

Statutory Issue Paper No. 134

Servicing Assets/Liabilities, An Amendment of SSAP No. 91

STATUS

Finalized March 29, 2008

Current Authoritative Guidance for Servicing Assets/Liabilities: SSAP No. 103R

This issue paper may not be directly related to the current authoritative statement.

Original SSAP from Issue Paper: SSAP No. 91R

Type of Issue:

Common Area

SUMMARY OF ISSUE:

1. In March 2006, the Financial Accounting Standards Board (FASB) issued *FASB Statement No. 156: Accounting for Servicing of Financial Assets, an amendment of FASB Statement No. 140* (FAS 156) to amend several aspects of accounting for servicing assets. The purpose of this issue paper is to incorporate and/or clarify specific amendments from FAS 156 into statutory accounting principles:

- a. Require subsequent fair value measurement of servicing assets and servicing liabilities;
- b. Clarify separate recognition of servicing assets and servicing liabilities resulting from a transfer of financial assets to a qualifying SPE in guaranteed mortgage securitizations in which the transferor retains all of the resulting securities;
- c. Include separately recognized servicing assets and servicing liabilities in the calculation for determining proceeds from the sale of assets; and
- d. Incorporate revised terminology, amending the term ‘retained interests’ to ‘interests that continue to be held by a transferor’.

2. Current statutory accounting guidance for servicing assets and servicing liabilities is located within *SSAP No. 91—Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (SSAP No. 91). The conclusions reached within SSAP No. 91 resulted from adoption with modification of *FASB Statement No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (FAS 140).

3. The purpose of this issue paper is to update statutory accounting principles for servicing assets and servicing liabilities. The result will be the incorporation of substantive and nonsubstantive revisions to SSAP No. 91. In accordance with the *NAIC Policy Statement on Statutory Accounting Principles Maintenance Agenda Process* (Maintenance Agenda Policy Statement), substantive revisions require the issuance of a new SSAP. However, as only some aspects of the revisions from FAS 156 are considered substantive, it is requested that the Statutory Accounting Principles Working Group approve the exposure of the adopted FAS 156 revisions within the existing SSAP No. 91, after the adoption of this issue paper.

SUMMARY CONCLUSION

4. This issue paper adopts revisions to FAS 156 indicating that all servicing assets and servicing liabilities should initially be measured at fair value. Consistent with these revisions, this issue paper

adopts guidance from FAS 156 requiring the inclusion of separately recognized servicing assets and servicing liabilities in the calculation of proceeds from the sale of assets and modifies the illustrations included within SSAP No. 91 accordingly. This issue paper rejects the optionality provided within FAS 156 for subsequent measurement of servicing assets and servicing liabilities, but revises the SSAP No. 91 accounting measurement method for such items to a fair value measurement method. This issue paper confirms adoption of guidance previously adopted from FAS 140 regarding servicing assets and servicing liabilities established from the transfer of financial assets to a qualifying SPE in a guaranteed mortgage securitization in which the transferor retains all of the resulting securities. This issue paper also adopts nonsubstantive revisions from FAS 156 in which the term ‘retained interests’ is replaced with ‘interests that continue to be held by the transferor’, with amendments to the definition to exclude servicing assets and servicing liabilities.

5. Substantive revisions to SSAP No. 91 from this issue paper are illustrated below:

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

- a. Initially recognize and measure at fair value, if practicable, servicing assets and servicing liabilities assumed under a separate contractual obligation to service financial assets (see paragraph 49);
- a-b. Allocate the previous carrying amount between the assets sold, if any, and the ~~retained interests~~ interests that continue to be held by a transferor, if any, based on their relative fair values at the date of transfer (see paragraphs 47 and 48).
- b-c. Continue to carry in its balance sheet any ~~retained interest~~ interest it continues to hold in the transferred assets, including, if applicable, beneficial interests in assets transferred to a qualifying special-purpose entity in a securitization, and retained undivided interests (see paragraphs 7 c., 47 and 48); and

Recognition and Measurement of Servicing Assets and Liabilities

11. Servicing rights become 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. Servicing rights become a distinct asset or liability of the reporting entity pursuant to:

- a. A transfer of the servicer’s financial assets that meets the requirements for sale accounting;
- b. A transfer of financial assets to a qualifying SPE in a guaranteed mortgage obligation in which the transferor retains all of the resulting securities; or
- c. An acquisition or assumption of a servicing obligation that does not relate to financial assets of the servicer.

