Transfers and servicing of financial assets

Handbook

US GAAP

August 2025

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An established model and evolving transactions

In the decades since the FASB first developed its guidance on transfers of financial assets, the capital markets – and the types of transfers that take place in them – have continued to evolve.

The accounting guidance has evolved as well, although the core principles have remained intact: a transaction is recognized as a sale when a financial asset has been transferred and control has been surrendered; and following a sale, a company measures both the benefits it controls and the resulting obligations.

This model is well-established, but the continued evolution of transactions involving transfers of financial assets often pushes the profession to make critical judgments about the application of the guidance.

We want to help you make those critical judgments.

In this Handbook, we navigate scope, deconstruct the sale criteria, and describe the accounting for both sales and secured borrowings. We seek to demystify securitization transactions and how to analyze repurchase agreements and securities lending. We also address the accounting for servicing assets and liabilities.

We hope you will find this Handbook to be a useful tool in applying the guidance on transfers and servicing of financial assets to the types of transactions most relevant to you.

Mark Northan and Kimber Bascom

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About this publication

The purpose of this Handbook is to assist you in understanding the standard on transfers and servicing of financial assets, Topic 860.

Organization of the text

Each chapter of this Handbook includes excerpts from FASB's Accounting Standards Codification® and overviews of the relevant requirements. Our in-depth guidance is explained through Q&As that reflect the questions we are encountering in practice. We include examples to explain key concepts.

Our commentary is referenced to the Codification and to other literature, where applicable. The following are examples.

- 860-10-40-5 is paragraph 40-5 of ASC Subtopic 860-10
- 2000 AICPA Conf is the 2000 AICPA National Conference on Current SEC Developments.
- AICPA PADA.Q1 is Question 1 of the AICPA's practice aid on Accounting and auditing of digital assets. This reference is available to its members through the AICPA's website
- ASU 2014-11.BC7 is paragraph 7 of the basis for conclusions to ASU 2014-11
- AU-C 9620.13 is paragraph 13 of Section 9620 of the AICPA's Clarified Statements on Auditing Standards
- FAS 166.BC.A39 is paragraph A39 of the basis for conclusions to FASB Statement No. 166
- FSP FAS 140-3.A13 is paragraph A13 of the background information and basis for conclusions to FASB Staff Position 140-3
- FRR 48 is Financial Reporting Release No. 48 from the SEC
- SIFMA letter 12/4/17 is a letter from SIFMA to the SEC's Office of the Chief Accountant dated December 4, 2017. This reference is hyperlinked to the source material on SIFMA's website
- S-X Rule 4-08(b) is Rule 4-08(b) of SEC Regulation S-X
- TRG 4-16.52 is agenda paper No. 52 from the meeting of the IASB and the FASB's Joint Transition Resource Group for Revenue Recognition (TRG) held in April 2016

August 2025 edition

This August 2025 edition of our Handbook includes updates for new and updated interpretations based on our experience with companies applying Topic 860. Compared to the August 2024 edition, new Questions and Examples added are identified throughout the Handbook with **** and items that have been significantly updated or revised are identified with **#**.

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Pending content

This edition of our Handbook incorporates amendments to Topic 860 from ASU 2024-02, Codification Improvements—Amendments to Remove References to the Concepts Statements. However, the Codification excerpts containing the amendments from this ASU are reproduced as if the pending content were currently effective for all entities – i.e. the amendments are not labeled as pending content.

In contrast, the amendments from ASU 2023-06, Disclosure Improvements: Codification Amendments in Response to the SEC's Disclosure Update and Simplification Initiative, are labeled as pending content in the Codification excerpts. Our interpretive guidance presumes these amendments have **not** been adopted.

When an excerpt from the Codification is affected by pending content in ASU 2023-06:

- the specific sentences that have been superseded are struck out and the added text is underlined; and
- the amended sentences are marked as pending content.

Recent ASU

ASU 2023-06, Disclosure Improvements: Codification Amendments in Response to the SEC's Disclosure Update and Simplification Initiative

In October 2023, the FASB issued ASU 2023-06, which incorporates into the Codification several disclosures and presentation requirements currently residing in SEC Regulations S-X and S-K.

As a result, the ASU is not expected to significantly affect entities currently subject to these SEC requirements. However, certain disclosures currently presented outside the financial statements as a result of Regulation S-K may need to be relocated into the financial statements.

The ASU's amended disclosure and presentation requirements are to be applied on a prospective basis. For entities subject to the existing SEC disclosure requirements, including those preparing for sale or issuance of securities, the effective date for amendments will be when the SEC removes the related disclosures from Regulation S-X or Regulation S-K, and early adoption is not permitted. For other entities, the amendments will be effective two years later, and early adoption is permitted. If the SEC has not removed the existing disclosure requirement from Regulation S-X or S-K by June 30, 2027, the corresponding disclosure pending requirements will be removed from the Codification and will not become effective for any entity.

Abbreviations

We use the following abbreviations in this Handbook.

ABS	Asset-backed security
AFS	Available-for-sale
AICPA	American Institute of Certified Public Accountants

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AOCI	Accumulated other comprehensive income
CDO	Collateralized debt obligation
CLO	Collateralized loan obligation
CMBS	Commercial mortgage backed security
FDIC	Federal Deposit Insurance Corporation
GNMA	Government National Mortgage Association (Ginnie Mae)
I/O	Interest only
OCI	Other comprehensive income
MBS	Mortgage backed security
PCAOB	Public Company Accounting Oversight Board
P/O	Principal only
ROAP	Removal of accounts provision
SEC	Securities and Exchange Commission
SIFMA	Securities Industry and Financial Markets Association
SPE	Special Purpose Entity
VA	United States Department of Veterans Affairs

We use the following additional abbreviation in the charts and diagrams in this Handbook:

FV	Fair value

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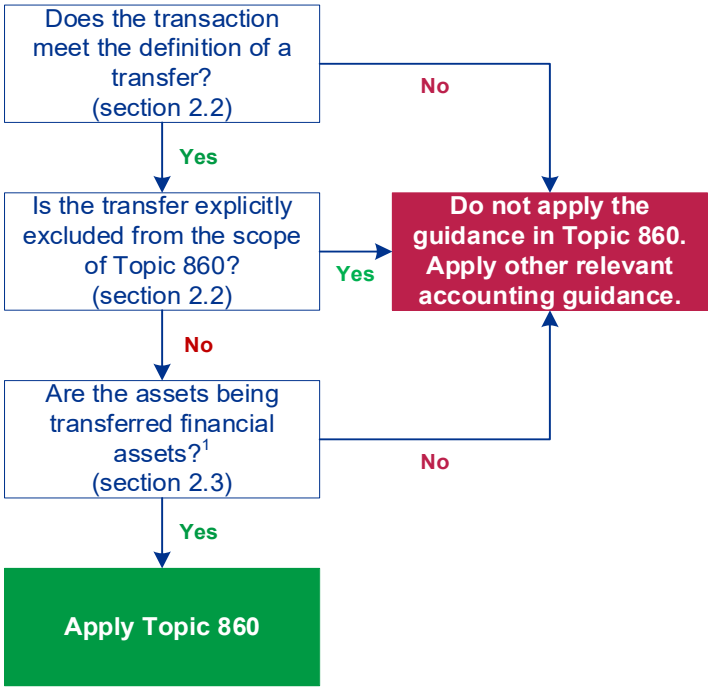
1. Executive summary

Scope

Topic 860 applies to transfers of financial assets by all entities (including not-for-profit entities), except for transfers specifically excluded from its scope. The following decision tree summarizes the steps in determining whether a transaction is in the scope of Topic 860.



Note:

1. Transfers of certain other derivative instruments are also within the scope of Topic 860. See section 2.3.

Subtopic 860-50 applies to servicing assets and servicing liabilities (see chapter 10). It has a scope that is separate and distinct from the rest of Topic 860.

Read more: Chapter 2

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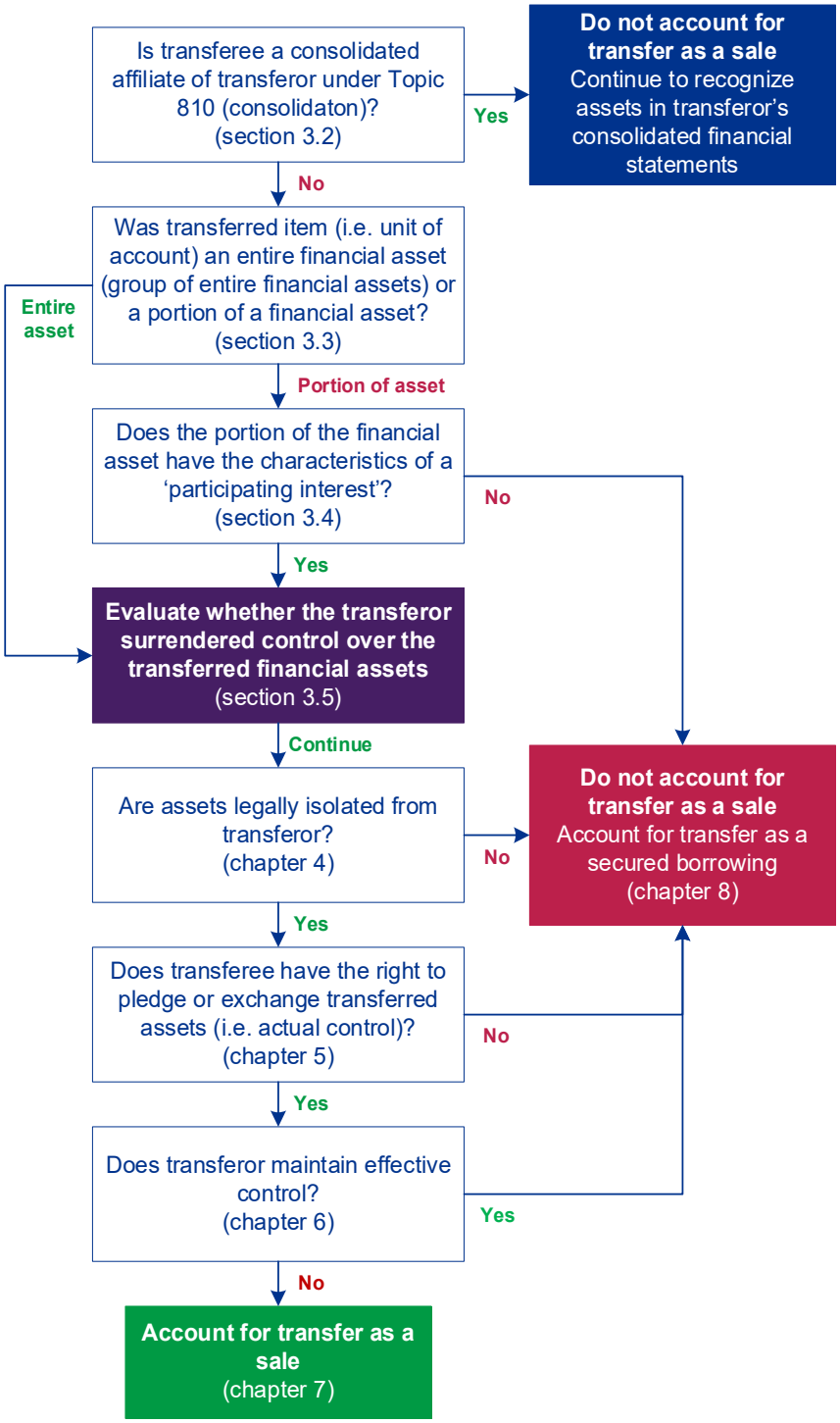
Determining whether to account for a transfer of financial assets as a sale or secured borrowing

The following decision tree summarizes the steps in determining whether to account for a transfer of financial assets as a sale (or a secured borrowing).



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Sale criteria: Overview

An entity evaluates whether to account for a transfer of financial assets as a sale (or a secured borrowing) throughout the life of the transferred assets.

The first step in determining whether a transfer of a financial asset is accounted for as a sale or secured borrowing is to evaluate whether the transferee is a consolidated affiliate of the transferor. Topic 810 (consolidation) is used to determine whether the transferee is a consolidated affiliate. A transfer to a consolidated affiliate is not accounted for as a sale.

When a transfer is not to a consolidated affiliate, the next step is to evaluate whether the transferred item (i.e. unit of account) is eligible for sale accounting. To be eligible for sale accounting, a transferred item must be one of the following:

- an entire financial asset;
- a group of entire financial assets; or
- a participating interest in an entire financial asset (or a group of such participating interests). To be eligible for sale accounting, a transferred interest that is less than an entire financial asset (a component of a financial asset) must meet all of the characteristics of a participating interest that are specified in Topic 860.

If the transferred item is eligible for sale accounting, the next step is to evaluate whether the transferor surrendered control over the transferred financial assets based on the control criteria: legal isolation, actual control and effective control. There is no requirement to evaluate these criteria in any particular sequence.

Read more: Chapter 3

Legal isolation

To achieve sale accounting, the transferred financial assets are required to be legally isolated from the transferor and its consolidated affiliates. This requirement is commonly referred to as the legal isolation criterion, and the determination is largely a legal analysis.

Read more: Chapter 4

Actual control

To achieve sale accounting, the transferee is required to have the ability to pledge or exchange the transferred financial assets. If this criterion is met, the transferor has surrendered actual control of the transferred financial assets.

The criterion is met if:

- the transferor, its consolidated affiliates and its agents have no continuing involvement with the transferred financial assets; or
- the transferor, its consolidated affiliates or its agents have continuing involvement, but:

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- the transferee is not constrained in its ability to pledge or exchange the transferred assets; or
- if the transferee is so constrained, the constraint does not provide a more-than-trivial benefit to the transferor.

For this criterion, the references to 'transferee' and 'financial assets' also apply to third-party beneficial interest holders and beneficial interests, respectively, if the transferee's sole purpose is to engage in securitizations or asset-backed financing arrangements.

Read more: Chapter 5

Effective control

A transferor does not account for a transfer of financial assets as a sale when it has maintained effective control over them (or over third-party beneficial interests related to them). A transferor maintains effective control through any of the following types of agreements.

