage loans, financial asset type refers to the various conventional or government guaranteed or insured mortgage loans and adjustable-rate or fixed-rate mortgage loans.

performing the servicing is the right to receive half of the interest income not sold. The remaining half of the interest income not sold is considered an interest-only strip receivable that Company C classifies as an available-for-sale security. At the date of the transfer, the fair value of the loans~~, including servicing,~~ is $1,100. The fair values of the servicing asset and the interest-only strip receivable are~~is~~ $40 and $60, respectively.

Fair Values

Cash proceeds	$1,000
Servicing asset	40
Interest-only strip receivable	60

Net Proceeds

Cash proceeds	$1,000
Servicing asset	40
Net proceeds	$1,040

Carrying Amount Based on Relative Fair Values

	~~Fair Value~~	~~Percentage of Total Fair Value~~	~~Allocated Carrying Amount~~
~~Loans sold~~	~~$1,000~~	~~91.0~~	~~$ 910~~
~~Servicing asset~~	~~40~~	~~3.6~~	~~36~~
~~Interest-only strip receivable~~	~~60~~	~~5.4~~	~~54~~
~~Total~~	~~$1,100~~	~~100.00~~	~~$1,000~~

	Fair Value	Percentage of Total Fair Value	Allocated Carrying Amount
Loans sold	$1,040	94.55	$ 945.50
Interest-only strip receivable	60	5.45	54.50
Total	$1,100	100.00	$1,000.00

Gain on Sale

Net proceeds	$1,040.00~~1,000~~
Less: Carrying amount of loans sold	945.50~~910~~
Gain on sale	$ 94.50~~90~~

Journal Entries

Cash	1,000.00	
Interest-only strip receivable	54.50	
Servicing asset	40.00	
Loans		1,000.00~~910~~
Gain on sale		94.50~~90~~
To record transfer and to recognize interest-only strip receivable and servicing asset		
~~Servicing asset~~	~~36~~	
~~Interest-only strip receivable~~	~~54~~	
~~Loans~~		~~90~~
~~To record servicing asset and interest-only strip receivable~~		
Interest-only strip receivable	5.50~~6~~	
~~Equity~~Other comprehensive income		5.50~~6~~
To begin to subsequently measure interest-only strip receivable like an available-for-sale security (paragraph 14)		

66. The previous illustration demonstrates how a transferor would account for a simple sale ~~or securitization~~ in which servicing is ~~retained~~obtained. Company C might instead transfer the financial assets to a corporation or a trust that is a qualifying SPE. The qualifying SPE then securitizes the loans by selling beneficial interests to the public. The qualifying SPE pays the cash proceeds to the original transferor, which accounts for the transfer as a sale and derecognizes the financial assets assuming that the criteria in paragraph 9 are met. Securitizations often combine the elements shown in paragraphs 57, 60, and 65, as illustrated below.

Illustration—Recording Transfers of Partial Interests with Proceeds of Cash, Derivatives, Other Liabilities, and Servicing

67. Company D originates $1,000 of prepayable loans that yield 10 percent interest income for their 9-year expected lives. Company D sells nine-tenths of the principal plus interest of 8 percent to another entity. Company D will continue to service the loans, and the contract stipulates that its compensation for performing the servicing is the 2 percent of the interest income not sold. Company D obtains an option to purchase

from the transferee loans similar to the loans sold (which are readily obtainable in the marketplace) and incurs a limited recourse obligation to repurchase delinquent loans. At the date of transfer, the fair value of the loans is $1,100.

Fair Values

Cash proceeds	$900
Call option	70
Recourse obligation	(60)
Servicing asset	90
One-tenth interest ~~retained~~that continues to be held by the transferor	100

Net Proceeds

Cash received	$ 900
Plus: Servicing asset	90
Plus: Call option	70
Less: Recourse obligation	(60)
Net proceeds	$1,000~~910~~

Carrying Amount Based on Relative Fair Values

	~~Fair Value~~	~~Percentage of Total Fair Value~~	~~Allocated Carrying Amount~~
~~Interest sold~~	~~$ 910~~	~~83~~	~~$ 830~~
~~Servicing asset~~	~~90~~	~~8~~	~~80~~
~~One-tenth interest retained~~	~~100~~	~~9~~	~~90~~
~~Total~~	~~$1,100~~	~~100~~	~~$1,000~~

	Fair Value	Percentage of Total Fair Value	Allocated Carrying Amount
Interest sold	$1,000	90.9	$ 909
One-tenth interest that continues to be held by the transferor	100	9.1	91
Total	$1,100	100.0	$1,000

Gain on Sale

Net proceeds	$1,000 ~~910~~
Less: Carrying amount of loans sold	(909) ~~830~~
Gain on sale	$91 ~~80~~

Loans Sold

Carrying amount of loans	$1,000
Less: Allocated carrying amount of interest that continues to be held by the transferor	(91)
Loans sold	$ 909

Journal Entries

Cash	900	
Call option	70	
Servicing asset	90	
Loans		909 ~~830~~
Recourse obligation		60
Gain on sale		91 ~~80~~

To record transfer and to recognize servicing asset, call option, and recourse obligation

~~Servicing asset~~	~~80~~	
~~Loans~~		~~80~~

~~To record servicing asset~~

~~At the time of the transfer, Company D reports its one-tenth retained interest in the loans at its allocated carrying amount of $90.~~

Fair Value

68. The fair value of an asset (or liability) is the amount at which that asset (or liability) could be bought (or incurred) or sold (or settled) in a current transaction between willing parties, that is, other than in a forced or liquidation sale. Quoted market prices in active markets are the best evidence of fair value and shall be used as the basis for the measurement, if available. If a quoted market price is available, the fair value is the product of the number of trading units times that market price.

69. If quoted market prices are not available, the estimate of fair value shall be based on the best information available in the circumstances. The estimate of fair value shall

consider prices for similar assets and liabilities and the results of valuation techniques to the extent available in the circumstances. Examples of valuation techniques include the present value of estimated future cash flows,[20] option-pricing models, matrix pricing, option-adjusted spread models, and fundamental analysis. Valuation techniques for measuring financial assets and liabilities and servicing assets and liabilities shall be consistent with the objective of measuring fair value. Those techniques shall incorporate assumptions that market participants would use in their estimates of values, future revenues, and future expenses, including assumptions about interest rates, default, prepayment, and volatility.[21] In measuring **financial liabilities** and servicing liabilities at fair value, the objective is to estimate the value of the assets required currently to (a) settle the liability with the holder or (b) transfer a liability to an entity of comparable credit standing.

70. Estimates of expected future cash flows, if used to estimate fair value, shall be based on reasonable and supportable assumptions and projections. All available evidence shall be considered in developing estimates of expected future cash flows. The weight given to the evidence shall be commensurate with the extent to which the evidence can be verified objectively. If a range is estimated for either the amount or timing of possible cash flows, the likelihood of possible outcomes shall be considered either directly, if applying an expected cash flow approach, or indirectly through the risk-adjusted discount rate, if determining the best estimate of future cash flows.