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 be recognized as a servicing asset or servicing liability.

12. (New paragraph – renumbering accordingly) ~~If distinct servicing rights to transferred assets exist in accordance with the above guidelines, and are retained by the reporting entity,~~ the reporting entity shall recognize a servicing asset or liability. When the servicing fees to be received exceed the cost of servicing the transferred assets, a servicing asset is recognized and nonadmitted. When the cost of servicing the transferred assets is greater than the servicing fees to be received, a liability shall be recorded for the excess to recognize this obligation. A corresponding loss shall be recorded through the Summary of Operations in other income. ~~If the servicing asset or liability was purchased or assumed rather than undertaken in a sale or~~

~~securitization of the financial assets being serviced, Servicing assets and servicing liabilities # shall be measured initially at its fair value, presumptively the price paid. The sServicing assets or liabilitiesy shall be measured subsequently at fair value at each reporting date with fluctuations in fair value reported as unrealized gains or losses. Declines in fair value which are determined to be other than temporary shall be recorded as realized losses. shall be amortized into income in proportion to, and over the period of estimated servicing income (if an asset) or estimated servicing loss (if a liability). A servicing asset or liability shall be assessed for impairment or increased obligation based on its fair value.~~

Assets Obtained and Liabilities Incurred as Proceeds

46. 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.

Disclosures

88. A reporting entity shall disclose the following:

1-j. For all servicing assets and servicing liabilities:

1-i. ~~The amounts of servicing assets nonadmitted or liabilities recognized and amortized during the period; and~~ A description of the valuation techniques or other models, including significant assumptions within models, used to estimate the fair value of servicing assets and servicing liabilities.

2-ii. ~~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.~~ Changes in fair value resulting from changes in valuation inputs or assumptions used in models and descriptions of other changes in fair value.

6. SSAP No. 91, Exhibit B provides illustrations to assist with the accounting of items subject to this standard. Pursuant to the substantive revisions noted above to paragraph 46 of SSAP No. 91, the proceeds from the sale of financial assets consist of the cash and any other assets obtained, including separately recognized servicing assets. Exhibit B illustrations three, four and five have been modified to convey these revisions:

Illustration—Sale of Receivables with Servicing RetainedObtained

3. 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. 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~~ \$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	<u>40</u>
Net Proceeds	<u>\$1,040</u>

Carrying Amount Based on Relative Fair Values

	<i>Fair Value</i>	Percentage Of Total Fair Value	Allocated Carrying Amount
Loans sold	\$ 1,040.00	91.094.55	\$910945.50
Servicing asset	40	3.6	36
Interest-only strip receivable	<u>60</u>	<u>5.4</u>	<u>5454.50</u>
Total	<u>\$ 1,100</u>	<u>100.0</u>	<u>\$ 1,000</u>

Gain on Sale

Net proceeds	\$10001,040
Carrying amount of loans sold	<u>910945</u>
Gain on sale	<u>\$ 9094.50</u>

Journal Entries

Cash	1,000	
Interest-only strip receivable	<u>54.50</u>	
Servicing Asset	<u>40</u>	
Loans		9101,000
Gain on sale		9094.50

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	<u>65.50</u>	
Equity		<u>65.50</u>

To begin to subsequently measure interest-only strip receivable like an available-for-sale security (FAS 140, paragraph 14)

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

4. 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	100

Net Proceeds

Cash received	\$900
Plus: Servicing Asset	90
Plus: Call option	70
Less: Recourse obligation	(60)
Net proceeds	<u>\$910</u>