Type 1	An agreement that both entitles and obligates the transferor to repurchase or redeem the transferred financial assets before their maturity.
Type 2	An agreement that provides the transferor with the following (other than through a cleanup call): — the unilateral ability to cause the holder to return specific financial assets; and — a more-than-trivial benefit attributable to that ability.
Type 3	An agreement that permits the transferee to require the transferor to repurchase the transferred financial assets (i.e. a put option) at a price that is so favorable to the transferee that it is probable the transferee will exercise its right.

As an exception to the effective control criterion, Topic 860 requires all repurchase-to-maturity transactions to be accounted for as secured borrowings as if the transferor had maintained effective control.

For this criterion:

— references to a transferred financial asset include beneficial interests issued by a transferee whose sole purpose is to engage in securitizations or asset-backed financing activities; and

— references to transferees include third-party holders of those beneficial interests.

Read more: Chapter 6

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Accounting for sales

This Handbook addresses the accounting by both the transferor and transferee for a transfer to which sale accounting applies. The accounting for a transfer accounted for as a sale is as follows.

Transferor	— Derecognizes an entire financial asset or group of entire financial assets. — For a participating interest: – allocates the carrying amount of the entire financial asset between the participating interest sold and participating interest retained based on their relative fair values at the date of transfer and recognizes any participating interest(s) retained based on its allocated carrying amount (i.e. the retained participating interest is not remeasured to its fair value); and – derecognizes the carrying amount of the participating interest sold. — Recognizes all assets obtained and liabilities incurred in the sale at fair value. — Recognizes a gain or loss on sale.
Transferee	— Generally, recognizes all assets acquired and liabilities incurred at fair value.

This Handbook also addresses the accounting when a transfer initially qualifies as a sale but subsequently no longer qualifies as a sale. This occurs if:

— the transferor regains control of the transferred financial asset; or
— the transferred financial asset was a participating interest at the time of the transfer but no longer qualifies as one.

Read more: Chapter 7

Accounting for secured borrowings

Transfers that do not qualify to be accounted for as sales by the transferor are accounted for as secured borrowings with a pledge of collateral by both the transferor and transferee. This Handbook addresses the accounting by both the transferor and transferee for a transfer accounted for as a secured borrowing. This accounting is generally as follows.

Transferor	— Continues to recognize the transferred assets – i.e. does not derecognize them or recognize a gain or loss. — Identifies the transferred assets as pledged/encumbered on the balance sheet if the transferee has the right to pledge or exchange them. — Recognizes any cash received along with an obligation (liability) to return it to the transferee. — Subsequently recognizes interest expense on the obligation.

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Transferee	— Derecognizes the cash paid. — Recognizes a receivable from the transferor. — Subsequently recognizes interest income on the receivable.

However, the subsequent accounting for noncash collateral (i.e. the transferred financial asset) for both the transferor and transferee is affected by whether the transferor (as the obligor) has defaulted and is no longer entitled to redeem the pledged asset. As a result, the transferor may subsequently be required to derecognize the transferred asset and the transferee may be required to recognize it.

Read more: Chapter 8

Special topics

This Handbook discusses several types of transactions involving transfers of financial assets that are common in practice. For each transaction type, this Handbook identifies some common features and identifies some relevant accounting considerations.

Transaction type	Description
Securitizations	The process of pooling financial assets into a group, and selling interests in that group of assets to investors.
Securities lending	The practice of loaning financial assets to others in exchange for a fee.
Repurchase agreements	A transaction involving the sale of securities with a corresponding agreement to repurchase the securities at a future date.
Dollar rolls	A variation of a repurchase agreement in which the repurchased securities are similar, but not identical, to the originally transferred securities.
Banker's acceptances and risk participations	— A banker's acceptance is a short-term financing arrangement in which an accepting bank agrees to pay a customer's liability to its vendor. The customer repays the bank at a later date. — A risk participation is a form of credit protection in which a second bank agrees to reimburse the accepting bank if the customer defaults on the acceptance.
Wash sales	A transaction in which a transferor sells securities with the intent to repurchase the same (or substantially the same) securities to obtain income tax or other benefits.

Read more: Chapter 9

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Servicing assets and liabilities

Servicing financial assets includes a variety of activities, including collecting payments from borrowers, monitoring delinquencies and remitting fees to service providers (e.g. trustees, guarantors). Servicing is inherent in all financial assets but is not accounted for separately as a distinct asset (or liability) until:

— the entity transfers the financial asset in a transaction accounted for as a sale under Topic 860 while retaining the servicing rights to that asset; or
— the entity acquires or assumes a servicing right but does not own the related financial asset.

This Handbook covers the life cycle of a servicing asset or liability, including:

— whether and how to recognize a servicing asset or liability;
— how to initially measure a servicing asset or liability;
— how to subsequently measure a servicing asset or liability under one of two available methods; and
— whether the transfer of a servicing asset or liability by the servicer qualifies as a sale.

Read more: Chapter 10

Disclosures

The principal objectives of Topic 860's disclosure requirements are to provide financial statement users with an understanding of:

— a transferor's continuing involvement (if any) with transferred financial assets;
— the nature of restrictions on assets on a transferor's balance sheet;
— how servicing assets and liabilities are reported; and
— how a transfer of financial assets affects a transferor's balance sheet, income statement and statement of cash flows.

The specific disclosures in Topic 860 include those related to:

— sales of financial assets;
— secured borrowings and collateral; and
— servicing assets and liabilities.

These disclosures represent the minimum requirements, and an entity may need to supplement them to achieve Topic 860's disclosure objectives.

Read more: Chapter 11

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2. Scope

Detailed contents

New item added in this edition: **

2.1 How the standard works

2.2 Transfers and scope exclusions

2.2.10 Overview

2.2.20 Loan syndications and loan participations

2.2.30 Factoring arrangements and transfers of receivables with recourse

2.2.40 Exchanges of beneficial interests

2.2.50 Dollar-roll repurchase agreements

Questions

2.2.10 What types of common transactions qualify as transfers as defined in Topic 860?

2.2.15 Is a transfer of fractional shares in the scope of Topic 860?

2.2.20 What is the difference between a loan syndication and loan participation and why is the distinction important under Topic 860?

2.2.30 Is an exchange of beneficial interests with the issuer in the scope of Topic 860?

2.3 Financial assets

2.3.10 Overview

2.3.20 In-substance nonfinancial assets

2.3.30 Financial asset definition applied to specific instruments

2.3.40 Securitized stranded costs

Questions

2.3.10 How are instruments analyzed to determine if they are financial instruments in the scope of Topic 860?

2.3.20 What are common examples of recognized financial assets that are in the scope of Topic 860?

2.3.25 Is the transfer of an ownership interest in a consolidated subsidiary that is not a business and holds financial and nonfinancial assets in the scope of Topic 860?

2.3.30 What are some examples of transfers of non-financial derivative instruments for which Topic 860 is applied by analogy?

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2.3.40 What are common examples of items that are not in the scope of Topic 860?

2.3.50 How does an entity determine whether an asset is an in-substance nonfinancial asset?

2.3.60 Is an intercompany loan considered a transfer of a financial asset for purposes of consolidated financial statements?

2.3.70 Is the transfer of an equity method investment in the scope of Topic 860?

2.3.80 Do cryptocurrencies represent financial assets?

2.3.85 Do stablecoins represent financial assets?

2.3.90 Is an investment in an entity presented using proportionate consolidation in the scope of Topic 860?

2.3.100 Is the transfer of a previously written off asset in the scope of Topic 860?

2.3.110 Is a contract asset a recognized financial asset?

2.3.120 Is the transfer of a customer receivable when the associated revenue has not been recognized in the scope of Topic 860?

2.3.130 Is the transfer of an account relationship in the scope of Topic 860?

2.3.140 Is a transfer of transferable tax credits in the scope of Topic 860?

2.3.150 Is an instrument a nonfinancial asset if it provides the holder with the option to receive either cash or a fixed number of nonfinancial assets with a variable monetary value? **

2.3.160 Is an instrument a financial asset if it provides the holder with the option to receive either cash or a variable number of nonfinancial assets with a fixed monetary amount? **

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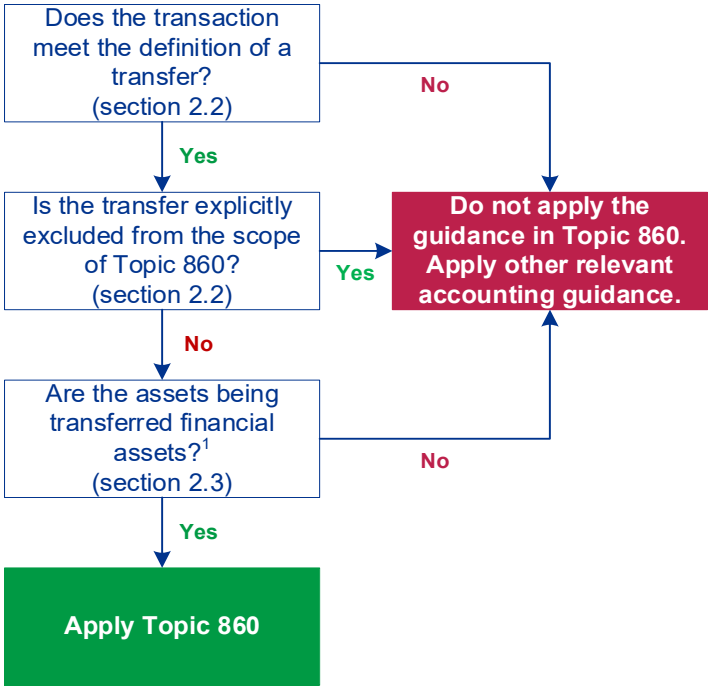
2.1 How the standard works

Topic 860 applies to transfers of financial assets by all entities (including not-for-profit entities), except for transfers specifically excluded from its scope. The following decision tree summarizes steps in determining whether a transaction is in the scope of Topic 860.



Note:

1. Transfers of certain other derivative instruments are also within the scope of Topic 860. See section 2.3.

Subtopic 860-50 (servicing assets and liabilities) applies to servicing assets and servicing liabilities (see chapter 10). It has a scope that is separate and distinct from the rest of Topic 860.

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2.2 Transfers and scope exclusions

2.2.10 Overview

Excerpt from ASC 860-10

20 Glossary

Transfer

The conveyance of a noncash financial asset by and to someone other than the issuer of that financial asset.

A transfer includes the following:

a. Selling a receivable
b. Putting a receivable into a securitization trust
c. Posting a receivable as collateral.

A transfer excludes the following:

a. The origination of a receivable
b. Settlement of a receivable
c. The restructuring of a receivable into a security in a troubled debt restructuring.

Transferee

An entity that receives a financial asset, an interest in a financial asset, or a group of financial assets from a transferor.

Transferor

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

> Types of Transfers

05-6 Transfers of financial assets take many forms. This guidance provides an overview of the following types of transfers discussed in this Topic:

a. **Securitizations**
b. Factoring
c. Transfers of receivables with recourse
d. Securities lending transactions
e. **Repurchase agreements**
f. **Loan participations**
g. Banker's acceptances.

> Entities

15-2 The guidance in the Transfers and Servicing Topic applies to all entities.

> Transactions

15-3 The guidance in the Transfers and Servicing Topic applies to the issues of accounting for **transfers** and servicing of **financial assets**.

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15-4 The guidance in this Topic does not apply to the following transactions and activities:

a. Except for transfers of servicing assets (see Section 860-50-40) and for the transfers noted in the following paragraph, transfers of nonfinancial assets
b. Transfers of unrecognized financial assets, for example, lease payments to be received under operating leases
c. Transfers of custody of financial assets for safekeeping
d. Contributions (for guidance on accounting for contributions, see Subtopic 958-605)
e. Transfers of **in substance nonfinancial assets**, see Subtopic 610-20
f. Investments by owners or distributions to owners of a business entity
g. Employee benefits subject to the provisions of Topic 712
h. Leveraged leases subject to Topic 842
i. **Money-over-money** and wrap lease transactions involving nonrecourse debt subject to Topic 842.

• • > Application of the Term Transfer

55-4 A payment of cash or a conveyance of noncash financial assets to the holder of a loan or other receivable in full or partial settlement of an obligation is not a transfer under this Subtopic. In addition, a **loan syndication** is not a transfer of financial assets. See paragraph 310-10-25-4 for further guidance on a loan syndication.

• • > Reacquisition by an Entity of Its Own Securities

55-15 A reacquisition by an entity of its own securities by exchanging noncash financial assets (for example, U.S. Treasury bonds or shares of an unconsolidated investee) for its common shares constitutes a distribution by an entity to its owners and, therefore, is excluded from the scope of this Subtopic.

Topic 860 applies to transfers of financial assets by all entities (including not-for-profit entities), except for transfers specifically excluded from its scope. [860-10-15-2 – 15-3]

As the decision tree in section 2.1 indicates, a transaction is in the scope of Topic 860 if it contains three elements:

— it involves a transfer as defined in Topic 860;
— it is not explicitly excluded from the scope of Topic 860; and
— a recognized financial asset (or in-scope derivative instrument) is being transferred (see section 2.3).

A transfer occurs when an entity conveys a noncash financial asset by and to someone other than the issuer of that financial asset. The entity that transfers the asset is the transferor; the entity that receives the asset is the transferee. [860-10 Glossary]

Topic 860 provides a list of specific transactions or activities that are outside its scope. Some on this list do not qualify as transfers and therefore do not meet the first element (see Question 2.2.10) or do not qualify as financial assets (see Question 2.3.20) and therefore do not meet the third element. The following are also transactions outside the scope because the Board chose not to change the accounting for such transactions or activities: [860-10-15-4(g) – 15-4(i)]

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— employee benefits subject to Topic 712 (nonretirement postemployment benefits)
— leveraged leases subject to Topic 840 or Topic 842 (leases)
— money-over-money and wrap lease transactions involving nonrecourse debt subject to Topic 842.

Question 2.2.10

What types of common transactions qualify as transfers as defined in Topic 860?