If It Is Not Practicable to Estimate Fair Values

71. If it is not practicable to estimate the fair values of assets, the transferor shall record those assets at zero. If it is not practicable to estimate the fair values of liabilities, the transferor shall recognize no gain on the transaction and shall record those liabilities at the greater of:

---

[20]FASB Concepts Statement No. 7, *Using Cash Flow Information and Present Value in Accounting Measurements,* discusses the use of present value techniques in measuring the fair value of an asset (or liability) in paragraphs 42–54 and 75–88. The Board believes that an expected present value technique is superior to traditional "best estimate" techniques, especially in situations in which the timing or amount of estimated cash flows is uncertain, as is often the case for ~~retained~~ interests that continue to be held by a transferor in transferred financial assets. Concepts Statement 7 also discusses in paragraph 44 the steps needed to complete a proper search for the "rate commensurate with the risk" in applying the traditional technique.

[21]The timing and amount of future cash flows for ~~retained~~ interests in securitizations that continue to be held by a transferor are commonly uncertain, especially if those interests are subordinate to more senior beneficial interests. Applying the present value approach depends heavily on assumptions about default and prepayment of all the assets securitized, because of the implicit credit or prepayment risk enhancement arising from the subordination.

a. The excess, if any, of (1) the fair values of assets obtained less the fair values of other liabilities incurred, over (2) the sum of the carrying values of the assets transferred
b. The amount that would be recognized in accordance with FASB Statement No. 5, *Accounting for Contingencies,* as interpreted by FASB Interpretation No. 14, *Reasonable Estimation of the Amount of a Loss.*

Illustration—Recording Transfers If It Is Not Practicable to Estimate a Fair Value

72. Company E sells loans with a carrying amount of $1,000 to another entity for cash proceeds of $1,050 plus a call option to purchase loans similar to the loans sold (which are readily obtainable in the marketplace) and incurs a limited recourse obligation to repurchase any delinquent loans. Company E undertakes an obligation to service the transferred assets for the other entity. In Case 1, Company E finds it impracticable to estimate the fair value of the servicing contract, although it is confident that servicing revenues will be more than adequate compensation for performing the servicing. In Case 2, Company E finds it impracticable to estimate the fair value of the recourse obligation.

Fair Values	**Case 1**	**Case 2**
Cash proceeds	$1,050	$1,050
Servicing asset	XX*	40
Call option	70	70
Recourse obligation	(60)	XX*
Fair value of loans transferred	1,100	1,100

*Not practicable to estimate fair value.

Net Proceeds	**Case 1**	**Case 2**
Cash received	$1,050	$1,050
Plus: Servicing asset	XX*	40
Plus: Call option	70	70
Less: Recourse obligation	(60)	XX†
Net proceeds	$1,060	$1,160~~1,120~~

~~**Carrying Amount Based on Relative Fair Values (Case 1)**~~

	~~Fair Value~~	~~Percentage of Total Fair Value~~	~~Allocated Carrying Amount~~
~~Loans sold~~	~~$1,060~~	~~100~~	~~$1,000~~
~~Servicing asset~~	~~0~~	~~0~~	~~0~~
~~Total~~	~~$1,060~~	~~100~~	~~$1,000~~

~~**Carrying Amount Based on Relative Fair Values (Case 2)**~~

	~~Fair Value~~	~~Percentage of Total Fair Value~~	~~Allocated Carrying Amount~~
~~Loans sold~~	~~$1,120~~	~~97~~	~~$ 970~~
~~Servicing asset~~	~~40~~	~~3~~	~~30~~
~~Total~~	~~$1,160~~	~~100~~	~~$1,000~~

Gain on Sale	**Case 1**	**Case 2**
Net proceeds	$1,060	$1,160
Carrying amount of loans	1,000	1,000
Less: Recourse obligation	0	(160)†
Gain on sale	$ 60	$ 0

Journal Entries	**Case 1**		**Case 2**	
Cash	1,050		1,050	
Servicing asset	0*		40~~30~~	
Call option	70		70	
Loans		1,000		1,000
Recourse obligation		60		160~~150~~†
Gain on sale		60		0
To record transfer				

*Assets shall be recorded at zero if an estimate of the fair value of the assets is not practicable.

†The amount recorded as a liability in this example equals the sum of the known assets less the fair value of the known liabilities, that is, the amount that results in no gain or loss.

Securitizations

73. Financial assets such as mortgage loans, automobile loans, trade receivables, credit card receivables, and other revolving charge accounts are assets commonly transferred in securitizations. Securitizations of mortgage loans may include pools of single-family residential mortgages or other types of real estate mortgage loans, for example, multifamily residential mortgages and commercial property mortgages. Securitizations of loans secured by chattel mortgages on automotive vehicles as well as other equipment (including direct financing or sales-type leases) also are common. Both financial and nonfinancial assets can be securitized; life insurance policy loans, patent and copyright royalties, and even taxi medallions also have been securitized. But securitizations of nonfinancial assets are outside the scope of this Statement.

74. An originator of a typical securitization (the transferor) transfers a portfolio of financial assets to an SPE, commonly a trust. In "pass-through" and "pay-through" securitizations, receivables are transferred to the SPE at the inception of the securitization, and no further transfers are made; all cash collections are paid to the holders of beneficial interests in the SPE. In "revolving-period" securitizations, receivables are transferred at the inception and also periodically (daily or monthly) thereafter for a defined period (commonly three to eight years), referred to as the revolving period. During the revolving period, the SPE uses most of the cash collections to purchase additional receivables from the transferor on prearranged terms.

75. Beneficial interests in the SPE are sold to investors and the proceeds are used to pay the transferor for the assets transferred. Those beneficial interests may comprise either a single class having equity characteristics or multiple classes of interests, some having debt characteristics and others having equity characteristics. The cash collected from the portfolio is distributed to the investors and others as specified by the legal documents that established the SPE.

76. Pass-through, pay-through, and revolving-period securitizations that meet the criteria in paragraph 9 qualify for sale accounting under this Statement. All financial assets obtained or ~~retained~~that continue to be held by a transferor and liabilities incurred by the originator of a securitization that qualifies as a sale shall be recognized and measured as provided in paragraphs 10 and 11; that includes the implicit forward contract to sell new receivables during a revolving period, which may become valuable or onerous to the transferor as interest rates and other market conditions change.

Revolving-Period Securitizations

77. The value of the forward contract implicit in a revolving-period securitization arises from the difference between the agreed-upon rate of return to investors on their beneficial interests in the trust and current market rates of return on similar investments. For example, if the agreed-upon annual rate of return to investors in a trust is 6 percent, and later market rates of return for those investments increased to 7 percent, the forward contract's value to the transferor (and burden to the investors) would approximate the present value of 1 percent of the amount of the investment for each year remaining in the revolving structure after the receivables already transferred have been collected. If a forward contract to sell receivables is entered into at the market rate, its value at inception may be zero. Changes in the fair value of the forward contract are likely to be greater if the investors receive a fixed rate than if the investors receive a rate that varies based on changes in market rates.

78. Gain or loss recognition for revolving-period receivables sold to a securitization trust is limited to receivables that exist and have been sold. Recognition of servicing assets or liabilities for revolving-period receivables is similarly limited to the servicing for the receivables that exist and have been transferred. As new receivables are sold, rights to service them become assets or liabilities and are recognized.

79. Revolving-period securitizations may use either a discrete trust, used for a single securitization, or a master trust, used for many securitizations. To achieve another securitization using an existing master trust, a transferor first transfers additional receivables to the trust and then sells additional ownership interests in the trust to investors. Adding receivables to a master trust, in itself, is neither a sale nor a secured borrowing under paragraph 9, because that transfer only increases the transferor's beneficial interest in the trust's assets. A sale or secured borrowing does not occur until the transferor receives consideration other than beneficial interests in the transferred assets. Transfers that result in an exchange of cash, that is, either transfers that in essence replace previously transferred receivables that have been collected or sales of beneficial interests to outside investors, are transfers in exchange for consideration other than beneficial interests in the transferred assets and thus are accounted for as sales (if they satisfy all the criteria in paragraph 9) or as secured borrowings.