Carrying Amount Based on Relative Fair Values

	<u>Fair Value</u>	<u>Percentage Of Total Fair Value</u>	<u>Allocated Carrying Amount</u>
Interest sold	\$ <u>910</u>	<u>83.9</u>	\$ <u>839.9</u>
Servicing asset	<u>90</u>	<u>8</u>	<u>80</u>
One-tenth interest retained <u>continued to be held by transferor</u>	<u>100</u>	<u>9.1</u>	<u>90.9</u>
Total	<u>\$ 1,100</u>	<u>100</u>	<u>\$ 1,000</u>

Gain on Sale

Net proceeds	\$ <u>910</u>
Less: Carrying amount of loans sold	<u>830(90.9)</u>
Gain on sale	<u>\$ 80.9</u>

Loans Sold

Carrying Amount of Loans	\$ <u>1,000</u>
Less: Allocated carrying amount of interest that continues to be held by the transferor	<u>(91)</u>
Loans Sold	<u>\$ 909</u>

Journal Entries

Cash	900	
Call option	70	
<u>Servicing Asset</u>	<u>90</u>	
Loans		<u>839.9</u>
Recourse obligation		60
Gain on sale		<u>80.9</u>

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

Servicing asset	80	
—Loans		80
<i>To record servicing asset</i>		

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

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

5. 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.

<u>Fair Values</u>	<u>Case 1</u>	<u>Case 2</u>
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

<u>Net Proceeds</u>	<u>Case 1</u>	<u>Case 2</u>
Cash received	\$1,050	\$1,050
Plus: Servicing Asset	XX*	40
Plus: Call option	70	70
Less: Recourse obligation	(60)	XX
Net proceeds	<u>\$1,060</u>	<u>\$1,120</u>

Carrying Amount Based on Relative Fair Values (Case 1)

	<u>Fair Value</u>	<u>Percentage Of Total Fair Value</u>	<u>Allocated Carrying Amount</u>
Loans sold	\$ 1,060	100	\$ 1,000
Servicing asset	0	0	0
—Total	<u>\$ 1,060</u>	<u>100</u>	<u>\$ 1,000</u>

Carrying Amount Based on Relative Fair Values (Case 2)

	<u>Fair Value</u>	<u>Percentage Of Total Fair Value</u>	<u>Allocated Carrying Amount</u>
Loans sold	\$1,120	97	\$970
Servicing asset	40	3	30
—Total	<u>\$1,160</u>	<u>100</u>	<u>\$1,000</u>

<u>Gain on Sale</u>	<u>Case 1</u>	<u>Case 2</u>
Cash received	\$1,060	\$1,060
Carrying	1,000	1,000

	<u>Amount of</u>		
	<u>Loans</u>		
	<u>Less:</u>	<u>0</u>	<u>(160)</u>
	<u>Recourse</u>		
	<u>obligation</u>		
	<u>Gain on Sale</u>	<u>\$60</u>	<u>\$0</u>
<u>Journal Entries</u>		<u>Case 1</u>	<u>Case 2</u>
Cash		1,050	1,050
Servicing asset		0*	3040
Call option		70	70
Loans		1,000	1,000
Recourse obligation		60	1560†
Gain on sale		60	0
<i>To record transfer</i>			

* 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.

Effective Date and Transition

7. Upon adoption of this issue paper, the NAIC will release an updated SSAP No. 91 for comment. The SSAP will contain the adopted nonsubstantive changes to SSAP No. 91, shown in this issue paper. Users of the Accounting Practices and Procedures Manual should note that issue papers are not represented in the Statutory Hierarchy (see Section IV of the Preamble) and therefore the conclusions reached in this issue paper should not be applied until the corresponding SSAP has been adopted by the Plenary of the NAIC. It is expected that the SSAP will contain an effective date of years beginning on or after January 1, 2009.