Interpretive response: Examples of common transactions that qualify as transfers include: [860-10 Glossary, 860-10-05-6]

— sales of receivables, including factoring receivables or transferring receivables (see section 2.2.30);
— transfers of receivables into a securitization trust;
— posting of receivables as collateral;
— loan participations (see section 2.2.20);
— securities lending transactions, including repurchase agreements;
— transfers of accepted drafts arising from banker's acceptances (see section 9.4.10);
— dollar-roll repurchase agreements with existing securities (see section 2.2.50); and
— wash sales (transactions in which an entity sells a security and repurchases the same or substantially the same security at some future date - generally within 15-30 days) (see section 9.4.20).

Examples of common transactions that do not qualify as transfers include: [860-10 Glossary, 860-10-55-4, 55-15]

— originations of receivables;
— settlements of loans or receivables, including full or partial settlements of obligations;
— restructuring of receivables into securities in troubled debt restructurings;
— loan syndications (see section 2.2.20);
— transfers of custody of financial assets for safekeeping;
— investments by owners or distributions to owners of a business entity;
— dollar-roll repurchase agreements with securities that do not yet exist or are to be announced (see section 2.2.50);
— reacquisitions by an entity of its own securities by exchanging noncash financial assets (this is a distribution); and
— certain exchanges of beneficial interests in the same transferred assets (see section 2.2.40).

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Question 2.2.15

Is a transfer of fractional shares in the scope of Topic 860?

Background: A broker-dealer entity purchases a whole share (e.g. common stock or a mutual fund share) from a third-party market participant for cash. The broker-dealer entity subsequently delivers a portion of that share to a third-party customer in the form of a fractional share in exchange for cash. These transactions may also be part of, but are not limited to, dividend reinvestment plans provided by the broker-dealer entity to its third-party customers.

Interpretive response: Yes. We believe a transaction that has the characteristics described above is a transfer of financial assets in the scope of Topic 860. A transaction that results in the delivery of a fractional share to the third-party customer is a transfer of a financial asset.

Because the third-party market participant transferred a whole share, and not a fractional share, we believe it should not be considered the transferor of the fractional share. Instead, the broker-dealer entity should be considered the transferor of the fractional share. Therefore, the broker-dealer entity needs to evaluate whether to account for the transfer of the fractional share as a sale or secured borrowing.

Question 3.4.35 discusses the applicability of the participating interest requirements for transfers of portions of equity shares.

2.2.20 Loan syndications and loan participations

Excerpt from ASC 860-10

• > Loan Participations

05-22 In certain industries, a typical customer's borrowing needs often exceed its bank's legal lending limits. To accommodate the customer, the bank may participate the loan to other banks (that is, transfer under a participation agreement a portion of the customer's loan to one or more participating banks).

05-23 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 on the terms of the participation agreement.

Loan participations are transfers under Topic 860, while loan syndications are not (see Question 2.2.20).

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Question 2.2.20

What is the difference between a loan syndication and loan participation and why is the distinction important under Topic 860?

Background: Loan syndications and loan participations may occur for a variety of reasons, including when a borrower wants to borrow an amount that is greater than a single lender is willing to lend. This may occur when the borrower's desired loan amount exceeds a bank's legal lending limit or internal credit risk management guidelines. In those circumstances, the loan may be funded through either a loan syndication or a loan participation. [860-10-05-22]

Interpretive response: A loan participation involves a transfer of financial assets, while a loan syndication does not. As a result, a loan syndication is not in the scope of Topic 860, while a loan participation is in scope. [860-10-55-3 – 55-4]

Determining whether an arrangement represents a loan syndication or loan participation for accounting purposes often requires an analysis of legal agreements.

A loan syndication is a transaction where several lenders share in lending to a single borrower. Each lender loans a specific amount directly to the borrower and has the right to repayment from the borrower. Because each loan that is part of the loan syndication is originated directly with the borrower, no transfer takes place. [310-20 Glossary]

A loan participation is a transaction where one lender originates a loan and then transfers an interest in that loan (effectively a portion of the loan) to one or more other lenders. Loan participations take a wide variety of forms, but all are in the scope of Topic 860 because they involve transfers of financial assets. [310-20 Glossary, 860-10-05-22 – 05-23]

Although Topic 860 applies to all loan participations, the form of a loan participation drives its accounting. They are accounted for as sales only if both the transferred portion qualifies as a 'participating interest' under Topic 860 and the criteria for sale accounting are met (see chapter 3).

2.2.30 Factoring arrangements and transfers of receivables with recourse

Excerpt from ASC 860-10

• > Factoring

05-14 Factoring arrangements are a means of discounting accounts receivable on a nonrecourse, notification basis. Accounts receivable in their entireties 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.

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• > Transfers of Receivables with Recourse

05-15 In a transfer of an entire receivable, a group of entire receivables, or a portion of an entire receivable 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.

• > Factoring Arrangements

55-45 Paragraph 860-10-05-14 provides background on factoring arrangements. Factoring arrangements that meet the conditions in paragraph 860-10-40-5 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

55-46 Paragraph 860-10-05-15 provides background on transfers of receivables with recourse. The effect of a recourse provision on the application of paragraph 860-10-40-5 may vary by jurisdiction. In some jurisdictions, transfers with full recourse may not place transferred financial assets beyond the reach of the transferor, its consolidated affiliates (that are not entities designed to make remote the possibility that it would enter bankruptcy or other receivership) included in the financial statements being presented, and its creditors, but transfers with limited recourse may.

a. Transfer consists of an entire financial asset or a group of entire financial assets. Before the method of recourse can be evaluated to determine the appropriate accounting treatment, the entity shall first determine whether a sale has occurred because in some jurisdictions recourse might mean that the transferred financial assets have not been isolated beyond the reach of the transferor, its consolidated affiliates (that are not entities designed to make remote the possibility that it would enter bankruptcy or other receivership) included in the financial statements being presented, and its creditors. A transfer of receivables in their entireties 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 conditions in paragraph 860-10-40-5 are met. Otherwise, a transfer of receivables with recourse shall be accounted for as a secured borrowing.
b. Transfer does not consist of an entire financial asset or a group of entire financial assets. The transferred financial asset must meet the definition of a **participating interest**. A transfer of a portion of a receivable with recourse, other than that permitted in paragraph 860-10-40-6A(c)(4), does not meet the requirements of a participating interest and shall be accounted for as a secured borrowing.

55-47 See paragraph 860-20-55-24 for further guidance on accounting for transfers of receivables with recourse.

Topic 860 identifies transfers of receivables with recourse and factoring arrangements as usually having the following characteristics.

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Type of arrangement	Description
Transfer of receivable with recourse	— the transferee is provided with full or limited recourse to the transferor; and — under the terms of the recourse provision, the transferor is obligated to either make payments to the transferee or repurchase receivables sold under certain circumstances, typically for defaults up to a specified percentage. [860-10-05-15]
Factoring arrangement	— a means of discounting accounts receivable on a nonrecourse, notification basis; — accounts receivable are sold outright in their entirety; — transferee doesn't have recourse to the transferor in the event of a loss; and — debtors send payments to the transferee, who assumes full risk of collection. [860-10-05-14]

While Topic 860 identifies factoring arrangements as usually having the above characteristics, there is a wide variety of arrangements referred to as 'factoring' in practice, many of which include limited or full recourse. In addition, transfers of receivables – with or without recourse – are subject to the guidance in Topic 860. However, the level and type of recourse may affect whether the sale criteria and the participating interest criteria are met. The participating interest criteria are evaluated when an entity does not transfer an entire financial asset or group of financial assets. See chapter 3 for further discussion on the sale and participating interest criteria. [860-10-55-46(b)]

2.2.40 Exchanges of beneficial interests

Excerpt from ASC 860-10

20 Glossary

Beneficial Interest

Rights to receive all or portions of specified cash inflows received by a trust or other entity, including, but not limited to, all of the following:

a. Senior and subordinated shares of interest, principal, or other cash inflows to be passed-through or paid-through
b. Premiums due to guarantors
c. Commercial paper obligations
d. Residual interests, whether in the form of debt or equity.

• • > Exchange of One Form of Beneficial Interest for Another

55-16 A **transferor's** exchange of one form of beneficial interests in financial assets that have been transferred into a trust that is consolidated by the transferor for an equivalent, but different, form of beneficial interests in the same transferred financial assets would not be a transfer under this Subtopic if

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the exchange is with the trust that initially issued the beneficial interests. If the exchange is not a transfer, then the provisions of paragraph 860-20-40-1B would not be applied to the transaction.

An entity may transfer a financial asset to a trust or other entity in exchange for a beneficial interest. A beneficial interest represents rights to receive all or a portion of specified cash inflows received by a trust or other entity, including: [860-10 Glossary]

- 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.

Question 2.2.30

Is an exchange of beneficial interests with the issuer in the scope of Topic 860?

Interpretive response: No. An exchange of one form of beneficial interests in financial assets that have been transferred into a trust that is consolidated by the transferor for an equivalent (but different) form of beneficial interests in the same transferred financial assets is not a transfer if it is with the same trust that initially issued the beneficial interests. This is because the transfer would not be the conveyance of a noncash financial asset by and to someone other than the issuer of that financial asset. [860-10-55-16]

2.2.50 Dollar-roll repurchase agreements

Excerpt from ASC 860-10

20 Glossary

Dollar-Roll Repurchase Agreement

An agreement to sell and repurchase similar but not identical securities. The securities sold and repurchased are usually of the same issuer. Dollar rolls differ from regular repurchase agreements in that the securities sold and repurchased have all of the following characteristics:

a. They are represented by different certificates.
b. They are collateralized by different but similar mortgage pools (for example, conforming single-family residential mortgages).
c. They generally have different principal amounts.

Fixed coupon and yield maintenance dollar agreements comprise the most common agreement variations. In a fixed coupon agreement, the seller and buyer agree that delivery will be made with securities having the same stated

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interest rate as the interest rate stated on the securities sold. In a yield maintenance agreement, the parties agree that delivery will be made with securities that will provide the seller a yield that is specified in the agreement.

• • > Dollar-Roll Repurchase Transactions

55-17 A transfer of financial assets under a **dollar-roll repurchase agreement** is within the scope of this Subtopic if that agreement arises in connection with a transfer of existing securities. In contrast, dollar-roll repurchase agreements for which the underlying securities being sold do not yet exist or are to be announced (for example, to-be-announced **Government National Mortgage Association [GNMA] rolls**) are outside the scope of this Subtopic because those transactions do not arise in connection with a transfer of recognized financial assets. See paragraph 860-10-55-60 for related guidance.

Dollar-roll repurchase agreements (dollar rolls) are agreements to sell and repurchase similar – but not identical – securities. Dollar rolls differ from regular repurchase agreements in that the securities sold and repurchased – which are usually of the same issuer – have the following characteristics: [860-10 Glossary]

— they are represented by different certificates;
— they are collateralized by different but similar mortgage pools (e.g. conforming single-family residential mortgages); and
— they generally have different principal amounts.

Topic 860 applies to a transfer of financial assets under a dollar-roll repurchase agreement if that agreement arises in connection with a transfer of existing securities. In contrast, Topic 860 does not apply to dollar-roll repurchase agreements for which the underlying securities being sold do not yet exist or are to be announced (TBA) because those transactions have not resulted from a transfer of recognized financial assets. See section 9.3.40 for additional discussion about accounting for dollar rolls. [860-10-55-17]

2.3 Financial assets

2.3.10 Overview

Excerpt from ASC 860-10

20 Glossary

Financial Asset

Cash, evidence of an ownership interest in an entity, or a contract that conveys to one entity a right to do either of the following:

a. Receive cash or another financial instrument from a second entity
b. Exchange other financial instruments on potentially favorable terms with the second entity.

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> Transactions

15-5 Paragraph 815-10-40-2 states that transfers of assets that are derivative instruments and subject to the requirements of Subtopic 815-10 but that are not financial assets shall be accounted for by analogy to this Topic.

> Application of the Sale Criteria for Financial Instruments That Have the Potential to Be Assets or Liabilities

40-40 Certain recognized financial instruments, such as forward contracts and swaps, have the potential to be financial assets or financial liabilities. Accordingly, transfers of those financial instruments must meet the conditions of both paragraphs 405-20-40-1 and 860-10-40-5 to be derecognized. Paragraph 815-10-40-2 states that transfers of assets that are derivative instruments and subject to the requirements of Subtopic 815-10 but that are not financial assets shall be accounted for by analogy to this Subtopic. The same criteria shall be applied to transfers of nonfinancial derivative instruments that have the potential to become either assets or liabilities (for example, forward contracts and swaps).

• • > Examples of Transactions and Activities That Are Included in the Scope

55-3 The guidance in this Topic applies to the following transactions and activities, among others:

a. All **loan participations**
b. Transfers of equity method investments
c. Transfers of cost-method investments
d. With respect to the guidance in paragraph 860-10-40-5 only, transfers of financial assets in desecuritization transactions.

• • > Application of the Term Financial Asset

55-5 The following implementation guidance addresses whether certain instruments are financial assets, the transfer of which is subject to the guidance in this Subtopic, specifically:

a. **Lease receivables** from **sales-type leases** and **direct financing leases**
b. Securitized stranded costs
c. Judgment from litigation
d. Forward contract on a financial instrument
e. Ownership interest in a consolidated subsidiary by its parent if the subsidiary holds nonfinancial assets
f. Investment in a nonconsolidated investee.

• • • > Lease Receivables from Sales-Type and Direct Financing Leases

55-6 Lease receivables from sales-type and direct financing leases are made up of two components: the right to receive lease payments and guaranteed residual values. Lease payments for sales-type and direct financing leases involve requirements for lessees to pay cash to lessors and meet the definition of a financial asset. Residual values represent the lessor's estimate of the salvage value of the underlying asset 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 commencement of the lease. Thus, transfers of lease receivables from sales-type and direct financing leases are subject to the requirements of this Subtopic.

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Unguaranteed residual assets do not meet the definition of financial assets, nor do residual values guaranteed after commencement, and transfers of them are not subject to the requirements of this Subtopic.