Isolation of Transferred Assets in Securitizations

80. A securitization carried out in one transfer or a series of transfers may or may not isolate the transferred assets beyond the reach of the transferor and its creditors. Whether it does depends on the structure of the securitization transaction taken as a whole, considering such factors as the type and extent of further involvement in

arrangements to protect investors from credit and interest rate risks, the availability of other assets, and the powers of bankruptcy courts or other receivers.

81. In certain securitizations, a corporation that, if it failed, would be subject to the U.S. Bankruptcy Code transfers financial assets to a special-purpose trust in exchange for cash. The trust raises that cash by issuing to investors beneficial interests that pass through all cash received from the financial assets, and the transferor has no further involvement with the trust or the transferred assets. The Board understands that those securitizations generally would be judged as having isolated the assets, because in the absence of any continuing involvement there would be reasonable assurance that the transfer would be found to be a true sale at law that places the assets beyond the reach of the transferor and its creditors, even in bankruptcy or other receivership.

82. In other securitizations, a similar corporation transfers financial assets to an SPE in exchange for cash and beneficial interests in the transferred assets. That entity raises the cash by issuing to investors commercial paper that gives them a senior interest in cash received from the financial assets. The beneficial interests ~~retained~~that continue to be held by the transferring corporation represent a junior interest to be reduced by any credit losses on the financial assets in trust. The commercial paper interests are highly rated by credit rating agencies only if both (a) the credit enhancement from the junior interest is sufficient and (b) the transferor is highly rated. Depending on facts and circumstances, the Board understands that those "single-step" securitizations often would be judged in the United States as not having isolated the assets, because the nature of the continuing involvement may make it difficult to obtain reasonable assurance that the transfer would be found to be a true sale at law that places the assets beyond the reach of the transferor and its creditors in U.S. bankruptcy (paragraph 113). If the transferor fell into bankruptcy and the transfer was found not to be a true sale at law, investors in the transferred assets might be subjected to an automatic stay that would delay payments due them, and they might have to share in bankruptcy expenses and suffer further losses if the transfer was recharacterized as a secured loan.

83. Still other securitizations use two transfers intended to isolate transferred assets beyond the reach of the transferor and its creditors, even in bankruptcy. In those "two-step" structures:

a. First, the corporation transfers financial assets to a special-purpose corporation that, although wholly owned, is so designed that the possibility that the transferor or its creditors could reclaim the assets is remote. This first transfer is designed to be judged to be a true sale at law, in part because the transferor does not provide "excessive" credit or yield protection to the special-purpose corporation, and the Board understands that transferred assets are likely to be judged beyond the reach of the transferor or the transferor's creditors even in bankruptcy.

b. Second, the special-purpose corporation transfers the assets to a trust or other legal vehicle with a sufficient increase in the credit or yield protection on the second transfer (provided by a junior ~~retained~~ beneficial interest that continues to be held by the transferor or other means) to merit the high credit rating sought by third-party investors who buy senior beneficial interests in the trust. Because of that aspect of its design, that second transfer might not be judged to be a true sale at law and, thus, the transferred assets could at least in theory be reached by a bankruptcy trustee for the special-purpose corporation.
c. However, the special-purpose corporation is designed to make remote the possibility that it would enter bankruptcy, either by itself or by substantive consolidation into a bankruptcy of its parent should that occur. For example, its charter forbids it from undertaking any other business or incurring any liabilities, so that there can be no creditors to petition to place it in bankruptcy. Furthermore, its dedication to a single purpose is intended to make it extremely unlikely, even if it somehow entered bankruptcy, that a receiver under the U.S. Bankruptcy Code could reclaim the transferred assets because it has no other assets to substitute for the transferred assets.

The Board understands that the "two-step" securitizations described above, taken as a whole, generally would be judged under present U.S. law as having isolated the assets beyond the reach of the transferor and its creditors, even in bankruptcy or other receivership.

84. The powers of receivers for entities not subject to the U.S. Bankruptcy Code (for example, banks subject to receivership by the FDIC) vary considerably, and therefore some receivers may be able to reach financial assets transferred under a particular arrangement and others may not. A securitization may isolate transferred assets from a transferor subject to such a receiver and its creditors even though it is accomplished by only one transfer directly to an SPE that issues beneficial interests to investors and the transferor provides credit or yield protection. For entities that are subject to other possible bankruptcy, conservatorship, or other receivership procedures in the United States or other jurisdictions, judgments about whether transferred assets have been isolated need to be made in relation to the powers of bankruptcy courts or trustees, conservators, or receivers in those jurisdictions.

Removal-of-Accounts Provisions

85. Many transfers of financial assets in securitizations empower the transferor to reclaim assets subject to certain restrictions. Such a power is sometimes called a

removal-of-accounts provision (ROAP). Whether a ROAP precludes sale accounting depends on whether the ROAP results in the transferor's maintaining effective control over specific transferred assets (paragraphs 9(c)(2) and 51–54).

86. The following are examples of ROAPs that preclude transfers from being accounted for as sales:

a. An unconditional ROAP or repurchase agreement that allows the transferor to specify the assets that may be removed, because such a provision allows the transferor unilaterally to remove specific assets
b. A ROAP conditioned on a transferor's decision to exit some portion of its business, because whether it can be triggered by canceling an affinity relationship, spinning off a business segment, or accepting a third party's bid to purchase a specified (for example, geographic) portion of the transferor's business, such a provision allows the transferor unilaterally to remove specific assets.

87. The following are examples of ROAPs that *do not* preclude transfers from being accounted for as sales:

a. A ROAP for random removal of excess assets, if the ROAP is sufficiently limited so that the transferor cannot remove specific transferred assets, for example, by limiting removals to the amount of the ~~transferor's retained~~ interests that continue to be held by the transferor and to one removal per month
b. A ROAP for defaulted receivables, because the removal would be allowed only after a third party's action (default) and could not be caused unilaterally by the transferor
c. A ROAP conditioned on a third-party cancellation, or expiration without renewal, of an affinity or private-label arrangement, because the removal would be allowed only after a third party's action (cancellation) or decision not to act (expiration) and could not be caused unilaterally by the transferor.

88. A ROAP that can be exercised only in response to a third party's action that has not yet occurred does not maintain the transferor's effective control over assets potentially subject to that ROAP. However, when a third party's action (such as default or cancellation) or decision not to act (expiration) occurs that allows removal of assets to be initiated solely by the transferor, the transferor must recognize any assets subject to the ROAP, whether the ROAP is exercised or not. If the ROAP is exercised, the assets are recognized because the transferor has reclaimed the assets. If the ROAP is not exercised, the assets are recognized because the transferor now can unilaterally cause the qualifying SPE to return those specific assets and, therefore, the transferor once again has effective control over those transferred assets (paragraph 55).