DISCUSSION

Initial Recognition and Measurement of Fair Value

8. Revisions to FAS 156 amended guidance regarding how servicing assets and servicing liabilities should be initially recognized and measured. FAS 140 requirements for initial measurement of servicing assets and servicing liabilities varied depending on whether they were purchased separately, assumed, or obtained in a sale or securitization transaction, as well as whether they were assets or liabilities. The revisions in FAS 156 clarified that servicing assets and servicing liabilities should be accounted for similarly, regardless of how they are obtained and that fair value is the most relevant measurement attribute.

9. For statutory accounting, guidance within SSAP No. 91 had previously adopted guidance within paragraph 13 of FAS 140 requiring initial fair value measurement for purchased and assumed servicing assets and servicing liabilities. Similar to GAAP rationale for FAS 156, it is appropriate for statutory accounting that all servicing assets and servicing liabilities be accounted for similarly. As such, this issue paper adopts the FAS 156 guidance that all servicing assets and servicing liabilities should be initially measured at fair value, regardless if such items are purchased, assumed, or undertaken in a sale or securitization.

10. Pursuant to the FAS 156 revisions to initially measure all servicing assets and liabilities at fair value, revisions were incorporated in FAS 156 to include separately recognized servicing assets as part of the proceeds of a sale in order to simplify the application of the accounting guidance and provide

consistency between servicing assets and servicing liabilities obtained in a transfer of financial assets that meet the requirements for sale accounting. These modifications have also been adopted for statutory accounting, with adjustments to statutory accounting illustrations accordingly.

11. Prior to the issuance of FAS 156, separately recognized servicing assets were included as part of retained interests. This issue paper incorporates nonsubstantive revisions to SSAP No. 91, similar to those included within FAS 156, to restate the term ‘retained interests’ with ‘interests that continue to be held by a transferor’ and to clarify within paragraph 47 that servicing assets are not considered within the context of this term. (Nonsubstantive revisions to SSAP No. 91 are included as a supplement to this issue paper.)

Subsequent Fair Value Measurement of Servicing Assets and Servicing Liabilities

12. Revisions to FAS 156 permit an entity to choose either an amortization method or fair value measurement method for the subsequent measurement of servicing assets and servicing liabilities. For statutory accounting, it is perceived that this subsequent measurement option hinders the comparability and consistency of financial statements. Although extensive disclosure requirements have been established within FAS 156 to counter the non-comparability created on the face of the financials, such disclosures cannot be considered a substitute for consistent and comparable measurement of similar items for statutory accounting.

13. Existing guidance within SSAP No. 91 requires amortization of servicing assets and servicing liabilities, however, based on the rationale provided below, SSAP No. 91 will be revised to require subsequent fair value measurement of servicing assets and servicing liabilities at each reporting date:

- a. SSAP No. 91 already requires an existing fair value consideration each reporting date for a servicing assets/liabilities impairment assessment;
- b. SSAP No. 91 already requires disclosure of fair value, if practicable, of recognized servicing assets/liabilities and the method and significant assumptions used to estimate that fair value.
- c. SSAP No. 91 nonadmits servicing assets, so positive fluctuations in fair value would not impact earnings;
- d. Fair value is the most appropriate measurement method for servicing assets/liabilities as it illustrates the value of the asset or obligation at the financial statement reporting date;
- e. There are no identified insurance industry specific characteristics of servicing assets/liabilities that would justify continued reporting of servicing assets/liabilities in a manner that does not represent the fair value of the asset or obligation at the financial statement reporting date.
- f. The FASB rationale permitting entities the option to continue using amortized cost, versus a fair value measurement, was based on some entities using non-derivative financial instruments to offset risks inherent in the servicing assets/liabilities (thus, avoiding volatility from the use of derivatives), and some entities considering servicing assets/liabilities to be contracts for services and not financial instruments. For these situations, subsequent measurement of servicing assets/liabilities at fair value would result in a new source of income statement volatility, which is viewed as not representationally faithful of their performance. Although this rationale was considered, for statutory accounting the recognition and measurement of assets and liabilities is a more relevant factor in assessing an insurer’s financial position. By utilizing fair value, the insurer’s financial position is more appropriately stated.