• • • > Judgment from Litigation

55-10 A judgment from litigation is generally not a financial asset. However, the determination depends on the facts and circumstances. A contingent receivable that ultimately may require the payment of cash but does not as yet arise from a contract (such as a contingent receivable for a tort judgment) is not a financial asset. However, when that judgment becomes enforceable by a government or a court of law and is thereby contractually reduced to a fixed payment schedule, the judgment would be a financial asset.

55-11 A judgment from litigation is a financial asset if it is transferred to an unrelated third party and would be within the scope of this Subtopic only if that judgment is enforceable by a government or a court of law and has been contractually reduced to a fixed payment schedule.

• • • > Forward Contract on a Financial Instrument

55-12 A forward contract to purchase or sell a financial instrument that must be (or may be) net settled or physically settled by exchanging that financial instrument for cash (or some other financial asset) is a financial asset or **financial liability**. Therefore, because a forward contract on a financial instrument that must be (or may be) physically settled by the delivery of that financial instrument in exchange for cash is a financial asset or financial liability, the transfer of such a financial asset is within the scope of this Subtopic (see paragraph 405-20-40-1 for guidance on extinguishments of liabilities).

• • • > Ownership Interest in a Consolidated Subsidiary by Its Parent If the Subsidiary Holds Nonfinancial Assets

55-13 An ownership interest in a consolidated subsidiary is evidence of control of the entity's individual assets and liabilities, not all of which are financial assets, and this guidance only applies to transfers of financial assets. (Note that in the parent's [transferor's] consolidated financial statements, the subsidiary's holdings are reported as individual assets and liabilities instead of as a single investment.) The guidance in this Subtopic does not apply to a transfer of an ownership interest in a consolidated subsidiary by its parent if that consolidated subsidiary holds nonfinancial assets.

• • • > Investment in a Nonconsolidated Investee

55-14 An entity (for example, a broker-dealer or an investment company) that carries an investment in a subsidiary at fair value will realize its investment by disposing of it rather than by realizing the values of the underlying assets through operations. Therefore, a transfer of an investment in a subsidiary by that entity is a transfer of the investment (a financial asset), not the underlying assets and liabilities (which might include nonfinancial assets). Generally, the guidance in this Subtopic applies to a transfer of an investment in a controlled entity that has not been consolidated by an entity because that entity accounts for its investment in the controlled entity at fair value.

To be in the scope of Topic 860, a transfer must be the transfer of a recognized financial asset or an in-scope derivative instrument. This is the third element of

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a transaction in the scope of Topic 860 – i.e. the transferred instrument is a financial asset; see the decision tree in section 2.1.

A financial asset is cash, evidence of an ownership interest in an entity, or a contract that conveys to one entity a right to either: [860-10 Glossary]

- receive cash or another financial instrument from a second entity; or
- exchange other financial instruments on potentially favorable terms with the second entity.

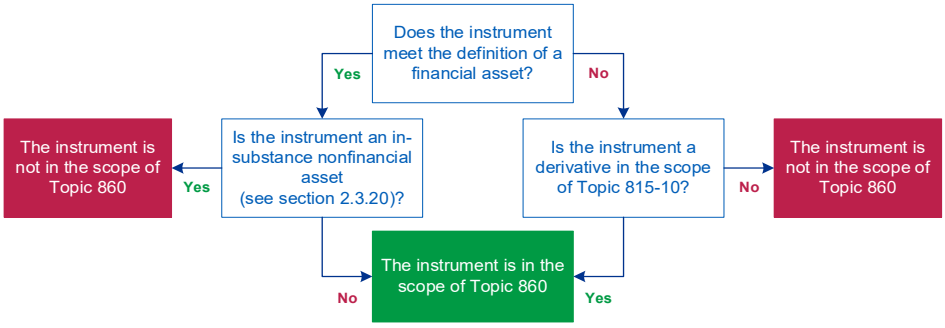
Further, Topic 860 is also applied to transfers of certain other derivative instruments that are not financial assets under this definition: [860-10-15-5, 40-40]

- derivative assets subject to Subtopic 815-10 (derivatives and hedging) that are not financial assets (e.g. physically settled commodity forward contract); and
- derivative instruments currently in a liability position that have the potential to become assets in the future (e.g. forward contracts and swaps).

Question 2.3.10

How are instruments analyzed to determine if they are financial instruments in the scope of Topic 860?

Interpretive response: The following decision tree summarizes the analysis required to determine whether an instrument qualifies as a financial asset in the scope of this Topic.



Topic 860 specifically excludes from its scope instruments that meet the definition of a financial asset but are in-substance nonfinancial assets (see section 2.3.20).

Question 2.3.20

What are common examples of recognized financial assets that are in the scope of Topic 860?

Interpretive response: The following table includes examples of recognized financial assets that are in the scope of Topic 860.

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However, any of the financial assets listed below are in-substance nonfinancial assets if they are sold either as part of a group or within a subsidiary that is not a business and for which substantially all of the fair value of the assets of that group or subsidiary is concentrated in nonfinancial assets – e.g. real estate and intangibles. If they are in-substance nonfinancial assets, they are not in the scope of Topic 860 (see section 2.3.20). See section 17.2.40 of KPMG Handbook, Revenue recognition, and KPMG Handbook, Revenue: Real estate, for additional guidance on the determination of, and accounting for, transfers of in-substance nonfinancial assets. [610-20-15-5]

Examples of instruments that are recognized financial assets	Analysis
Loans, notes and trade receivables, including: residential and commercial real estate mortgage loans, credit cards, construction loans, nonperforming loans.	Loans, notes and trade receivables represent a contract that conveys to one entity a right to receive cash or another financial instrument.
Debt securities in the scope of Topic 320 (investments – debt securities)	Debt securities represent a contract that conveys to one entity a right to receive cash or another financial instrument.
Beneficial interests in securitizations, including: mortgage-backed securities, collateralized mortgage obligation securities, collateralized loan obligation securities, other asset-backed securities, residual interests.	Beneficial interests represent a contract that conveys to one entity a right to receive cash or another financial instrument. This includes investments in beneficial interests of securitizations that hold nonfinancial assets.
Ownership interests (e.g. common stock) in the scope of Topic 321 (investments – equity securities) and Topic 323 (equity method investments and joint ventures) [860-10-55-3(b)]	Investments in common stock or other forms of ownership interests are financial assets. Transfers of ownership interests in the scope of Topic 321 or Topic 323 are in the scope of Topic 860 even if the underlying assets of the investee are predominately nonfinancial assets such as real estate.
Ownership interests in consolidated subsidiaries that hold financial assets	A transfer of an ownership interest in a consolidated subsidiary that is not a business and holds only financial assets is in the scope of Topic 860. A transfer of an ownership interest in a consolidated subsidiary that is a business and only holds financial assets is in the scope of the deconsolidation guidance (Topic 810); see chapter 7 of KPMG Handbook, Consolidation. Section 2 of KPMG Handbook, Business combinations, provides guidance on how to determine what constitutes a business. [860-10-55-13,1997 AICPA Conf, 2009 AICPA Conf]
Cost-method investments [860-10-55-3(c)]	Investments in cost-method investments are financial assets and represent a contract that conveys the right to receive cash.

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Examples of instruments that are recognized financial assets	Analysis
Investment in controlled but nonconsolidated investee that is carried at fair value	An entity may hold a controlling financial interest in an investee but not consolidate it because the entity accounts for its investment at fair value based on industry specific guidance (e.g. a broker-dealer or an investment company). A transfer of such an investment in a subsidiary is a transfer of the investment (a financial asset), and not the underlying assets and liabilities (which might include nonfinancial assets). [860-10-55-14]
Sales-type and direct financing lease receivables	Sales-type and direct-financing lease receivables are considered financial assets because they arise from a contract (the lease) that conveys to the lessor a contractual right to receive cash or another financial instrument from the lessee. [860-10-55-6]
Residual values that are guaranteed at lease commencement	Residual values represent the lessor's estimate of the salvage value of the leased equipment at the end of the lease term. Residual values meet the definition of financial assets to the extent they are guaranteed at commencement of the lease. [860-10-55-6]
Certain judgments from litigation	Depends on the facts and circumstances. A judgment from litigation (e.g. amounts to be received under legal settlements or certain insurance claims) is a financial asset once it is reduced to a fixed payment schedule enforceable by contract. [860-10-55-10 – 55-11]
Forward contract to purchase or sell a financial instrument that must be (or may be) physically settled	Forward contracts on financial instruments are financial assets because they convey a contractual right: — to receive cash or another financial instrument from another entity; or — to exchange other financial instruments on potentially favorable terms with the other entity. [860-10-55-12]
Acquisition, development and construction (ADC) arrangements	ADC arrangements are accounted for either as a loan, or as an investment in real estate or a joint venture (both of which are financial assets). [610-20-15-5, 15-7]

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Question 2.3.25

Is the transfer of an ownership interest in a consolidated subsidiary that is not a business and holds financial and nonfinancial assets in the scope of Topic 860?

Background: As discussed in Question 2.3.20, a transfer of an ownership interest in a consolidated subsidiary is in the scope of Topic 860 if the subsidiary is not a business and holds only financial assets. In contrast, the transfer is in the scope of Topic 810's deconsolidation guidance if the consolidated subsidiary is a business and holds only financial assets.

Interpretive response: It depends. We believe that the transfer of an ownership interest in a consolidated subsidiary that is not a business and holds both financial and nonfinancial assets is generally outside the scope of Topic 860. However, if substantially all of the subsidiary's assets are financial assets, we believe the transfer should be considered in the scope of Topic 860. We believe transfers of ownership interests in consolidated subsidiaries that hold either only financial assets or substantially all financial assets should be accounted for in a similar manner because the nature of both is a transfer of financial assets. See section 17.2 in KPMG Handbook, Revenue recognition, for further discussion on accounting for transfer of an ownership interest in a consolidated subsidiary that is not a business that holds nonfinancial assets or a combination of nonfinancial and in-substance nonfinancial assets.

Question 2.3.30

What are some examples of transfers of non-financial derivative instruments for which Topic 860 is applied by analogy?

Excerpt from ASC 860-10

> Transactions

15-5 Paragraph 815-10-40-2 states that transfers of assets that are derivative instruments and subject to the requirements of Subtopic 815-10 but that are not financial assets shall be accounted for by analogy to this Topic.

Excerpt from ASC 815-10

40-2 Transfers of assets that are derivative instruments and subject to the requirements of this Subtopic but that are not financial assets shall be accounted for by analogy to Subtopic 860-10. This guidance is limited to transfers of nonfinancial assets that are derivative instruments that are or will

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be subject to the requirements of this Subtopic. An example would be a transfer to another entity of a derivative instrument, such as a forward contract to purchase gold that requires physical settlement and is or will be subject to the requirements of this Subtopic.

Interpretive response: Derivative instruments in the scope of Topic 815-10 include financial and nonfinancial instruments. Examples of transfers of nonfinancial derivative instruments for which Topic 860 is applied by analogy include certain contracts such as forwards or options that will be settled by the physical delivery of a commodity that is readily convertible to cash. [860-10-15-5, 815-10-40-2]

Question 2.3.40

What are common examples of items that are not in the scope of Topic 860?

Interpretive response: The following table includes examples of items that are either:

- explicitly out of the scope of Topic 860; or
- out of the scope of Topic 860 because they are not recognized financial assets.

Instrument	Analysis
Shareholder note classified in equity	A shareholder note classified in equity is a component of equity and is not a recognized financial asset.
Treasury stock	Treasury stock is recognized as contra-equity and is not a recognized financial asset.
Stranded costs	Stranded costs are not financial assets because they are not contractual rights to receive cash from another party (see section 2.3.40).
Sale of future revenue (when a customer receivable has not yet been recognized)	In a sale of future revenue, an entity receives cash from an investor and agrees to pay to the investor a specified amount of revenue in the future for a defined period of time. [470-10-25-1] The future revenue has not been earned. If the future revenue streams are not currently recognized as a customer receivable, a transfer of those future revenues does not involve a transfer of financial assets.
Servicing rights	Servicing rights are rights to service financial assets in exchange for future revenue. Subtopic 860-50 provides guidance on accounting for servicing

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Instrument	Analysis
	rights, including recognition criteria and when a transfer of such rights qualifies as a sale. See chapter 10.
Ownership interests in consolidated subsidiaries that hold nonfinancial assets	An ownership interest in a consolidated subsidiary is evidence of control over the individual assets and liabilities of the subsidiary. The ownership interest is not an investment in a single financial asset or group of financial assets. Transfers of an ownership interest in a consolidated subsidiary that holds nonfinancial assets are not in the scope of Topic 860 because Topic 860 only applies to transfers of financial assets. [860-10-55-13]
Unguaranteed residual values and residual values guaranteed after commencement of the lease	Residual values represent the lessor's interest in the salvage value of the underlying asset at the end of the lease term. Unguaranteed residual values of a leased asset and residual values guaranteed after lease commencement are not financial assets. [860-10-55-6]
Minimum lease payments to be received by the lessor under operating leases	Minimum lease payments to be received by the lessor under operating leases are unrecognized financial assets. [860-10-15-4(b)]
Certain judgments from litigation	Depends on the facts and circumstances. A judgment from litigation (e.g. amounts to be received under legal settlements or certain insurance claims) is usually not a financial asset because it has generally not been reduced to a fixed payment schedule enforceable by contract. [860-10-55-10]
In-substance nonfinancial assets	In-substance nonfinancial assets are financial assets that are being sold either as part of a group or within a subsidiary that is not a business and for which substantially all of the fair value of the assets of that group or subsidiary is concentrated in nonfinancial assets (see section 2.3.20).

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2.3.20 In-substance nonfinancial assets

Excerpt from ASC 610-20

15-5 An **in substance nonfinancial asset** is a financial asset (for example, a receivable) promised to a counterparty in a contract if substantially all of the fair value of the assets (recognized and unrecognized) that are promised to the counterparty in the contract is concentrated in nonfinancial assets. If substantially all of the fair value of the assets that are promised to a counterparty in a contract is concentrated in nonfinancial assets, then all of the financial assets promised to the counterparty in the contract are in substance nonfinancial assets. For purposes of this evaluation, when a contract includes the transfer of ownership interests in one or more consolidated **subsidiaries** that is not a business, an entity shall evaluate the underlying assets in those subsidiaries.