Sales-Type and Direct Financing Lease Receivables

89. Sales-type and direct financing receivables secured by leased equipment, referred to as gross investment in lease receivables, are made up of two components: minimum lease payments and residual values. Minimum lease payments are requirements for lessees to pay cash to lessors and meet the definition of a financial asset. Thus, transfers of minimum lease payments are subject to the requirements of this Statement. Residual values represent the lessor's estimate of the "salvage" value of the leased equipment at the end of the lease term and may be either guaranteed or unguaranteed; residual values meet the definition of financial assets *to the extent that they are guaranteed at the inception of the lease*. Thus, transfers of residual values guaranteed at inception also are subject to the requirements of this Statement. Unguaranteed residual values do not meet the definition of financial assets, nor do residual values guaranteed after inception, and transfers of them are not subject to the requirements of this Statement. Transfers of residual values not guaranteed at inception continue to be subject to Statement 13, as amended. Because residual values guaranteed at inception are financial assets, increases to their estimated value over the life of the related lease are recognized. Entities selling or securitizing lease financing receivables shall allocate the gross investment in receivables between minimum lease payments, residual values guaranteed at inception, and residual values not guaranteed at inception using the individual carrying amounts of those components at the date of transfer. Those entities also shall record a servicing asset or liability in accordance with paragraphs 10 and 13, if appropriate.

Illustration—Recording Transfers of Lease Financing Receivables with Residual Values

90. At the beginning of the second year in a 10-year sales-type lease, Company F sells for $505 a nine-tenths interest in the minimum lease payments and retains a one-tenth interest in the minimum lease payments and a 100 percent interest in the unguaranteed residual value of leased equipment. Company F receives no explicit compensation for servicing, but it estimates that the other benefits of servicing are just adequate to compensate it for its servicing responsibilities and hence initially records no servicing asset or liability. The carrying amounts and related gain computation are as follows:

Carrying Amounts		
Minimum lease payments		$ 540
Unearned income related to minimum lease payments		370
Gross investment in minimum lease payments		910
Unguaranteed residual value	$30	
Unearned income related to residual value	60	
Gross investment in residual value		90
Total gross investment in financing lease receivable		$1,000

Gain on Sale

Cash received		$505
Nine-tenths of carrying amount of gross investment in minimum lease payments	$819	
Nine-tenths of carrying amount of unearned income related to minimum lease payments	333	
Net carrying amount of minimum lease payments sold		486
Gain on sale		$ 19

Journal Entry

Cash	505	
Unearned income	333	
Lease receivable		819
Gain on sale		19
To record sale of nine-tenths of the minimum lease payments at the beginning of year 2		

Securities Lending Transactions

91. Securities lending transactions are initiated by broker-dealers and other financial institutions that need specific securities to cover a short sale or a customer's failure to deliver securities sold. Transferees ("borrowers") of securities generally are required to provide "collateral" to the transferor ("lender") of securities, commonly cash but sometimes other securities or standby letters of credit, with a value slightly higher than that of the securities "borrowed." If the "collateral" is cash, the transferor typically earns a return by investing that cash at rates higher than the rate paid or "rebated" to the transferee. If the "collateral" is other than cash, the transferor typically receives a fee. Securities custodians or other agents commonly carry out securities lending activities on behalf of clients. Because of the protection of "collateral" (typically valued daily and adjusted frequently for changes in the market price of the securities transferred) and the short terms of the transactions, most securities lending transactions in themselves do not impose significant credit risks on either party. Other risks arise from what the parties to the transaction do with the assets they receive. For example, investments made with cash "collateral" impose market and credit risks on the transferor.

92. In some securities lending transactions, the criteria in paragraph 9 are met, including the effective control criterion in paragraph 9(c), and consideration other than

beneficial interests in the transferred assets is received. Those transactions shall be accounted for (a) by the transferor as a sale of the "loaned" securities for proceeds consisting of the cash "collateral"[22] and a forward repurchase commitment and (b) by the transferee as a purchase of the "borrowed" securities in exchange for the "collateral" and a forward resale commitment. During the term of that agreement, the transferor has surrendered control over the securities transferred and the transferee has obtained control over those securities with the ability to sell or transfer them at will. In that case, creditors of the transferor have a claim only to the "collateral" and the forward repurchase commitment.

93. However, many securities lending transactions are accompanied by an agreement that entitles and obligates the transferor to repurchase or redeem the transferred assets before their maturity under which the transferor maintains effective control over those assets (paragraphs 47–49). Those transactions shall be accounted for as secured borrowings, in which cash (or securities that the holder is permitted by contract or custom to sell or repledge) received as "collateral" is considered the amount borrowed, the securities "loaned" are considered pledged as collateral against the cash borrowed and reclassified as set forth in paragraph 15(a), and any "rebate" paid to the transferee of securities is interest on the cash the transferor is considered to have borrowed.

94. The transferor of securities being "loaned" accounts for cash received in the same way whether the transfer is accounted for as a sale or a secured borrowing. The cash received shall be recognized as the transferor's asset—as shall investments made with that cash, even if made by agents or in pools with other securities lenders—along with the obligation to return the cash. If securities that may be sold or repledged are received, the transferor of the securities being "loaned" accounts for those securities in the same way as it would account for cash received.

Illustration—Securities Lending Transaction Treated as a Secured Borrowing

95. The following example illustrates the accounting for a securities lending transaction treated as a secured borrowing, in which the securities borrower sells the securities upon receipt and later buys similar securities to return to the securities lender:

[22]If the "collateral" in a transaction that meets the criteria in paragraph 9 is a financial asset that the holder is permitted by contract or custom to sell or repledge, that financial asset is proceeds of the sale of the "loaned" securities. To the extent that the "collateral" consists of letters of credit or other financial instruments that the holder is not permitted by contract or custom to sell or repledge, a securities lending transaction does not satisfy the sale criteria and is accounted for as a loan of securities by the transferor to the transferee.

Facts

Transferor's carrying amount and fair value of security loaned	$1,000
Cash "collateral"	1,020
Transferor's return from investing cash collateral at a 5 percent annual rate	5
Transferor's rebate to the securities borrower at a 4 percent annual rate	4

For simplicity, the fair value of the security is assumed not to change during the 35-day term of the transaction.

Journal Entries for the Transferor

At inception:

Cash	1,020	
Payable under securities loan agreements		1,020
To record the receipt of cash collateral		
Securities pledged to creditors	1,000	
Securities		1,000
To reclassify loaned securities that the secured party has the right to sell or repledge		
Money market instrument	1,020	
Cash		1,020
To record investment of cash collateral		

At conclusion:

Cash	1,025	
Interest		5
Money market instrument		1,020
To record results of investment		
Securities	1,000	
Securities pledged to creditors		1,000
To record return of security		
Payable under securities loan agreements	1,020	
Interest ("rebate")	4	
Cash		1,024
To record repayment of cash collateral plus interest		

Journal Entries for the Transferee

At inception:

Receivable under securities loan agreements	1,020	
Cash		1,020
To record transfer of cash collateral		
Cash	1,000	
Obligation to return borrowed securities		1,000
To record sale of borrowed securities to a third party and the resulting obligation to return securities that it no longer holds		

At conclusion:

Obligation to return borrowed securities	1,000	
Cash		1,000
To record the repurchase of securities borrowed		
Cash	1,024	
Receivable under securities loan agreements		1,020
Interest revenue ("rebate")		4
To record the receipt of cash collateral and rebate interest		

Repurchase Agreements and "Wash Sales"

96. Government securities dealers, banks, other financial institutions, and corporate investors commonly use repurchase agreements to obtain or use short-term funds. Under those agreements, the transferor ("repo party") transfers a security to a transferee ("repo counterparty" or "reverse party") in exchange for cash[23] and concurrently agrees to reacquire that security at a future date for an amount equal to the cash exchanged plus a stipulated "interest" factor.