14. Pursuant to the revisions to require subsequent fair value measurement of servicing assets and servicing liabilities, corresponding disclosure requirements will adequately document the valuation methods and models and the fair value impact caused by input and assumption changes within such models and methods. These revisions will not alter the existing guidance within paragraph 49 of SSAP No. 91 regarding instances in which it is not practicable to estimate fair value:

If It Is Not Practicable to Estimate Fair Values

49. If it is not practicable to estimate the fair values of assets, the transferor shall record those assets at an allocated cost basis of 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:

- a. The excess, if any, of (i) the fair values of assets obtained less the fair values of other liabilities incurred, over (ii) the sum of the carrying values of the assets transferred;
- b. The amount that would be recognized in accordance with SSAP No. 5.

Servicing Assets and Servicing Liabilities from Securitizations

15. This issue paper confirms adoption of guidance previously included within FAS 140, and revised within FAS 156, that requires separate recognition of servicing assets and servicing liabilities resulting from a transfer of financial assets to a qualifying SPE in a guaranteed mortgage securitization in which the transferor retains all of the resulting securities. This guidance was previously adopted from FAS 140 and noted in paragraph 11 of SSAP No. 91: (bolded for emphasis)

11. Servicing rights become 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. ..

16. The guidance regarding servicing assets and servicing liabilities from such securitizations within FAS 140, revised in FAS 156, included caveats regarding when servicing assets and servicing liabilities could be recognized in accordance with such securitizations. As these limitations were determined through the classification status of the resulting securities (held-for-maturity, available-for-sale, and trading) prescribed by *FAS 115, Accounting for Certain Investments in Debt and Equity Securities* (FAS 115), which was previously rejected for statutory accounting, the caveats for the guaranteed mortgage securitizations were not originally incorporated into SSAP No. 91 for statutory accounting. To clarify the appropriate recognition of servicing assets and servicing liabilities for such securitizations, revisions have been incorporated to mirror the language including within FAS 156, with the exclusion of any limitation imposed by the debt security classification of the resulting securities. (Per FAS 156, securities resulting from such securitizations that are classified as available-for-sale or trading pursuant to FAS 115 should be recognized as a servicing asset or servicing liability. Entities that classify such securities as held-to-maturity are given an option to recognize them as servicing assets or servicing liabilities or report the servicing assets or servicing liabilities with the asset being serviced. FAS 156 was revised from FAS 140 in which entities with held-to-maturity securities were prohibited from recognizing these retained securities as servicing assets or servicing liabilities.)

RELEVANT STATUTORY ACCOUNTING AND GAAP GUIDANCE

Statutory Accounting

17. Statutory accounting for the transfers, servicing of financial assets and extinguishments of liabilities is provided in SSAP No. 91. The accounting guidance in SSAP No. 91 was established from the

guidance provided in *SSAP No. 18—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (SSAP No. 18), *SSAP No. 33—Securitization* (SSAP No. 33) and *SSAP No. 45—Repurchase Agreements, Reverse Repurchase Agreements and Dollar Repurchase Agreements* (SSAP No. 45), and was expanded to include issues addressed in *FASB Statement No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (FAS 140).

18. SSAP No. 91 adopted FAS 140 with the following modifications:

- a. Servicing rights assets are nonadmitted;
- b. Sales treatment is not permitted for transactions including recourse provisions or removal-of-accounts provisions on the transferred assets whereas GAAP would permit the recognition of the transfer as a sale under some circumstances;
- c. As statutory financial statements are prepared on a legal entity basis, special-purpose entities shall not be consolidated in a reporting entity's statutory financial statements;
- d. Leases shall be accounted for in accordance with *SSAP No. 22—Leases*;
- e. Reporting entities required to maintain an IMR shall account for realized and unrealized capital gains and losses in accordance with SSAP No. 7; and
- f. The concepts of revolving-period securitizations, banker's acceptances and risk participations in banker's acceptances are not applicable for statutory accounting purposes.
- g. This statement does not adopt the accounting for collateral as outlined in FAS 140.