15-6 When a contract includes the transfer of ownership interests in one or more consolidated subsidiaries that is not a business, and substantially all of the fair value of the assets promised to a counterparty in the contract is not concentrated in nonfinancial assets, an entity shall evaluate whether substantially all of the fair value of the assets promised to the counterparty in an individual subsidiary within the contract is concentrated in nonfinancial assets. If substantially all of the fair value of the assets in an individual subsidiary is concentrated in nonfinancial assets, then the financial assets in that subsidiary are in substance nonfinancial assets. (See Case C of Example 1 in paragraphs 610-20-55-9 through 55-10.)

15-7 When determining whether substantially all of the fair value of the assets promised to a counterparty in a contract (or an individual consolidated subsidiary within a contract) is concentrated in nonfinancial assets, **cash** or **cash equivalents** promised to the counterparty shall be excluded. Also, any liabilities assumed or relieved by the counterparty shall not affect the determination of whether substantially all of the fair value of the assets transferred is concentrated in nonfinancial assets.

15-8 If all of the assets promised to a counterparty in an individual consolidated subsidiary within a contract are not nonfinancial assets and/or in substance nonfinancial assets, an entity shall apply the guidance in paragraph 810-10-40-3A(c) or 810-10-45-21A(b)(2) to determine the guidance applicable to that subsidiary.

This section includes different questions related to whether an instrument is in the scope of Topic 860. Topic 860 generally applies to financial assets. However, there is an exception for financial assets that are considered in-substance nonfinancial assets. If a financial asset is considered an in-substance nonfinancial asset, the guidance in Subtopic 610-20 applies instead of the guidance in Topic 860. For brevity, we have generally not repeated this exception when referring to transfers of financial assets throughout this section. [860-10-15-4(e)]

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Question 2.3.50

How does an entity determine whether an asset is an in-substance nonfinancial asset?

Interpretive response: An in-substance nonfinancial asset is a financial asset (e.g. receivable) in a contract that is being transferred: [610-20-15-5 – 15-6]

- either as part of a group or within a subsidiary that is not a business; and
- for which substantially all of the fair value of the assets (recognized and unrecognized) that are promised to the counterparty in the contract is concentrated in nonfinancial assets – e.g. real estate and intangible assets.

When determining whether substantially all of the fair value of the collective assets of the group or in the subsidiary promised to a counterparty in a contract relates to nonfinancial assets, the seller includes recognized and unrecognized assets but excludes cash and cash equivalents. The seller also excludes liabilities that are assumed or relieved by the counterparty. [610-20-15-7]

An entity may consider qualitative factors in addition to quantitative factors to determine whether substantially all of the fair value is concentrated in nonfinancial assets. See section 17.2.40 of KPMG Handbook, Revenue recognition, and KPMG Handbook, Revenue: Real estate, for additional guidance on the determination of, and accounting for, transfers of in-substance nonfinancial assets.

For example, Parent has two consolidated subsidiaries (Sub A and Sub B) and has entered into a contract with Buyer to transfer 100% of the ownership in these two subsidiaries that are not businesses individually or collectively. Sub A's only asset is a parcel of land (i.e. a nonfinancial asset) with a fair value of $1,000,000. Sub B's only asset is an equity method investment (i.e. a financial asset) with a fair value of $1,000. The equity method investment held by Sub B is an in-substance nonfinancial asset because it is being transferred along with other assets and the fair value of the nonfinancial assets in the group of assets being sold comprises substantially all of the fair value of the group.

2.3.30 Financial asset definition applied to specific instruments

Question 2.3.60

Is an intercompany loan considered a transfer of a financial asset for purposes of consolidated financial statements?

Background: Subsidiary is consolidated by Parent. Parent makes a loan to Subsidiary, which is eliminated in Parent's consolidated financial statements. Parent subsequently sells the intercompany loan to a third party for cash.

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Interpretive response: No. For Topic 860 to apply to a transfer, the transfer must be of a recognized financial asset. For purposes of a parent company's consolidated financial statements, the sale of the intercompany loan is not in the scope of Topic 860 because the loan is not a recognized financial asset.

In the background example, before the sale of the loan, Parent's loan to Subsidiary was eliminated in Parent's consolidated financial statements. Therefore, Parent did not have a recognized financial asset to sell.

Question 2.3.70

Is the transfer of an equity method investment in the scope of Topic 860?

Excerpt from ASC 810-10

> Deconsolidation of a Subsidiary or Derecognition of a Group of Assets

40-3A The deconsolidation and derecognition guidance in this Section applies to the following: …

c. A subsidiary that is not a nonprofit activity or a business if the substance of the transaction is not addressed directly by guidance in other Topics that include, but are not limited to, all of the following:

   1. Topic 606 on **revenue** from contracts with customers
   2. Topic 845 on exchanges of nonmonetary assets
   3. Topic 860 on transferring and servicing financial assets
   4. Topic 932 on conveyances of mineral rights and related transactions
   5. Subtopic 610-20 on gains and losses from the derecognition of nonfinancial assets.

Interpretive response: It depends. A transfer of an equity method investment is in the scope of Topic 860 unless it is held by a business or subsidiary that is accounted for under the derecognition/deconsolidation guidance in Topic 810. [810-10-40-3A]

The unit of account for this determination is the equity method investment, and not the underlying assets of the equity method investee. Therefore, the composition of the assets held by the investee (i.e. financial or nonfinancial assets) does not impact whether the transfer is in the scope of Topic 860 – i.e. an entity does not evaluate each of the equity method investee's assets for derecognition.

See exception in section 2.3.20 when a financial asset is sold either as part of a group or within a subsidiary that is not a business and for which substantially all of the fair value of the assets (recognized and unrecognized) that are promised to the counterparty in the contract is concentrated in nonfinancial assets.

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Question 2.3.80

Do cryptocurrencies represent financial assets?

Background: An entity may purchase cryptocurrency for cash. Assume that the crypto asset functions as a medium of exchange and has all of the following characteristics: [AICPA PADA.Q1]

- is not issued by a jurisdictional authority (e.g. a sovereign government);
- does not give rise to a contract between the holder and another party;
- is not considered a security under the Securities Act of 1933 or the Securities Exchange Act of 1934;
- it is not an ownership interest in an entity.

Examples of crypto assets meeting these characteristics include bitcoin, bitcoin cash and ether.

Interpretive response: It depends. A cryptocurrency that has the characteristics in the background section is a digital asset that does not meet the definition of a financial asset because it neither represents an ownership interest in an entity nor establishes a right to deliver or receive cash or another financial instrument from another party. Therefore, we believe a cryptocurrency with these characteristics does not represent a financial asset. Instead, these assets meet the definition of intangible assets to be accounted for under Topic 350.

However, different digital assets may have different characteristics and, in each case, the particular facts and circumstances should be evaluated. If an entity holds a cryptocurrency that does not have the characteristics in the background section, further analysis may be required to determine if it represents a financial asset.

Question 2.3.85

Do stablecoins represent financial assets?

Background: Stablecoins are digital assets that 'peg' their value typically to a fiat currency (e.g. the US dollar) or commodity (e.g. gold or oil) and, in this way, differ substantially from digital assets like bitcoin or ether. This peg has the goal of minimizing price volatility of the digital asset and is usually accomplished by the stablecoin issuer holding an appropriate reserve of the pegged asset. Examples of stablecoins include USDT, USDC, and PAX Gold.

Interpretive response: It depends. Not all stablecoins are the same. Depending on its specific attributes, a stablecoin may be classified as either a crypto intangible asset or a financial asset (if it meets the definition of a financial asset). Understanding the rights and obligations of the stablecoin holder and issuer and the other relevant facts and circumstances is vital to determining a stablecoin's appropriate classification and, therefore, the appropriate accounting model. The understanding should include whether stablecoins are cash or give the holder either:

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— an ownership interest in another entity; or
— a contractual right to receive cash or another financial asset or instrument.

For further discussion on factors to consider in this evaluation, see chapter 2 in our overall publication, Accounting and reporting for crypto intangible assets, and our Issues In-Depth, Investment company accounting for crypto intangible assets.

Question 2.3.90

Is an investment in an entity presented using proportionate consolidation in the scope of Topic 860?

Background: In certain industries, an entity may hold an investment that provides it with an undivided interest in the underlying assets of the investee and be proportionately liable for its share of each underlying liability of the investee. In this case, the entity may present its investment using proportionate gross presentation (proportionate consolidation). This means that the investor may present its proportionate share of the investee's individual assets, liabilities and components of comprehensive income in its financial statements. [810-10-45-14, 910-810-45-1, 930-810-45-1, 932-810-45-1]

Interpretive response: Yes. We believe that Topic 860 applies when an entity transfers an equity method investment, including those for which an entity applies proportionate consolidation; this is because an equity method investment meets the definition of a financial asset. Section 8.2.210 of KPMG Handbook, Consolidation, provides additional guidance on when proportionate consolidation is applied.

For example, if Investor accounts for its 30% noncontrolling interest in Entity (an oil and gas entity in the business of extracting minerals) using proportionate gross presentation, Investor's interest in Entity is a financial asset.

See exception in section 2.3.20 when a financial asset is sold either as part of a group or within a subsidiary that is not a business and for which substantially all of the fair value of the assets (recognized and unrecognized) that are promised to the counterparty in the contract is concentrated in nonfinancial assets.

Question 2.3.100

Is the transfer of a previously written off asset in the scope of Topic 860?

Background: An entity writes off a financial asset in the period that it is deemed uncollectible. [326-20-35-8]

Interpretive response: Yes. We believe a previously written off asset is a financial asset if the purchaser/transferee has the contractual right to cash flows at the acquisition/purchase date. In this case, we believe a writeoff, even a full writeoff that reduces the carrying amount to zero, is a change in measurement as opposed to the derecognition of the financial asset. Therefore, the asset

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continues to be a financial asset even though it was written off, and is in the scope of Topic 860.

See exception in section 2.3.20 when a financial asset is sold either as part of a group or within a subsidiary that is not a business and for which substantially all of the fair value of the assets (recognized and unrecognized) that are promised to the counterparty in the contract is concentrated in nonfinancial assets.

Question 2.3.110

Is a contract asset a recognized financial asset?

Background: A contract asset is an entity's right to consideration in exchange for goods or services that the entity has transferred to a customer when that right is conditioned on something other than the passage of time. [606-10 Glossary]

Interpretive response: No. A contract asset is not a recognized financial asset and is therefore not in the scope of Topic 860. For a contract asset to be a financial asset, it must convey a contractual right to receive payments from another party (i.e. the right to bill and collect). [860-10 Glossary]

For example, ABC Corp. has a long-term construction contract under which it will invoice based on predetermined milestone dates. ABC satisfies its performance obligation over time, recognizing revenue before the date that it is eligible to invoice the customer. As a result, ABC records a contract asset and corresponding revenue under Topic 606 as its performance obligation is satisfied over time. When ABC is entitled to invoice the customer for these amounts, the contract asset amount to which ABC has a right to bill is recorded as a financial asset (specifically, a customer receivable).

If ABC transfers its rights to a contract asset, it is transferring the rights after the revenue has been recognized but before the customer receivable has been recognized. Because such a transfer does not involve a recognized financial asset, it is not in the scope of Topic 860.

Question 2.3.120

Is the transfer of a customer receivable when the associated revenue has not been recognized in the scope of Topic 860?

Excerpt from ASC 606-10

45-4 A receivable is an entity's right to consideration that is unconditional. A right to consideration is unconditional if only the passage of time is required before payment of that consideration is due. For example, an entity would recognize a receivable if it has a present right to payment even though that amount may be subject to refund in the future. …

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Background: Some entities enter into non-cancellable contracts with customers that entitle the entity to bill and collect consideration before the entity transfers goods or services to the customer. Topic 606 includes examples that illustrate an entity that has an unconditional right to consideration (i.e. a customer receivable) before it has transferred goods or services to the customer. A customer receivable and a contract liability are recorded and no revenue is recognized until the entity transfers goods or services to the customer. [606-10–55-284 – 55-286]

Interpretive response: Yes. If the entity has an unconditional right to consideration such as in the example provided in Topic 606 under a non-cancellable contract, the entity recognizes a customer receivable before revenue has been recognized. Subsequently, if the entity transfers the customer receivable to a third party, the transaction is in the scope of Topic 860 because it is the transfer of a receivable, which is a recognized financial asset. [860-10-15-2]

However, see the in-substance nonfinancial asset exception in section 2.3.20, which applies when a financial asset is sold either as part of a group or within a subsidiary that is not a business and for which substantially all of the fair value of the assets (recognized and unrecognized) that are promised to the counterparty in the contract is concentrated in nonfinancial assets.

Question 2.3.130

Is the transfer of an account relationship in the scope of Topic 860?

Excerpt from ASC 310-10

• > Credit Card Portfolio Purchased

25-7 When an entity purchases a credit card portfolio that includes the cardholder relationships at an amount that exceeds the sum of the amounts due under the credit card receivables, the difference between the amount paid and the sum of the balances of the credit card loans at the date of purchase (the premium) shall be allocated between the cardholder relationships acquired and the loans acquired. The premium relating to the cardholder relationships represents an identifiable intangible asset that shall be accounted for in accordance with Topic 350.

Background: An entity may enter into an arrangement in which it purchases a credit card portfolio that includes both credit card receivables and the cardholder relationship.

Interpretive response: No. A cardholder relationship is a separately identifiable asset from credit card receivables. The cardholder relationship is an intangible asset in the scope of Subtopic 350-30, and not a financial asset in the scope of Topic 860. [310-10-25-7]

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Question 2.3.140

Is a transfer of transferable tax credits in the scope of Topic 860?

Background: Certain jurisdictions, including the US, allow an entity to make a one-time transfer of certain income tax credit (or portions of the credit) to another unrelated taxpayer (the buyer) in exchange for cash.

Interpretive response: No. We believe it is generally appropriate to consider the derecognition guidance in Subtopic 610-20 (sales of nonfinancial assets) when accounting for the transfer of a transferable tax credit. See chapter 5 in KPMG Handbook, Tax credits, for further discussion on accounting for transferable tax credits.