97. Repurchase agreements can be effected in a variety of ways. Some repurchase agreements are similar to securities lending transactions in that the transferee has the right to sell or repledge the securities to a third party during the term of the repurchase agreement. In other repurchase agreements, the transferee does not have the right to sell

[23]Instead of cash, other securities or letters of credit sometimes are exchanged. Those transactions are accounted for in the same manner as securities lending transactions (paragraphs 92–94).

or repledge the securities during the term of the repurchase agreement. For example, in a tri-party repurchase agreement, the transferor transfers securities to an independent third-party custodian that holds the securities during the term of the repurchase agreement. Also, many repurchase agreements are for short terms, often overnight, or have indefinite terms that allow either party to terminate the arrangement on short notice. However, other repurchase agreements are for longer terms, sometimes until the maturity of the transferred asset. Some repurchase agreements call for repurchase of securities that need not be identical to the securities transferred.

98. If the criteria in paragraph 9 are met, including the criterion in paragraph 9(c)(1), the transferor shall account for the repurchase agreement as a sale of financial assets and a forward repurchase commitment, and the transferee shall account for the agreement as a purchase of financial assets and a forward resale commitment. Other transfers that are accompanied by an agreement to repurchase the transferred assets that shall be accounted for as sales include transfers with agreements to repurchase at maturity and transfers with repurchase agreements in which the transferee has not obtained collateral sufficient to fund substantially all of the cost of purchasing replacement assets.

99. Furthermore, “wash sales” that previously were not recognized if the same financial asset was purchased soon before or after the sale shall be accounted for as sales under this Statement. Unless there is a concurrent contract to repurchase or redeem the transferred financial assets from the transferee, the transferor does not maintain effective control over the transferred assets.

100. As with securities lending transactions, under many agreements to repurchase transferred assets before their maturity the transferor maintains effective control over those assets. Repurchase agreements that do not meet all the criteria in paragraph 9 shall be treated as secured borrowings. Fixed-coupon and dollar-roll repurchase agreements, and other contracts under which the securities to be repurchased need not be the same as the securities sold, qualify as borrowings if the return of substantially the same (paragraph 48) securities as those concurrently transferred is assured. Therefore, those transactions shall be accounted for as secured borrowings by both parties to the transfer.

101. If a transferor has transferred securities to an independent third-party custodian, or to a transferee, under conditions that preclude the transferee from selling or repledging the assets during the term of the repurchase agreement (as in most tri-party repurchase agreements), the transferor has not surrendered control over those assets.

Loan Syndications

102. Borrowers often borrow amounts greater than any one lender is willing to lend. Therefore, it is common for groups of lenders to jointly fund those loans. That may be accomplished by a syndication under which several lenders share in lending to a single borrower, but each lender loans a specific amount to the borrower and has the right to repayment from the borrower.

103. A loan syndication is not a transfer of financial assets. Each lender in the syndication shall account for the amounts it is owed by the borrower. Repayments by the borrower may be made to a lead lender that then distributes the collections to the other lenders of the syndicate. In those circumstances, the lead lender is simply functioning as a servicer and, therefore, shall not recognize the aggregate loan as an asset.

Loan Participations

104. Groups of banks or other entities also may jointly fund large borrowings through loan participations in which a single lender makes a large loan to a borrower and subsequently transfers undivided interests in the loan to other entities.

105. Transfers by the originating lender may take the legal form of either assignments or participations. The transfers are usually on a nonrecourse basis, and the transferor ("originating lender") continues to service the loan. The transferee ("participating entity") may or may not have the right to sell or transfer its participation during the term of the loan, depending upon the terms of the participation agreement.

106. If the loan participation agreement gives the transferee the right to pledge or exchange those participations and the other criteria in paragraph 9 are met, the transfers to the transferee shall be accounted for by the transferor as sales of financial assets. A transferor's right of first refusal on a bona fide offer from a third party, a requirement to obtain the transferor's permission that shall not be unreasonably withheld, or a prohibition on sale to the transferor's competitor if other potential willing buyers exist is a limitation on the transferee's rights but presumptively does not constrain a transferee from exercising its right to pledge or exchange. However, if the loan participation agreement constrains the transferees from pledging or exchanging their participations, the transferor presumptively receives a more than trivial benefit, has not relinquished control over the loan, and shall account for the transfers as secured borrowings.

Banker's Acceptances and Risk Participations in Them

107. Banker's acceptances provide a way for a bank to finance a customer's purchase of goods from a vendor for periods usually not exceeding six months. Under an agreement between the bank, the customer, and the vendor, the bank agrees to pay the customer's liability to the vendor upon presentation of specified documents that provide evidence of delivery and acceptance of the purchased goods. The principal document is a draft or bill of exchange drawn by the customer that the bank stamps to signify its "acceptance" of the liability to make payment on the draft on its due date.

108. Once the bank accepts a draft, the customer is liable to repay the bank at the time the draft matures. The bank recognizes a receivable from the customer and a liability for the acceptance it has issued to the vendor. The accepted draft becomes a negotiable financial instrument. The vendor typically sells the accepted draft at a discount either to the accepting bank or in the marketplace.

109. A risk participation is a contract between the accepting bank and a participating bank in which the participating bank agrees, in exchange for a fee, to reimburse the accepting bank in the event that the accepting bank's customer fails to honor its liability to the accepting bank in connection with the banker's acceptance. The participating bank becomes a guarantor of the credit of the accepting bank's customer.

110. An accepting bank that obtains a risk participation shall not derecognize the liability for the banker's acceptance, because the accepting bank is still primarily liable to the holder of the banker's acceptance even though it benefits from a guarantee of reimbursement by a participating bank. The accepting bank shall not derecognize the receivable from the customer because it has not transferred the receivable: it controls the benefits inherent in that receivable and it is still entitled to receive payment from the customer. The accepting bank shall, however, record the guarantee purchased, and the participating bank shall record a liability for the guarantee issued.

Illustration—Banker's Acceptance with a Risk Participation

111. An accepting bank assumes a liability to pay a customer's vendor and obtains a risk participation from another bank. The details of the banker's acceptance are provided below:

Facts

Face value of the draft provided to vendor	$1,000
Term of the draft provided to vendor	90 days
Commission with an annual rate of 10 percent	25
Fee paid for risk participation	10

Journal Entries for Accepting Bank

At issuance of acceptance:

Receivable from customer	1,000	
Cash	25	
Time draft payable to vendor		1,000
Deferred acceptance commission revenue		25

At purchase of risk participation from a participating bank:

Guarantee purchased	10	
Cash		10

Upon presentation of the accepted time draft:

Time draft payable to vendor	1,000	
Deferred acceptance commission revenue	25	
Cash		1,000
Acceptance commission revenue		25

Upon collection from the customer (or the participating bank, if the customer defaults):

Cash	1,000	
Guarantee expense	10	
Receivable from customer		1,000
Guarantee purchased		10

Journal Entries for Participating Bank

Upon issuing the risk participation:

Cash	10	
Guarantee liability		10

Upon payment by the customer to the accepting bank:

Guarantee liability	10	
Guarantee revenue		10

OR:

In the event of total default by the customer:

Guarantee loss	990	
Guarantee liability	10	
Cash (paid to accepting bank)		1,000

Factoring Arrangements

112. Factoring arrangements are a means of discounting accounts receivable on a nonrecourse, notification basis. Accounts receivable are sold outright, usually to a transferee (the factor) that assumes the full risk of collection, without recourse to the transferor in the event of a loss. Debtors are directed to send payments to the transferee. Factoring arrangements that meet the criteria in paragraph 9 shall be accounted for as sales of financial assets because the transferor surrenders control over the receivables to the factor.