19. With the adoption of this issue paper, SSAP No. 91 will be substantively revised (referred as SSAP No. 91R – Jan. 2009) to reflect the adoption of FAS 156 with the following modifications:

- a. This statement adopts provisions within FAS 156 requiring 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:
 - i. A transfer of the servicer's financial assets that meets the requirements for sale accounting.
 - ii. 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. (This rejects FAS 156 language that considers the classification of such securities (held-to-maturity, available-for-sale or trading) prescribed in accordance with FAS 115.)
 - iii. An acquisition or assumption of an obligation to service a financial asset that does not relate to financial assets of the servicer. (This rejects FAS 156 language pertaining to consolidated affiliates.)
- b. This statement adopts provisions within FAS 156 requiring all separately recognized servicing assets and servicing liabilities to be initially measured at fair value, if practicable.

- c. This statement rejects provisions provided within FAS 156 allowing entities to choose either an amortization method or a fair value measurement method for subsequent measurement of separately recognized servicing assets and servicing liabilities. In accordance with this issue paper, subsequent measurement of such items should be completed in accordance with a fair value measurement method. If fair value is not practicable to determine, the guidance in paragraph 49 of SSAP No. 91 should be followed.
- d. This statement rejects FAS 156 provisions permitting 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 FAS 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. (FAS 115 was rejected for statutory accounting, thus these classifications are not relevant to statutory accounting and do not impact the measurement of securities.)
- e. This statement adopts provisions within FAS 156 requiring 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.

Generally Accepted Accounting Principles

- 20. This issue paper adopts with modifications guidance included within FAS 156.
- 21. FAS 156 nullifies *EITF Issue No. 88-11, Allocation of Recorded Investment When a Loan or Part of a Loan is Sold (EITF No. 88-11)*. This issue was adopted within *SSAP No. 18—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities (SSAP No. 18)* and *SSAP No. 91*. EITF No. 88-11 addressed how a recorded investment in a loan should be allocated between the portion of the loan sold and the portion retained. Per the consensus issued within this statement, such allocation should be based on the relative fair value on the date the loan was acquired, adjusted for payments and other activity from the date of sale. Similar to GAAP's nullification of this consensus, this item is no longer relevant for statutory accounting.
- 22. With the exception of the nullification of EITF 88-11, there is no other impact to the GAAP guidance referenced within paragraphs 94 and 95 of SSAP No. 91:
 - 94. This statement adopts 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. This statement adopts FASB Emerging Issues Task Force (EITF) No. 87-34, Sale of Mortgage Servicing Rights with a Subservicing Agreement, ~~FASB EITF No. 88-11, Allocation of Recorded Investment When a Loan as Part of a Loan is Sold~~, FASB EITF No. 88-18, Sales of Future Revenues, FASB EITF No. 88-22, Securitization of Credit Card and Other Receivable Portfolios, FASB EITF No. 90-21, Balance Sheet Treatment of a Sale of Mortgage Servicing Rights with a Subservicing Agreement, FASB EITF No. 95-5, Determination of What Risks and Rewards, If Any, Can Be Retained and Whether Any Unresolved Contingencies May Exist in a Sale of Mortgage Loan Servicing Rights and FASB EITF No. 96-19, Debtor's Accounting for a Modification or Exchange of Debt Instruments.
 - 95. This statement rejects FASB EITF No. 84-5, Sale of Marketable Securities with a Put Option, and FASB EITF No. 92-2, Measuring Loss Accruals by Transferors of Receivables with Recourse and FASB Technical Bulletin 01-1: Effective Date for Certain Financial Institutions of Certain Provisions of Statement 140 related to Isolation of Transferred Financial Assets.