Question 2.3.150**

Is an instrument a nonfinancial asset if it provides the holder with the option to receive either cash or a fixed number of nonfinancial assets with a variable monetary value?

Background: This factual scenario can be illustrated by assuming an instrument provides its holder with the contractual right to elect to redeem it for either $1,000 in cash or a fixed number of nonfinancial assets with a variable monetary value.

Interpretive response: We believe it is acceptable to classify an instrument with these characteristics as a nonfinancial asset. We believe contracts that permit or require settlement by delivery of a nonfinancial asset may be viewed as nonfinancial assets because the future economic benefit may include the receipt of nonfinancial assets (such as goods or services) instead of solely the right to receive cash or an ownership interest in an entity. Because the monetary value of the nonfinancial assets is variable, the holder may receive an incremental economic benefit by electing to receive the nonfinancial assets instead of cash. [FAS 105.BC32]

Question 2.3.160**

Is an instrument a financial asset if it provides the holder with the option to receive either cash or a variable number of nonfinancial assets with a fixed monetary value?

Background: This factual scenario can be illustrated by assuming an instrument provides its holder with the contractual right to elect to redeem it for either $1,000 in cash or a variable number of nonfinancial assets worth $1,000 (a fixed monetary amount). The cash amount and the fixed monetary amount of the nonfinancial assets are the same.

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Interpretive response: We believe it is acceptable to classify an instrument with these characteristics as a financial asset. In contrast to Question 2.3.150, the holder cannot receive an incremental economic benefit by electing to receive a nonfinancial asset instead of cash. Settlement in nonfinancial assets in this situation could be considered akin to settlement in cash because the holder's return is fixed and unrelated to the change in the value of the nonfinancial assets.

2.3.40 Securitized stranded costs

Excerpt from ASC 860-10

• • • > Securitized Stranded Costs

55-7 The deregulation of utility rates charged for electric power generation has caused electricity-producing entities (utilities) to identify some of their electric power generation operations as stranded costs. Before deregulation, utilities typically expected to be reimbursed for costs through regulation of rates charged to customers. After deregulation, some of these costs may no longer be recoverable through unregulated rates. Hence, such potentially unrecoverable costs often are referred to as stranded costs. However, some of those stranded costs may be recovered through a surcharge or tariff imposed on rate-regulated goods or services provided by another portion of the entity whose pricing remains regulated. Some entities have securitized their enforceable rights to impose that tariff (often referred to as securitized stranded costs), thereby obtaining cash from investors in exchange for the future cash flows to be realized from collecting surcharges imposed on customers of the rate-regulated goods or services.

55-8 Securitized stranded costs are not financial assets, and therefore transfers of securitized stranded costs are not within the scope of this Subtopic. Securitized stranded costs are not financial assets because they are imposed on ratepayers by a state government or its regulatory commission and, thus, while an enforceable right for the utility, they are not a contractual right to receive payments from another party. To elaborate, while a right to collect cash flows exists, it is not the result of a contract and, thus, not a financial asset.

55-9 However, **beneficial interests** in a **securitization** trust that holds nonfinancial assets such as securitized stranded costs or other similar imposed rights would be considered financial assets by the third-party investors, unless that third party must consolidate the trust. The Variable Interest Entities Subsections of Subtopic 810-10 should be applied, together with other guidance on consolidation policy, as appropriate, to determine whether such a special-purpose entity should be consolidated by a third-party investor.

Stranded costs have resulted from the deregulation of utility rates charged for electric power generation. An entity may recover some stranded costs through a surcharge or tariff imposed on rate-regulated goods or services provided by another portion of the entity whose pricing remains regulated. Some entities

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have securitized their enforceable rights to impose tariffs (often referred to as securitized stranded costs) and have obtained cash from investors in exchange for the future cash flows to be realized from collecting the surcharges.

Stranded costs are imposed on ratepayers by a state government or its regulatory commission but are not a financial asset because they are not contractual rights to receive payments from another party. Because stranded costs are not a financial asset, transfers of stranded costs to a securitization trust and subsequent transfers of the beneficial interests in that trust to third-party investors by the transferor are not in the scope of Topic 860. [860-10-55-7 – 55-8]

In contrast, beneficial interests in a securitization trust that holds securitized stranded costs or other similar imposed rights represent financial assets when held by a third-party investor (unless that investor consolidates the trust). [860-10-55-9]

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3. Sale criteria: Overview

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3.5.30 Does a transfer of a participating interest that does not meet the control criteria cause an earlier transfer of a participating interest to not be eligible for sale accounting?

3.5.40 What is a transferor's 'continuing involvement'?

3.5.50 What are some examples of continuing involvement?

3.5.60 Are a common parent's involvements considered when evaluating whether control has been surrendered in a transfer between consolidated subsidiaries?

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3.5.70 Is a transferor's equity method investee's involvement considered continuing involvement when evaluating whether control has been surrendered?

3.5.80 Can a transfer from an investor to its equity method investee be accounted for as a sale?

Example

3.5.10 Transfer of participating interest that meets control criteria followed by transfer that does not

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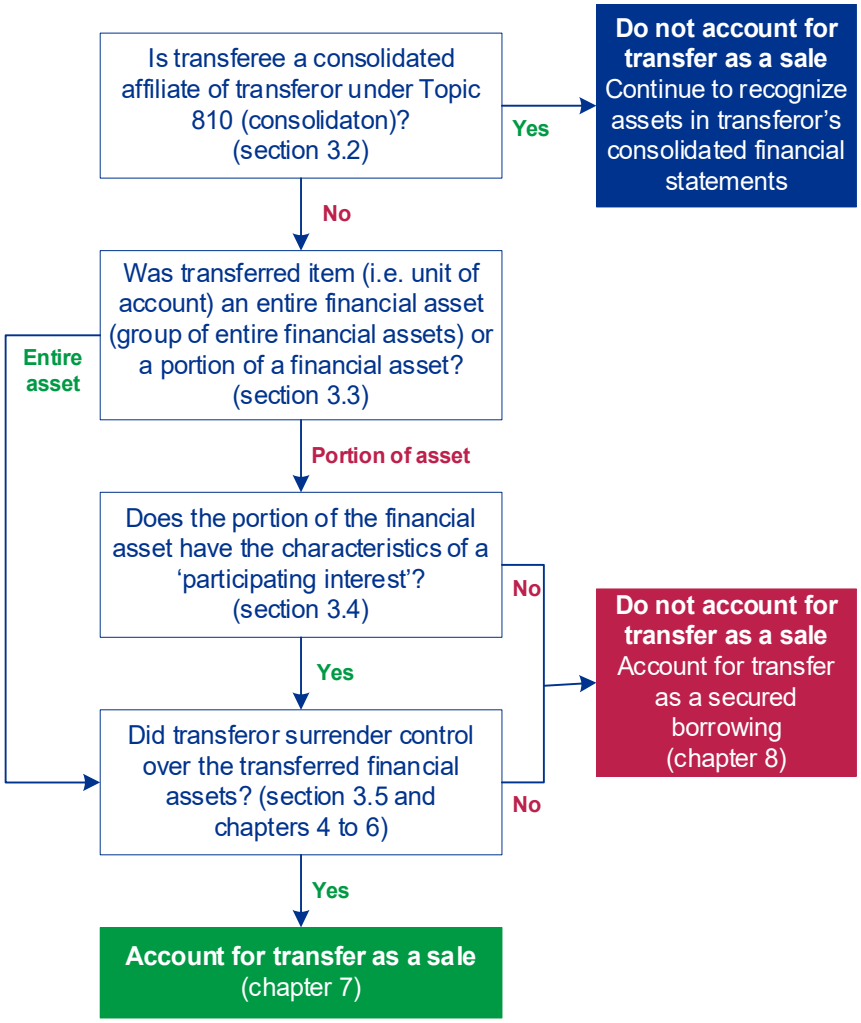
3.1 How the standard works

The following decision tree summarizes the steps in determining whether to account for a transfer of financial assets as a sale (or a secured borrowing):



An entity evaluates whether to account for a transfer of financial assets as a sale (or a secured borrowing) throughout the life of the transferred assets.

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3.2 Evaluate whether the transferee is a consolidated affiliate

Excerpt from ASC 860-10

> Conditions for a Sale of Financial Assets

40-4 The objective of paragraph 860-10-40-5 and related implementation guidance is to determine whether a transferor and its **consolidated affiliates** included in the financial statements being presented have surrendered control over **transferred financial assets** or third-party **beneficial interests**. This determination:

a. Shall first consider whether the **transferee** would be consolidated by the transferor (for implementation guidance, see paragraph 860-10-55-17D) …

• > Consolidation of Transferee by Transferor

55-17D Paragraph 860-10-40-4 states that the determination of whether a transferor and its **consolidated affiliates** included in the financial statements being presented have surrendered control over transferred financial assets shall first consider whether the transferee would be consolidated by the transferor. If all other provisions of this Topic are met with respect to a particular transfer, and the transferee would be consolidated by the transferor, then the transferred financial assets would not be treated as having been sold in the financial statements being presented. However, if the transferee is a consolidated subsidiary of the transferor (its parent), the transferee shall recognize the transferred financial assets in its separate entity financial statements, unless the nature of the transfer is a secured borrowing with a pledge of collateral (for example, a repurchase agreement that would not be accounted for as a sale under the provisions of paragraph 860-10-40-24).

The first step in determining whether a transfer of a financial asset is accounted for as a sale or secured borrowing is to evaluate whether the transferee is a consolidated affiliate of the transferor. Topic 860 defines a consolidated affiliate as an entity whose assets and liabilities are included in the consolidated, combined or other financial statements being presented. [860-10-20, 40-4]

When a transferee is the transferor's consolidated affiliate, the transferred financial assets continue to be recognized (and related intercompany transactions are eliminated) in the consolidated financial assets. Therefore, a transfer to a consolidated affiliate is not accounted for as a sale. [860-10-40-4, 55-17D]

Topic 810 (consolidation) is used to determine whether the transferee is a consolidated affiliate; see KPMG Handbook, Consolidation.

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Question 3.2.10

When does an entity evaluate whether the transferee is the transferor's consolidated affiliate?

Interpretive response: An entity evaluates whether a transfer is accounted for as a sale (or a secured borrowing) throughout the transferred asset's life. This evaluation may be impacted by a change in the determination of whether the transferee is a consolidated affiliate of the transferor.

For example, Topic 810 requires an entity to reconsider whether a voting interest entity is a variable interest entity (or vice versa) when certain events occur and to continually reassess which party is a variable interest entity's primary beneficiary. Further, whether a transferor has a controlling financial interest in a voting interest entity may change over time. See KPMG Handbook, Consolidation, for guidance about when and how to determine whether an entity should be consolidated.

If the transfer of a financial asset is treated as a sale upon the initial transfer, a change in whether the transferee is a consolidated affiliate of the transferor can have the following outcomes.

Transferee becomes a consolidated affiliate	In this situation, the transferor re-recognizes the transferred financial asset and accounts for the asset as if the transferor has regained control. See section 7.4 for guidance on regaining control.
Transferee is deconsolidated	In this situation, the entity evaluates whether the transferred item (i.e. unit of account) is eligible for sale accounting (see sections 3.3 and 3.4) and, if so, whether the transferor has surrendered control (see section 3.5).

Question 3.2.20

Does a transfer to a special-purpose entity that is a consolidated affiliate qualify for sale accounting?

Background: Assume that Bank (transferor) transfers financial assets (e.g. loans) to a special-purpose entity (SPE) that issues both senior and subordinated beneficial interests in the SPE to third-party investors. Bank consolidates SPE under Topic 810.

Interpretive response: No. Because the SPE is a consolidated affiliate, the financial assets transferred to the SPE do not qualify for sale accounting and are not derecognized in the transferor's consolidated financial statements. [860-10-40-4, 55-17D]

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Question 3.2.30

How does a transferee that is a consolidated affiliate of the transferor recognize a transfer in its stand-alone financial statements?

Interpretive response: We believe the guidance in paragraph 860-10-55-17D clarifies that a subsidiary recognizes the financial assets transferred from its parent in its stand-alone financial statements if the nature of the transfer is consistent with a transaction with a third party that qualifies as a sale. Otherwise, the subsidiary accounts for the transfer as a secured borrowing with a pledge of collateral.

We believe that judgment is applied considering all terms of the transfer. Some indicators that support a conclusion that the nature of the transfer is more consistent with a sale include:

- the subsidiary acquires legal title to the financial assets;
- consideration paid by the subsidiary to its parent equals or approximates fair value; and
- no contractual provision either entitles or obligates the parent to repurchase the transferred financial assets at a fixed or determinable price.

In contrast, an example of when a transferee does not recognize a transferred financial asset is if it was transferred pursuant to a repurchase agreement that would not qualify for sale accounting had it been transacted with a third party. [860-10-55-17D]

3.3 Evaluate the unit of account

Excerpt from ASC 860-10

> Conditions for a Sale of Financial Assets

40-4D To be eligible for sale accounting, an entire financial asset cannot be divided into components before a transfer unless all of the components meet the definition of a **participating interest**. The legal form of the asset and what the asset conveys to its holders shall be considered in determining what constitutes an entire financial asset (for implementation guidance, see paragraph 860-10-55-17E). An entity shall not account for a transfer of an entire financial asset or a participating interest in an entire financial asset partially as a sale and partially as a secured borrowing.

40-4E If a transfer of a portion of an entire financial asset meets the definition of a participating interest, the transferor shall apply the guidance in the following paragraph. If a transfer of a portion of a financial asset does not meet the definition of a participating interest, the transferor and transferee shall account for the transfer in accordance with the guidance in paragraph 860-30-25-2. However, if the transferor transfers an entire financial asset in portions that do not individually meet the participating interest definition, the following

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paragraph shall be applied to the entire financial asset once all portions have been transferred.

• > Application of the Term Transferred Financial Assets

• • > Meaning of the Term Entire Financial Asset

55-17E This implementation guidance addresses the application of what constitutes an entire financial asset.