Transfers of Receivables with Recourse

113. In a transfer of receivables with recourse, the transferor provides the transferee with full or limited recourse. The transferor is obligated under the terms of the recourse provision to make payments to the transferee or to repurchase receivables sold under certain circumstances, typically for defaults up to a specified percentage. The effect of a recourse provision on the application of paragraph 9 may vary by jurisdiction. In some jurisdictions, transfers with full recourse may not place transferred assets beyond the reach of the transferor and its creditors, but transfers with limited recourse may. A transfer of receivables with recourse shall be accounted for as a sale, with the proceeds of the sale reduced by the fair value of the recourse obligation, if the criteria in paragraph 9 are met. Otherwise, a transfer of receivables with recourse shall be accounted for as a secured borrowing.

Extinguishments of Liabilities

114. If a creditor releases a debtor from primary obligation on the condition that a third party assumes the obligation and that the original debtor becomes secondarily liable, that release extinguishes the original debtor's liability. However, in those circumstances, whether or not explicit consideration was paid for that guarantee, the original debtor becomes a guarantor. As a guarantor, it shall recognize a guarantee obligation in the same manner as would a guarantor that had never been primarily liable to that creditor, with due regard for the likelihood that the third party will carry out its obligations. The guarantee obligation shall be initially measured at fair value, and that amount reduces the gain or increases the loss recognized on extinguishment.

Appendix C

ILLUSTRATIVE GUIDANCE

342. This appendix provides specific examples that illustrate the disclosures that are required by this Statement. The formats in the illustrations are not required by the Statement. The Board encourages entities to use a format that displays the information in the most understandable manner in the specific circumstances. References to paragraphs of this Statement in which the relevant requirements appear are given in parentheses.

343. The first example illustrates the disclosure of accounting policies for ~~retained~~ interests that continue to be held by the transferor. In particular, it describes the accounting policies for (a) initial measurement (paragraph 17(~~f~~h)(1)) and (b) subsequent measurement (paragraph 17(~~g~~i)(1)), including determination of fair value.

NOTE X—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Receivable Sales

When the Company sells receivables in securitizations of automobile loans, credit card loans, and residential mortgage loans, it may hold~~retains~~ interest-only strips, one or more subordinated tranches, ~~servicing rights,~~ and in some cases a cash reserve account, all of which are ~~retained~~ interests that continue to be held by the transferor in the securitized receivables. It may also obtain servicing assets or assume servicing liabilities that are initially measured at fair value. Gain or loss on sale of the receivables depends in part on both (a) the previous carrying amount of the financial assets involved in the transfer, allocated between the assets sold and the ~~retained~~ interests that continue to be held by the transferor based on their relative fair value at the date of transfer, and (b) the proceeds received. To obtain fair values, quoted market prices are used if available. However, quotes are generally not available for ~~retained~~ interests that continue to be held by the transferor, so the Company generally estimates fair value based on the present value of future expected cash flows estimated using management's best estimates of the key assumptions—credit losses, prepayment speeds, forward yield curves, and discount rates commensurate with the risks involved.

344. In addition to the disclosure of assumptions used in determining the values of ~~retained~~ interests that continue to be held by the transferor at the time of securitization that are presented in paragraph 343, this Statement also requires similar disclosures at the end of the latest period being presented. The following example illustrates disclosures about the characteristics of securitizations and gain or loss from securitizations and other sales by major type of asset (paragraph 17(~~f~~h)(2)).

NOTE Y—SALES OF RECEIVABLES

During 20X2 and 20X1, the Company sold automobile loans, residential mortgage loans, and credit card loans in securitization transactions. In all those securitizations, the Company ~~retained~~obtained servicing responsibilities and subordinated interests. The Company receives annual servicing fees approximating 0.5 percent (for mortgage loans), 2 percent (for credit card loans), and 1.5 percent (for automobile loans) of the outstanding balance and rights to future cash flows arising after the investors in the securitization trust have received the return for which they contracted. The investors and the securitization trusts have no recourse to the Company's other assets for failure of debtors to pay when due. The ~~Company's retained~~ interests that continue to be held by the Company are subordinate to investor's interests. Their value is subject to credit, prepayment, and interest rate risks on the transferred financial assets.

In 20X2, the Company recognized pretax gains of $22.3 million on the securitization of the automobile loans, $30.2 million on the securitization of credit card loans, and $25.6 million on the securitization of residential mortgage loans.

In 20X1, the Company recognized pretax gains of $16.9, $21.4, and $15.0 million on the securitization of the automobile loans, credit card loans, and residential mortgage loans, respectively.

345. The following is an illustration of the quantitative information about key assumptions used in measuring ~~retained~~ interests that continue to be held by the transferor at the date of sale or securitization for each financial period presented (paragraph17(~~f~~h)(3)).

Key economic assumptions used in measuring the ~~retained~~ interests that continue to be held by the transferor at the date of securitization resulting from securitizations completed during the year were as follows (rates* per annum):

	20X2				20X1			
			Residential Mortgage Loans				Residential Mortgage Loans	
	Automobile Loans	**Credit Card Loans**	**Fixed-Rate**	**Adjustable†**	**Automobile Loans**	**Credit Card Loans**	**Fixed-Rate**	**Adjustable†**
Prepayment speed	1.00%	15.0%	10.00%	8.0%	1.00%	12.85%	8.00%	6.00%
Weighted-average life (in years)[33]	1.8	0.4	7.2	6.5	1.8	0.4	8.5	7.2
Expected credit losses	3.10–3.40%	6.10%	1.25%	1.30%	3.50–3.80%	5.30%	1.25%	2.10%
Residual cash flows discounted at	12.0–13.0%	12.00%	10.00%	8.50%	13.00–13.50%	13.00%	11.75%	11.00%
Variable returns to transferees	Forward Eurodollar yield curve plus contractual spread over LIBOR ranging from 30 to 80 basis points		Not applicable		Forward Eurodollar yield curve plus contractual spread over LIBOR ranging from 28 to 70 basis points		Not applicable	

Notes:

*Weighted-average rates for securitizations entered into during the period for securitizations of loans with similar characteristics.

†Rates for these loans are adjusted based on an index (for most loans, the 1-year Treasury note rate plus 2.75 percent). Contract terms vary, but for most loans, the rate is adjusted every 12 months by no more than 2 percent.

[33]The weighted-average life in periods (for example, months or years) of prepayable assets is calculated by summing the product of (a) the sum of the principal collections expected in each future period times (b) the number of periods until collection, and then dividing that total by (c) the initial principal balance.

346. The following is an illustration that combines disclosure of the key assumptions used in valuing ~~retained~~ interests that continue to be held by the transferor at the end of the latest period (paragraph 17(~~g~~i)(2)) and the hypothetical effect on current fair value of two or more pessimistic variations from the expected levels for each of the key assumptions (paragraph 17(~~g~~i)(3)).