RELEVANT LITERATURE:**Statutory Accounting**

- *SSAP No. 91—Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*
- *INT 99-07: EITF 97-3: Accounting for Fees and Casts Associated with Loan Syndications and Loan Participations after the Issuance of FASB Statement No. 125*
- *INT 99-08: EITF 97-6: Application of Issue No. 96-20 to Qualifying Special-Purpose Entities Receiving Transferred Financial Assets Prior to the Effective Date of FASB Statement No. 125*
- *INT 99-14: EITF 96-16: Debtor’s Accounting for a Modification or Exchange of Debt Instruments*
- *INT 99-22: EITF 98-8: Accounting for Transfers of Investments That Are in Substance Real Estate*
- *INT 00-11: EITF 98-15: Structured Notes Acquired for a Specified Investment Strategy*
- *INT 01-31: Assets Pledged as Collateral*
- *INT 03-05: EITF 01-7: Creditor’s Accounting for a Modification or Exchange of Debt Instruments*
- *INT 04-21: EITF 02-9: Accounting for Changes That Result in a Transferor Regaining Control of Financial Assets Sold*

Generally Accepted Accounting Principles

- *FASB Statement No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*
- *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*
- *FASB Emerging Issues Task Force No. 87-34, Sale of Mortgage Servicing Rights with a Subservicing Agreement*
- *FASB Emerging Issues Task Force No. 88-18, Sales of Future Revenues*
- *FASB Emerging Issues Task Force No. 88-22, Securitization of Credit Card and Other Receivable Portfolios*
- *FASB Emerging Issues Task Force No. 90-21, Balance Sheet Treatment of a Sale of Mortgage Servicing Rights with a Subservicing Agreement*
- *FASB Emerging Issues Task Force No. 95-5, Determination of What Risks and Rewards, If Any, Can Be Retained and Whether Any Unresolved Contingencies May Exist in a Sale of Mortgage Loan Servicing Rights*
- *FASB Emerging Issues Task Force No. 96-19, Debtor’s Accounting for a Modification or Exchange of Debt Instruments*

STATE REGULATIONS:

- No additional guidance obtained from state statutes or regulations.

Issue Paper No. 134—Supplement of Nonsubstantive Revisions

1. As noted within paragraph 4, this issue paper adopts nonsubstantive revisions to SSAP No. 91R regarding the definition and terminology for ‘interests that continue to be held by the transferor’. The following paragraphs illustrate the nonsubstantive revisions that will be made in accordance with this change in terminology or additional nonsubstantive revisions incorporated within SSAP No. 91R:

7. Upon completion of a transfer of financial assets that satisfies the conditions to be accounted for as a sale (see paragraph 5), the transferor (seller) shall:

Retained InterestsInterests That Continue to be Held by a Transferor

47. Other interests in transferred assets, those that are not part of the proceeds of the transfer, are ~~retained interests~~interests that continue to be held by a transferor over which the transferor has not relinquished control. 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~~interests that continue to be held by a transferor, based on their relative fair values. That procedure shall be applied to all transfers in which interests are retained, even those that do not qualify as sales. Examples of ~~retained interests~~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 a retained interest or proceeds from the sale, the asset shall be treated as proceeds from the sale and accounted for in accordance with paragraph 46.

48. If the ~~retained interests~~interests that continue to be held by a transferor are subordinated to more senior interests held by others, that subordination may concentrate into the ~~retained interests~~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 the ~~retained interests~~interests that continue to be held by a transferor. For example, if the amount of the gain recognized, after allocation, on a securitization with a subordinated retained interest is greater than the gain would have been had the entire asset been sold, the transferor needs to be able to identify why that can occur. Otherwise, it is likely that the impact of 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.