55-17F A loan to one borrower in accordance with a single contract that is transferred to a securitization entity before securitization shall be considered an entire financial asset. Similarly, a beneficial interest in securitized financial assets after the securitization process has been completed shall be considered an entire financial asset. In contrast, a transferred interest in an individual loan shall not be considered an entire financial asset; however, if the transferred interest meets the definition of a **participating interest**, the participating interest would be eligible for sale accounting.

55-17G In a transaction in which the transferor creates an interest-only strip from a loan and transfers the interest-only strip, the interest-only strip does not meet the definition of an entire financial asset (and an interest-only strip does not meet the definition of a participating interest; therefore, sale accounting would be precluded). In contrast, if an entire financial asset is transferred to a securitization entity that it does not consolidate and the transfer meets the conditions for sale accounting, the transferor may obtain an interest-only strip as proceeds from the sale. An interest-only strip received as proceeds of a sale is an entire financial asset for purposes of evaluating any future transfers that could then be eligible for sale accounting.

55-17H If multiple advances are made to one borrower in accordance with a single contract (such as a line of credit, credit card loan, or a construction loan), an advance on that contract would be a separate unit of account if the advance retains its identity, does not become part of a larger loan balance, and is transferred in its entirety. However, if the transferor transfers an advance in its entirety and the advance loses its identity and becomes part of a larger loan balance, the transfer would be eligible for sale accounting only if the transfer of the advance does not result in the transferor retaining any interest in the larger balance or if the transfer results in the transferor's interest in the larger balance meeting the definition of a participating interest. Similarly, if the transferor transfers an interest in an advance that has lost its identity, the interest must be a participating interest in the larger balance to be eligible for sale accounting.

To be eligible for sale accounting, a transferred item (unit of account) must be one of the following (collectively referred to as 'transferred financial assets'): [860-10 Glossary, 40-4D]

— an entire financial asset;
— a group of entire financial assets; or
— a participating interest in an entire financial asset (or a group of such participating interests).

If the unit of account is one of the first two items on this list, an entity applies the control criteria in section 3.5 to determine if the transferor has surrendered

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control and can account for the transfer as a sale. If the transferor has not surrendered control, the transfer is accounted for as a secured borrowing. [860-10-40-4E]

If the item transferred is less than an entire financial asset (i.e. a component of an entire financial asset), sale accounting is only appropriate if: [860-10-40-4D]

- the transferred interest meets the characteristics of a participating interest to be eligible for sale accounting (see section 3.4); and
- the transferor has surrendered control based on the control criteria (see section 3.5).

If sale accounting is not appropriate for a transfer of less than an entire financial asset because one or both of those conditions are not met, the transfer is accounted for as a secured borrowing. [860-10-40-4D]

Question 3.3.10

What is an 'entire financial asset'?

Interpretive response: Topic 860 requires an entity to consider both of the following when determining whether the transferred item is an entire financial asset: [860-10-40-4D]

- the asset's legal form; and
- what the asset conveys to its holders (e.g. rights and/or obligations).

The following table provides examples of what does (and does not) constitute an entire financial asset.

An 'entire financial asset'	Not an 'entire financial asset'
A loan or account receivable to one borrower that is transferred to a securitization entity before securitization. [860-10-55-17F]	A transferred interest in an individual loan. [860-10-55-17F]
An interest-only (I/O) strip received by the transferor as proceeds from a securitization transaction that is accounted for as a sale. Further, such an I/O strip is an entire financial asset when evaluating future transfers of it. [860-10-55-17G]	An I/O strip created in a transaction in which only the I/O strip from a loan is transferred (not the entire loan). [860-10-55-17G]
An individual advance made in accordance with a single contract to one borrower (e.g. line of credit, credit card loan, construction loan) on which multiple advances have been made, if the following conditions are met: [860-10-55-17H] — the individual advance is transferred in its entirety; — the individual advance retains its identity; and	An individual advance made in accordance with a single contract to one borrower (e.g. line of credit, credit card loan, construction loan) on which multiple advances have been made, if the individual advance loses its identity and becomes part of a larger loan balance. [860-10-55-17H]

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An 'entire financial asset'	Not an 'entire financial asset'
— the individual advance does not become part of a larger loan balance.	

Question 3.3.20

Can an entity account for a transfer of financial assets partially as a sale, and partially as a secured borrowing?

Interpretive response: No. An entity is not allowed to account for a transfer partially as a sale and partially as a secured borrowing, regardless of whether the transferred item is an entire financial asset or a participating interest. [860-10-40-4D]

3.4 Participating interest characteristics

3.4.10 Overview

Excerpt from ASC 860-10

• > Meaning of the Term Participating Interest

40-6A A participating interest has all of the following characteristics:

a. From the date of the transfer, it represents a proportionate (pro rata) ownership interest in an entire financial asset. The percentage of ownership interests held by the transferor in the entire financial asset may vary over time, while the entire financial asset remains outstanding as long as the resulting portions held by the transferor (including any participating interest retained by the transferor, its consolidated affiliates included in the financial statements being presented, or its agents) and the transferee(s) meet the other characteristics of a participating interest. For example, if the transferor's interest in an entire financial asset changes because it subsequently sells another interest in the entire financial asset, the interest held initially and subsequently by the transferor must meet the definition of a participating interest.

b. From the date of the transfer, all cash flows received from the entire financial asset are divided proportionately among the participating interest holders (including any interest retained by the transferor, its consolidated affiliates included in the financial statements being presented, or its agents) in an amount equal to their share of ownership. An allocation of specified cash flows is not an allowed characteristic of a participating interest unless each cash flow is proportionately allocated to the participating interest holders. In determining proportionate cash flows:

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1. Cash flows allocated as compensation for services performed, if any, shall not be included provided those cash flows meet both of the following conditions:
    i. They are not subordinate to the proportionate cash flows of the participating interest.
    ii. They are not significantly above an amount that would fairly compensate a substitute service provider, should one be required, which includes the profit that would be demanded in the marketplace.
2. Any cash flows received by the transferor as proceeds of the transfer of the participating interest shall be excluded provided that the transfer does not result in the transferor receiving an ownership interest in the financial asset that permits it to receive disproportionate cash flows.

c. The priority of cash flows has all of the following characteristics:
    1. The rights of each participating interest holder (including the transferor in its role as a participating interest holder) have the same priority.
    2. No participating interest holder's interest is subordinated to the interest of another participating interest holder.
    3. The priority does not change in the event of bankruptcy or other receivership of the transferor, the original debtor, or any other participating interest holder.
    4. Participating interest holders have no recourse to the transferor (or its consolidated affiliates included in the financial statements being presented or its agents) or to each other, other than any of the following:
        i. **Standard representations and warranties**
        ii. Ongoing contractual obligations to service the entire financial asset and administer the transfer contract
        iii. Contractual obligations to share in any set-off benefits received by any participating interest holder.

        That is, no participating interest holder is entitled to receive cash before any other participating interest holder under its contractual rights as a participating interest holder. For example, if a participating interest holder also is the servicer of the entire financial asset and receives cash in its role as servicer, that arrangement would not violate this requirement.

d. No party has the right to pledge or exchange the entire financial asset unless all participating interest holders agree to pledge or exchange the entire financial asset.

A set-off right is not an impediment to meeting the participating interest definition. For implementation guidance on the application of the term *participating interest*, see paragraphs 860-10-55-17I through 55-17N.

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Excerpt from ASC 860-20

55-24A If the transfer does not consist of an entire financial asset or group of entire financial assets, the transferred financial asset must meet the definition of a **participating interest**. Paragraph 860-10-40-6A(c)(4) states that, to meet that definition, participating interest holders shall have no recourse to the transferor (or its **consolidated affiliates** included in the financial statements being presented or its **agents**) or to each other, other than any of the following:

a. Standard representations and warranties
b. Ongoing contractual obligations to service the entire financial asset and administer the transfer contract
c. Contractual obligations to share in any set-off benefits received by any participating interest holder.

That recourse would result in the transfer being accounted for as a secured borrowing under Subtopic 860-30.

To be eligible for sale accounting, a transferred interest that is less than an entire financial asset (a component of a financial asset) must meet all of the characteristics of a participating interest. [860-10-40-4D, 40-6A]

Question 3.4.10

What are the characteristics of a participating interest?

Interpretive response: To be a participating interest, a transferred portion of a financial asset must have all of the following characteristics. [860-10-40-6A]

Characteristic 1	The interest represents a proportionate (pro rata) ownership interest in an entire financial asset.	Section 3.4.20
Characteristic 2	All cash flows received from the entire financial asset are divided proportionately among the participating interest holders in an amount equal to their share of ownership. However, if certain conditions are met, an allocation of cash flows as compensation for services is permitted and cash flows received by the transferor as proceeds in the transfer are excluded.	Section 3.4.30
Characteristic 3	The priority of cash flows: — does not entitle any participating interest holder to receive cash before any other participating interest holder; and — involves no recourse (other than standard representations and warranties) to – or subordination by – any participating interest holder.	Section 3.4.40

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Characteristic 4	No party has the right to pledge or exchange the entire financial asset unless all participating interest holders agree to it.	

These characteristics inherently result in a participating interest representing a portion of a financial asset that mirrors the characteristics of the original financial asset – i.e. a participating interest shares proportionately in all of the rights, risks and benefits of the entre financial asset.

Question 3.4.20

Does a set-off right result in an interest not meeting the participating interest characteristics?

Interpretive response: No. A set-off right is a right of a party that is both a debtor and a creditor to the same counterparty to reduce its obligation to that counterparty if that counterparty fails to pay its obligation. A set-off right is not an impediment to an interest meeting the participating interest characteristics. [860-10-40-6A, FAS 166.A39]

Example 3.4.10

Set-off rights for lending and deposit relationship

Bank and Customer have both a lending and a deposit relationship. The loan has an outstanding balance of $50,000 and the deposit account has a balance of $60,000. These relationships are subject to the following set-off rights.

- If Customer goes bankrupt, Bank has the right to reduce Customer's deposit account by up to $50,000 to offset any loss Bank B might incur from Customer's failure to repay the loan.
- In the event of Bank's receivership, Customer has the right to reduce the amount due to Bank under the loan obligation by up to $50,000 to offset any loss it might incur from Bank's failure to redeem the amount on deposit.

Bank transfers a 40% interest in Customer's loan receivable balance to Investor. The set-off rights of Bank and Customer are unaffected by the transfer. As a result, if Bank is in receivership, Investor may have only an unsecured claim against Bank for its share of the amount (if any) set off by Customer.

The 40% interest transferred by Bank is eligible to meet the participating interest characteristics – i.e. the set-off rights do not preclude the transferred interest from being considered a participating interest.

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Question 3.4.30

Can a loan participation be a participating interest?

Excerpt from ASC 860-10

• • > Loan Participations

55-61 Paragraph 860-10-05-23 provides background on loan participations. If a loan participation agreement transfers a participating interest in an entire financial asset (as described in paragraph 860-10-40-6A) and the conditions in paragraph 860-10-40-5 are met, the transfers shall be accounted for by the transferor as a sale of a participating interest. However, if the loan participation agreement constrains the transferee from pledging or exchanging its participating interest and that constraint provides a more-than-trivial benefit to the transferor, the transferor has not relinquished control and shall account for the transfer as a secured borrowing.

Interpretive response: Yes, if it meets the participating interest characteristics. A transfer of a portion of a loan via a 'loan participation' is in the scope of Topic 860 (see section 2.2.20). Therefore, such a transfer may only be accounted for as a sale if the transferred portion qualifies as a participating interest. [860-10-55-61]

If a loan participation agreement transfers a participating interest and the conditions for sale accounting are met, the transfer is accounted for as a sale of a participating interest. In contrast, the transfer is accounted for as a secured borrowing if the sale criteria are not met – e.g. because the loan participation agreement constrains the transferee from pledging or exchanging its participating interest and that constraint provides a more-than-trivial benefit to the transferor. [860-10-55-61]

Question 3.4.35

Do the participating interest requirements apply to a transfer of a portion of an equity share?

Interpretive response: Yes. A transfer of a portion of an equity share (e.g. fractional share) is in the scope of Topic 860 (see Question 2.2.15). Therefore, such a transfer may only be accounted for as a sale if the transferred portion meets the requirements to qualify as a participating interest.

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Question 3.4.40

Are the participating interest characteristics relevant when an entity transfers an entire financial asset in portions to multiple third parties at the same time?

Interpretive response: No. If the result is that an entity has transferred all of an entire financial asset to multiple third parties, the entity is not required to evaluate whether each portion individually meets the characteristics of a participating interest (i.e. each portion does not need to meet the participating interest characteristics). This is because if an entire financial asset is transferred in portions, the criteria for sale accounting are applied to the entire financial asset once all portions have been transferred. [860-10-40-4E, 40-6A]

Question 3.4.50

When interests in sales-type or direct-financing lease receivables are transferred, must a pro rata interest in the residual value be transferred to meet the participating interest characteristics?

Interpretive response: It depends. We believe that when a third party provides a residual value guarantee that is a separate freestanding contract, no portion of the residual value is required to be transferred for an interest in the receivables to meet the participating interest characteristics. [860-10-40-4D]

However, when a guarantee provided by the lessee is embedded in the lease contract, we believe a portion of the lessee-guaranteed residual value must be transferred for a transfer of an interest in the receivables to meet the participating interest characteristics. Transfers of sales-type and direct-financing lease receivables and residual values that are guaranteed at lease commencement are financial assets subject to the guidance in Topic 860 (see Question 2.3.20). [860-10-40-4D]

Further, an unguaranteed residual value is not a financial asset (see Question 2.3.40). Therefore, no portion of it is required to be transferred for an interest in the receivables to meet the participating interest characteristics.

3.4.20 Proportionate (pro rata) ownership interest in an entire financial asset

The first participating interest characteristic requires that the transferred portion represents a proportionate (pro rata) ownership interest in the entire transferred financial asset from the date of transfer. [860-10-40-6A(a)]

A financial asset can be divided into components that are transferred in multiple transfers. Further, those transfers may occur over time, instead of all at once. This may result in a transferor owning different percentages of an asset over

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time – e.g. because the transferor purchases or sells additional interests in that asset.