At December 31, 20X2, key economic assumptions and the sensitivity of the current fair value of residual cash flows to immediate 10 percent and 20 percent adverse changes in those assumptions are as follows ($ in millions):

			Residential Mortgage Loans	
	Automobile Loans	**Credit Card Loans**	**Fixed-Rate**	**Adjustable**
Carrying amount/fair value of ~~retained~~ interests that continue to be held by the transferor	$15.6	$21.25	$12.0	$13.3
Weighted-average life (in years)[34]	1.7	0.4	6.5	6.1
Prepayment speed assumption (annual rate)	**1.3%**	**15.0%**	**11.5%**	**9.3%**
Impact on fair value of 10% adverse change	*$0.3*	*$1.6*	*$3.3*	*$2.6*
Impact on fair value of 20% adverse change	*$0.7*	*$3.0*	*$7.8*	*$6.0*
Expected credit losses (annual rate)	**3.0%**	**6.1%**	**0.9%**	**1.8%**
Impact on fair value of 10% adverse change	*$4.2*	*$3.2*	*$1.1*	*$1.2*
Impact on fair value of 20% adverse change	*$8.4*	*$6.5*	*$2.2*	*$3.0*
Residual cash flows discount rate (annual)	**14.0%**	**14.0%**	**12.0%**	**9.0%**
Impact on fair value of 10% adverse change	*$1.0*	*$0.1*	*$0.6*	*$0.5*
Impact on fair value of 20% adverse change	*$1.8*	*$0.1*	*$0.9*	*$0.9*
Interest rates on variable and adjustable contracts	**Forward Eurodollar yield curve plus contracted spread**			
Impact on fair value of 10% adverse change	*$1.5*	*$4.0*	*$0.4*	*$1.5*
Impact on fair value of 20% adverse change	*$2.5*	*$8.1*	*$0.7*	*$3.8*

[34] Footnote 8, paragraph 17(~~f~~h)(3), describes how weighted-average life can be calculated.

These sensitivities are hypothetical and should be used with caution. As the figures indicate, changes in fair value based on a 10 percent variation in assumptions generally cannot be extrapolated because the relationship of the change in assumption to the change in fair value may not be linear. Also, in this table, the effect of a variation in a particular assumption on the fair value of the ~~retained~~ interest that continues to be held by the transferor is calculated without changing any other assumption; in reality, changes in one factor may result in changes in another (for example, increases in market interest rates may result in lower prepayments and increased credit losses), which might magnify or counteract the sensitivities.

347. The following is an illustration of disclosure of expected static pool credit losses (paragraph 17(~~g~~i)(2)).

	Automobile Loans Securitized in		
Actual and Projected Credit Losses (%) as of:	**20X0**	**20X1**	**20X2**
December 31, 20X2	5.0	5.9	5.1
December 31, 20X1	5.1	5.0	
December 31, 20X0	4.5		

Note: Static pool losses are calculated by summing the actual and projected future credit losses and dividing them by the original balance of each pool of assets. The amount shown here for each year is a weighted average for all securitizations during the period.

348. The following is an illustration of the disclosure of cash flows between the securitization SPE and the transferor (paragraph 17(~~f~~h)(4)).

The table below summarizes certain cash flows received from and paid to securitization trusts ($ in millions):

	Year Ended December 31	
	20X2	**20X1**
Proceeds from new securitizations	$1,413	$ 971
Proceeds from collections reinvested in previous credit card securitizations	3,150	2,565
Servicing fees received	23	19
Other cash flows received on ~~retained~~ interests that continue to be held by the transferor*	81	52
Purchases of delinquent or foreclosed assets	(45)	(25)
Servicing advances	(102)	(73)
Repayments of servicing advances	90	63

Note:

*This amount represents total cash flows received from ~~retained~~ interests that continue to be held by the transferor ~~other than servicing fees~~. Other cash flows include, for example, all cash flows from interest-only strips and cash above the minimum required level in cash collateral accounts.

349. The following illustration presents quantitative information about delinquencies, net credit losses, and components of securitized financial assets and other assets managed together with them ($ in millions):

	Total Principal Amount of Loans		Principal Amount of Loans 60 Days or More Past Due*		Average Balances[35]		Net Credit Losses†	
	At December 31				During the Year			
Type of Loan	**20X2**	**20X1**	**20X2**	**20X1**	**20X2**	**20X1**	**20X2**	**20X1**
Automobile loans	$ 830	$ 488	$42.3	$26.8	$ 720	$ 370	$21.6	$12.6
Residential mortgage loans (fixed-rate)	482	302	5.8	3.6	470	270	5.6	3.2
Residential mortgage loans (adjustable)	544	341	7.1	6.8	520	300	6.2	6.0
Credit card loans	300	250	15	12.5	350	300	16	15
Total loans managed or securitized ‡	2,156	1,381	$70.2	$49.7	2,060	1,240	$49.4	$36.8
Less:								
Loans securitized§	1,485	905			1,368	752		
Loans held for sale or securitization	19	11			17	9		
Loans held in portfolio[36]	$ 652	$ 465			$ 675	$ 479		

Notes:

*Loans 60 days or more past due are based on end of period total loans.

†Net credit losses are charge-offs and are based on total loans outstanding.

‡Owned and securitized loans are customer loans, credit card loans, mortgage loans, auto loans, and other loans, as applicable, in which the transferor retains a subordinate interest or retains any risk of loss (for example, 10 percent recourse).

§Represents the principal amount of the loan. Interest-only strips (or other interests that continue to be held by a transferor) and servicing assets and servicing liabilities~~rights (or other retained interests)~~ held for securitized assets are excluded from this table because they are recognized separately.

[35] This disclosure is optional.

[36] Loans held in portfolio are reported separately from loans held for securitization because they are measured differently.

(This page intentionally left blank.)

349A. The following is an illustration of disclosures related to the activity in the balance of servicing assets and servicing liabilities by class (paragraphs 17(f)(1) and 17(g)(1)):

Tabular Disclosure of Changes in Servicing Assets and Servicing Liabilities Subsequently Measured Using the Fair Value Measurement Method

	Class 1		Class 2		
Balance Sheet Disclosures	**Servicing Asset**	**Servicing Liability**	**Servicing Asset**	**Servicing Liability**	**Reference**
Fair value as of the beginning of the period	XX	XX	XX	XX	17(f)(1)(a)
Additions:					17(f)(1)(b)
Purchases of servicing assets	XX	N/A	XX	N/A	
Assumption of servicing obligations	XX	XX	XX	XX	
Servicing obligations that result from transfers of financial assets	XX	XX	XX	XX	
Subtractions:					
Disposals	(XX)	(XX)	(XX)	(XX)	17(f)(1)(c)
Changes in fair value:					17(f)(1)(d)
Due to change in valuation inputs or assumptions used in the valuation model	XX/(XX)	XX/(XX)	XX/(XX)	XX/(XX)	
Other changes in fair value	XX/(XX)	XX/(XX)	XX/(XX)	XX/(XX)	
Other changes that affect the balance	XX/(XX)	XX/(XX)	XX/(XX)	XX/(XX)	17(f)(1)(e)
Fair value as of the end of the period	XX	XX	XX	XX	17(f)(1)(a)

Tabular Disclosure of Changes in Servicing Assets and Servicing Liabilities Subsequently Measured Using the Amortization Method