Disclosures

88. A reporting entity shall disclose the following:

- d. 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):
 - i. Its accounting policies for initially measuring the ~~retained interests~~interests that continue to be held by a transferor, 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 (Glossary to the Statements of Statutory Accounting Principles); and
 - ii. 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~~interests that continue to be held by a transferor) and the gain or loss from sale of financial assets in securitizations;
 - iii. The key assumptions used in measuring the fair value of ~~retained interests~~interests that continue to be held by a transferor 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, and anticipated credit losses, if applicable); and

- iv. Cash flows between the securitization SPE and the transferor (including proceeds from new securitizations, purchases of delinquent or foreclosed loans, servicing fees, and cash flows received on interests retained.)
- g. If the entity has ~~retained interests~~ interests that continue to be held by a transferor in securitized financial assets at the date of the latest statement of financial position presented, for each major asset type (for example, mortgage loans):
 - i. Its accounting policies for subsequently measuring those ~~retained interests~~ interests that continue to be held by a transferor, 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 (Glossary to the Statements of Statutory Accounting Principles);
 - ii. 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, if applicable);
 - iii. A sensitivity analysis or stress test showing the hypothetical effect on the fair value of those interests of two or more unfavorable variations from the expected levels for each key assumption that is reported under ii. 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; and
 - iv. For the securitized assets and any other financial assets that the entity manages together with the ~~retained interests~~ interests that continue to be held by a transferor¹:
 - (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; and
 - (c) Credit losses, net of recoveries, during the period.
 - v. Disclosure of average balances during the period is encouraged, but not required.

2. Additionally, the illustration ‘Recording Transfers of Partial Interests’ will have nonsubstantive revisions as the terms ‘one-tenth interest retained’ will be revised to reflect ‘One-tenth interest that continues to be held by the transferor’. Replication of this illustration in this Issue Paper for these terminology revisions was not considered necessary.

¹ Excluding securitized assets that an entity continues to service but with which it has no other continuing involvement.

EXHIBIT A - GLOSSARY

Asset Securitization

An asset securitization is the process of converting assets which would normally serve as collateral for a loan into securities. The largest category of securitized assets is real estate mortgage loans, which serve as collateral for mortgage-backed securities.

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.

Beneficial Interest Holder (“BIH”)

Holder of beneficial interests

Cleanup Call

An option held by the servicer, which may be the transferor, to purchase 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), when the amount of outstanding assets falls to a level at which the cost of servicing those assets becomes burdensome in relation to the benefits or servicing.

Collateral

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

Derecognize

Remove previously recognized assets or liabilities from the balance sheet.

Derivative Financial Instrument

A derivative instrument (as defined in *SSAP No. 86—Accounting for Derivative Instruments and Hedging, Income Generation, and Replication (Synthetic Asset) Transactions*) that is a financial instrument (refer to *SSAP No. 27—Disclosure of Information about Financial Instruments with Off-Balance-Sheet Risk, Financial Instruments with Concentrations of Credit Risk and Disclosures about Fair Value of Financial Instruments*, paragraph 2).

Embedded Call (See paragraphs 40 and 42)

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.

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.

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.

Guaranteed Mortgage Securitization

A securitization of mortgage loans which includes a substantive guarantee by a third party.

Interests that continue to be held by a transferor

Other interests in transferred assets, those that are not part of the proceeds of the transfer, over which the transferor has not relinquished control. Includes securities backed by the transferred assets, undivided interests, and cash reserve accounts and residual interests in securitization trusts

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.

Residual

Residuals are a class of retained or purchased beneficial interests that have rights to the last cash flows from the pool of securitized assets and are not rated by a Nationally Recognized Statistical Rating Organization (NRSRO). Residuals are to be carried at fair value with the difference between fair value and the allocated cost basis recognized as an unrealized gain or loss;

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 stated 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.

Unrestricted Collateral

Securities received that may be sold or repledged and which were obtained under agreements that are not subject to repurchase or redemption on short notice, for example, by substitution of other collateral or termination of the contract.

Unilateral Ability (See paragraphs 40 and 41)

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