	Class 3		Class 4		
Balance Sheet Disclosures	**Servicing Asset**	**Servicing Liability**	**Servicing Asset**	**Servicing Liability**	**Reference**
Carrying amount as of the beginning of the period	XX	XX	XX	XX	17(g)(1)(a)
Additions:					17(g)(1)(b)
Purchases of servicing assets	XX	N/A	XX	N/A	
Assumption of servicing obligations	XX	XX	XX	XX	
Servicing obligations that result from transfers of financial assets	XX	XX	XX	XX	
Subtractions:					
Disposals	(XX)	(XX)	(XX)	(XX)	17(g)(1)(c)
Amortization	(XX)	(XX)	(XX)	(XX)	17(g)(1)(d)
Application of valuation allowance to adjust carrying values of servicing assets	XX/(XX)	N/A	XX/(XX)	N/A	17(g)(1)(e)
Other-than-temporary impairments	(XX)	(XX)	(XX)	(XX)	17(g)(1)(f)
Other changes that affect the balance	XX/(XX)	XX/(XX)	XX/(XX)	XX/(XX)	17(g)(1)(g)
Carrying amount before valuation allowance	XX	XX	XX	XX	

Valuation allowance for servicing assets:					17(g)(5)
Beginning balance	XX	N/A	XX	N/A	
Provisions/recoveries	XX/(XX)	N/A	XX/(XX)	N/A	
Other-than-temporary impairments	(XX)	N/A	(XX)	N/A	17(g)(1)(f)
Sales and disposals	(XX)	N/A	(XX)	N/A	
Ending balance	XX/(XX)	N/A	XX/(XX)	N/A	
Carrying amount as of the end of the period	XX	XX	XX	XX	17(g)(1)(a)

Fair Value Disclosures

Fair value as of the beginning of the period	XX	XX	XX	XX	17(g)(2)
Fair value as of the end of the period	XX	XX	XX	XX	17(g)(2)

Appendix E

GLOSSARY

364. This appendix defines terms used in this Statement.

Adequate compensation

The amount of benefits of servicing that would fairly compensate a substitute servicer should one be required, which includes the profit that would be demanded in the marketplace.

Agent

A party that acts for and on behalf of another party. For example, a third-party intermediary is an agent of the transferor if it acts on behalf of the transferor.

Attached call

A call option held by the transferor of a financial asset that becomes part of and is traded with the underlying instrument. Rather than being an obligation of the transferee, an attached call is traded with and diminishes the value of the underlying instrument transferred subject to that call.

Beneficial interests

Rights to receive all or portions of specified cash inflows to a trust or other entity, including senior and subordinated shares of interest, principal, or other cash inflows to be "passed-through" or "paid-through," premiums due to guarantors, commercial paper obligations, and residual interests, whether in the form of debt or equity.

Benefits of servicing

Revenues from contractually specified servicing fees, late charges, and other ancillary sources, including "float."

Cleanup call

An option held by the servicer or its affiliate, which may be the transferor, to purchase the remaining transferred financial assets, or the remaining beneficial interests not held by the transferor, its affiliates, or its agents in a qualifying SPE (or in a series of beneficial interests in transferred assets within a qualifying SPE), if the amount of outstanding assets or beneficial interests falls to a level at which the cost of servicing those assets or beneficial interests becomes burdensome in relation to the benefits of servicing.

Collateral

Personal or real property in which a security interest has been given.

Consolidated affiliate of the transferor

An entity whose assets and liabilities are included with those of the transferor in the consolidated, combined, or other financial statements being presented.

Contractually specified servicing fees

All amounts that, per contract, are due to the servicer in exchange for servicing the financial asset and would no longer be received by a servicer if the beneficial owners of the serviced assets (or their trustees or agents) were to exercise their actual or potential authority under the contract to shift the servicing to another servicer. Depending on the servicing contract, those fees may include some or all of the difference between the interest rate collectible on the asset being serviced and the rate to be paid to the beneficial owners of those assets.

Derecognize

Remove previously recognized assets or liabilities from the statement of financial position.

Derivative financial instrument

A derivative instrument (as defined in Statement 133) that is a financial instrument (refer to Statement 107, paragraph 3).

Embedded call

A call option held by the issuer of a financial instrument that is part of and trades with the underlying instrument. For example, a bond may allow the issuer to call it by posting a public notice well before its stated maturity that asks the current holder to submit it for early redemption and provides that interest ceases to accrue on the bond after the early redemption date. Rather than being an obligation of the initial purchaser of the bond, an embedded call trades with and diminishes the value of the underlying bond.

Fair value

Refer to paragraphs 68–70.

Financial asset

Cash, evidence of an ownership interest in an entity, or a contract that conveys to a second entity a contractual right (a) to receive cash or another financial instrument from a first entity or (b) to exchange other financial instruments on potentially favorable terms with the first entity (Statement 107, paragraph 3(b)).

Financial liability

A contract that imposes on one entity a contractual obligation (a) to deliver cash or another financial instrument to a second entity or (b) to exchange other financial instruments on potentially unfavorable terms with the second entity (Statement 107, paragraph 3(a)).

Freestanding call

A call that is neither embedded in nor attached to an asset subject to that call.

Guaranteed mortgage securitization

A securitization of mortgage loans that is within the scope of FASB Statement No. 65, *Accounting for Certain Mortgage Banking Activities,* as amended, and includes a substantive guarantee by a third party.

Interest-only strip

A contractual right to receive some or all of the interest due on a bond, mortgage loan, collateralized mortgage obligation, or other interest-bearing financial asset.

Proceeds

Cash, derivatives, or other assets that are obtained in a transfer of financial assets, less any liabilities incurred.

Recourse

The right of a transferee of receivables to receive payment from the transferor of those receivables for (a) failure of debtors to pay when due, (b) the effects of prepayments, or (c) adjustments resulting from defects in the eligibility of the transferred receivables.

Securitization

The process by which financial assets are transformed into securities.

Security interest

A form of interest in property that provides that upon default of the obligation for which the security interest is given, the property may be sold in order to satisfy that obligation.

Seller

A transferor that relinquishes control over financial assets by transferring them to a transferee in exchange for consideration.

Servicing asset

A contract to service financial assets under which the estimated future revenues from contractually specified servicing fees, late charges, and other ancillary revenues are expected to more than adequately compensate the servicer for performing the servicing. A servicing contract is either (a) undertaken in conjunction with selling or securitizing the financial assets being serviced or (b) purchased or assumed separately.

Servicing liability

A contract to service financial assets under which the estimated future revenues from contractually specified servicing fees, late charges, and other ancillary revenues are not expected to adequately compensate the servicer for performing the servicing.

Transfer

The conveyance of a noncash financial asset by and to someone other than the issuer of that financial asset. Thus, a transfer includes selling a receivable, putting it into a securitization trust, or posting it as collateral but excludes the origination of that receivable, the settlement of that receivable, or the restructuring of that receivable into a security in a troubled debt restructuring.

Transferee

An entity that receives a financial asset, a portion of a financial asset, or a group of financial assets from a transferor.

Transferor

An entity that transfers a financial asset, a portion of a financial asset, or a group of financial assets that it controls to another entity.

Undivided interest

Partial legal or beneficial ownership of an asset as a tenant in common with others. The proportion owned may be pro rata, for example, the right to receive 50 percent of all cash flows from a security, or non–pro rata, for example, the right to receive the interest from a security while another has the right to the principal.

Unilateral ability

A capacity for action not dependent on the actions (or failure to act) of any other party.