Example 3.4.20
Proportionate (pro rata) ownership interest

Bank originates a loan to Borrower on January 1, Year 1. Bank makes the following transfers of interests in the loan:

Date	Transferee	Transferred interest description
Dec 31, Year 1	Investor A	— 70% of loan's principal cash flows — 60% of loan's interest cash flows
Dec 31, Year 2	Investor B	Remaining interest in the loan: — 30% of loan's principal cash flows — 40% of loan's interest cash flows

Neither of the transferred interests individually qualifies as a participating interest because neither represents a proportionate (pro rata) ownership interest in the loan – e.g. Investor A is entitled to 70% of the principal cash flows but only 60% of the interest cash flows.

Question 3.4.70 and Example 3.4.30 discuss whether the transfers are eligible for sale accounting.

Question 3.4.60
Must the interests held by the transferor and transferee meet the definition of a participating interest at all times that the transferor owns an interest?

Interpretive response: The first participating interest characteristic requires that the interests held by the transferor (including interests held by the transferor, its consolidated affiliates and its agents) and the transferee(s) meet the definition of a participating interest at all times that the transferor owns an interest. This may result in a transfer that initially meets the participating characteristics – and is accounted for as a sale – subsequently not qualifying as a participating interest (and, as a result, the transferor regaining control). [860-10-40-6A(a)]

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Question 3.4.70

Are the participating interest characteristics relevant when an entity transfers an entire financial asset in portions to multiple third parties over time?

Interpretive response: Yes. An entity is required to evaluate whether each individual transfer of a portion of an entire financial asset meets the participating interest characteristics until it has transferred 100% of its interest in the entire financial asset. This contrasts with the situation in which a transferor transfers an entire financial asset in portions to multiple third parties *at the same time* (see Question 3.4.40). [860-10-40-4E, 40-6A]

Example 3.4.30

Transfer of 100% ownership interest in multiple transfers over time

This Example continues Example 3.4.10.

In that Example, Bank transfers 100% of its interests in a loan via two transfers of interests in that loan, one transfer on December 31, Year 1 and the other on December 31, Year 2. Neither transferred interest meets the participating interest characteristics.

On December 31, Year 1, Bank accounts for the interest transferred to Investor A as a secured borrowing. This is because the transferred portion does not meet the participating interest characteristics and therefore is not a unit of account that is eligible for sale accounting.

However, after the transfer to Investor B on December 31, Year 2, Bank has transferred 100% of its interest in the loan. As a result, the transferred item represents – in total – an entire financial asset. Bank is not required to evaluate whether the characteristics of a participating interest are met. Instead, Bank evaluates whether it has surrendered control of the loan (see section 3.5 and chapters 4, 5 and 6).

Question 3.4.80

Does a subsequent transfer of a portion of an interest that is not a participating interest cause an earlier transfer to not be eligible for sale accounting?

Interpretive response: Yes. To meet the characteristics of a participating interest, from the date of transfer, the interest must represent a proportionate (pro rata) ownership interest in an entire financial asset. If the transferor's interest changes because it subsequently sells another interest in the entire

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financial asset, the interest initially and subsequently held by the transferor must meet the characteristics of a participating interest. [860-10-40-6A(a)]

Therefore, we believe a transfer of a portion of an entire financial asset that does not meet the participating interest characteristics results in previously transferred portions also ceasing to meet the participating interest characteristics at that time. This is the case even if the entity accounted for an earlier transfer of a portion of an entire financial asset as a sale (because it met the characteristics of a participating interest at that time and the transferor had surrendered control).

Example 3.4.40

Transfer that meets participating interest characteristics followed by transfer that does not

Bank originates a loan to Borrower on January 1, Year 1. Bank makes the following transfers of interests in the loan.

Date	Transferee	Transferred interest description	Participating interest characteristics met?
Dec 31, Year 1	Investor A	— 50% of loan's principal cash flows — 50% of loan's interest cash flows	Yes, and Bank concludes it has surrendered control of the transferred portion.
Dec 31, Year 2	Investor B	— 30% of loan's principal cash flows — 25% of loan's interest cash flows	No.

On December 31, Year 1, Bank accounts for the interest transferred to Investor A as a sale. This is because the transferred portion meets the participating interest characteristics and Bank has surrendered control over it.

However, after the transfer to Investor B, Bank continues to hold an interest in 20% of the loan's principal cash flows and 25% of the interest cash flows. This interest does not represent a participating interest because it is not a proportionate (pro rata) ownership interest.

Bank continues to have an interest in the loan and its interest does not meet the participating interest characteristics. As a result, none of the transferred portions of the loan represent participating interests and none is a unit of account that is eligible for sale accounting. Instead, Bank accounts for the transfer on December 31, Year 2 as follows.

— Bank regains control of – and re-recognizes – the 50% interest previously transferred to Investor A; see section 7.4 about regaining control of transferred financial assets.

— Bank recognizes a secured borrowing for the transfer to Investor B.

Bank therefore reflects the entire financial asset on its balance sheet.

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3.4.30 Cash flows received are divided proportionately

Excerpt from ASC 860-10

• • > Application of the Term Participating Interest

55-17I Paragraph 860-10-40-6A(b) states that an allocation of specified cash flows precludes a portion from meeting the definition of a participating interest unless each cash flow is proportionately allocated to the participating interest holders. Following are several examples implementing that guidance:

a. In the circumstance of an individual loan in which the borrower is required to make a contractual payment that consists of a principal amount and interest amount on the loan, the transferor and transferee shall share in the principal and interest payments on the basis of their proportionate ownership interest in the loan.
b. In contrast, if the transferor is entitled to receive an amount that represents the principal payments and the transferee is entitled to receive an amount that represents the interest payments on the loan, that arrangement would not be consistent with the participating interest definition because the transferor and transferee do not share proportionately in the cash flows received from the loan.
c. In other circumstances, a transferor may transfer a portion of an individual loan that represents either a senior interest or a junior interest in an individual loan. In both of those circumstances, the transferor would account for the transfer as a secured borrowing because the senior interest or junior interest in the loan do not meet the requirements to be participating interests (see paragraph 860-10-40-6A(c)).

The second participating interest characteristic requires that all cash flows received from the entire financial asset be divided among the participating interest holders (including any interests retained by the transferor, its consolidated affiliates, or its agents) in proportion to their share of ownership, from the date of transfer. Allocations of specific cash flows (as compared to proportionate shares of cash flows) generally preclude a portion of an entire financial asset from being a participating interest. [860-10-40-6A(b)]

Question 3.4.90

What are examples of cash flows that are (and are not) divided proportionately?

Interpretive response: The following are examples of cash flows that are (and are not) divided proportionately. [860-10-55-17I]

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Cash flows that are divided proportionately	Cash flows that are *not* divided proportionately
The right to receive a specified percentage of both principal and interest payments received for a loan.	The right to receive interest – but not principal – payments from a loan.
The right to receive cash flows for a portion of an individual loan pari passu with other interests in the loan.	The right to receive cash flows for a portion of an individual loan represents either a senior or a junior interest. This interest also does not meet the 'priority of cash flows' characteristic (see section 3.4.40).

Question 3.4.100

What are the exceptions to the requirement to divide cash flows proportionately?

Interpretive response: As exceptions, the following cash flows are not required to be divided proportionately for an interest in a financial asset to be deemed a participating interest.

Compensation for services performed	These cash flows are not required to be divided proportionately if the following conditions are met: [860-10-40-6A(b)(1), 860-50 Glossary] — they are not subordinate to the proportionate cash flows of the participating interest; and — they are not for an amount significantly above the amount a substitute service provider would require as fair compensation (including the profit that would be demanded in the marketplace). That is, they are not for an amount significantly greater than the amount that represents adequate compensation.	See Questions 3.4.110 and 3.4.120
Cash flows received by the transferor as proceeds	These cash flows are not required to be divided proportionately, provided the transfer does not result in the transferor receiving an ownership interest in the financial asset that permits it to receive disproportionate cash flows. [860-10-40-6A(b)(2)]	See Question 3.4.130

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Question 3.4.110

What are some examples of cash flows that are compensation for services performed?

Excerpt from ASC 860-10

• • > Application of the Term Participating Interest

55-17J Given the conditions in paragraph 860-10-40-6A(b)(1), cash flows allocated as compensation for services performed that are significantly above an amount that would fairly compensate a substitute service provider would result in a disproportionate division of cash flows of the entire financial asset among the participating interest holders and, therefore, would preclude the portion of a transferred financial asset from meeting the definition of a participating interest. Examples of cash flows that are compensation for services performed include all of the following:

a. **Loan origination fees** paid by the borrower to the transferor
b. Fees necessary to arrange and complete the transfer paid by the transferee to the transferor
c. Fees for servicing the financial asset.

Interpretive response: Examples include: [860-10-55-17J]

— loan origination fees paid by the borrower to the transferor;
— fees necessary to arrange and complete the transfer that are paid by the transferee to the transferor;
— fees paid to a service provider (which may be the transferor) for servicing the financial asset.

Question 3.4.120

How does an entity evaluate whether compensation is 'significantly above' adequate compensation?

Interpretive response: The amount of compensation that represents adequate compensation is a function of the marketplace, not the individual servicer's servicing costs (see section 10.3.20). Topic 860 does not provide guidance on how to evaluate whether compensation is significantly above adequate compensation. Therefore, judgment is required when determining whether compensation for services performed causes an ownership interest to fail to meet the participating interest characteristics.

We believe a transferor should consider all relevant aspects of the servicing arrangement in evaluating whether compensation for services performed is significantly greater than adequate compensation. The following table presents

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examples of aspects of the servicing arrangement that we believe are relevant to this evaluation.

Aspect	Example
Type of financial assets being serviced	Residential versus commercial mortgage loans
Terms of the financial assets being serviced	— Variable rate versus fixed rate loans — Monthly versus quarterly payment frequency
Risks associated with the financial assets being serviced	Subprime versus prime obligors
Compensation structure for servicing arrangements in the market	Whether the arrangement entitles the servicer to more or fewer sources of ancillary income as compared to other agreements in the marketplace

Question 3.4.125**

Is a servicing fee that includes a variable incentive component consistent with the second participating interest characteristic?

Interpretive response: Generally no, although judgment is required to determine whether the incentive component is consistent with the second participating interest characteristic. For example, an incentive component could be included in a contractually specified fee such that the fee depends on the returns of the underlying cash flows from the transferred assets (e.g. a servicing fee that increases from 10 to 50 basis points depending on the rate of return received by the transferee on transferred financial assets). Including such a component in a servicing fee is frequently not distinguishable from incorporating an embedded IO strip in the arrangement. As discussed in Question 3.4.130, an I/O strip that is incorporated in a contractually specified servicing fee results in the transferred portion not being a participating interest.

In contrast, an incentive component that is not based on the performance of the underlying transferred assets may be consistent with the second participating characteristic. For example, an incentive component could be included in a contractually specified fee that increases depending on the total unpaid principal balance of serviced assets. Including such a component would be consistent with the second participating interest characteristic.

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Question 3.4.130

Can a transferor be compensated (or compensate the transferee) for an asset's off-market interest rate when only a portion of the asset is transferred?

Excerpt from ASC 860-10

• • > Application of the Term Participating Interest

55-17K The transfer of a portion of an entire financial asset may result in a gain or loss on the transfer if the contractual interest rate on the entire financial asset differs from the market rate at the time of transfer. Paragraph 860-10-40-6A(b)(2) precludes a portion from meeting the definition of a participating interest if the transfer results in the transferor receiving an ownership interest in the financial asset that permits it to receive disproportionate cash flows. For example, if the transferor transfers an interest in an entire financial asset and the transferee agrees to incorporate the excess interest (between the contractual interest rate on the financial asset and the market interest rate at the date of transfer) into the contractually specified servicing fee, the excess interest would likely result in the conveyance of an interest-only strip to the transferor from the transferee. An interest-only strip would result in a disproportionate division of cash flows of the financial asset among the participating interest holders and would preclude the portion from meeting the definition of a participating interest.

Interpretive response: Yes, if the compensation is made through a premium or discount included in the purchase price (i.e. proceeds) and not through a disproportionate share of cash flows from the transferred asset. An example is when the transferee pays higher cash proceeds to the transferor for an above-market rate loan than it would have paid for a loan with an at-market interest rate. Any value equalization for an interest rate differential must be in the form of a premium or discount on the purchase price of the transferred interest as opposed to any form of subsequent reallocation of principal or interest on a disproportionate basis. [860-10-40-6A(b)(2), 55-17K]

The Board decided that this approach is consistent with the concept of a participating interest because a premium received as cash proceeds (as compared to an I/O strip) does not depend on the cash flows from the transferred participating interest. If excess interest from an entire financial asset (i.e. contractually due interest on a financial asset that is in excess of a market rate at the time of transfer) is incorporated in the contractually specified servicing fee, it likely results in the conveyance of an I/O strip to the transferor, resulting in the transferred portion not being a participating interest. [860-10-55-17K, FAS 166.A16]

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Example 3.4.50
Transfer of loan with above-market interest rate

Bank originates a five-year, non-prepayable loan with a $2,000,000 principal amount that bears a contractual interest rate of 5%. The loan requires $200,000 principal payments at the end of each of Years 1 – 4 with the remaining principal amount due at the loan's maturity.

At the end of Year 1 (after contractual principal and interest payments are received), the market interest rate for the loan is 4.5%. Bank transfers a 50% interest in the loan to Investor.

The following table reflects the contractual cash flows and fair value of the 50% interest in the loan. This example assumes no other changes in market participant assumptions for the loan since it was originated and ignores the effect of servicing.

Year	Beginning principal balance	Principal payments	Ending principal balance	Contractual interest (5%)	Total cash flows
2	$900,000	$100,000	$800,000	$ 45,000	$ 145,000
3	800,000	100,000	700,000	40,000	140,000
4	700,000	100,000	600,000	35,000	135,000
5	600,000	600,000	–	30,000	630,000
Total		**$900,000**		**$150,000**	**$1,050,000**
Contractual interest rate					5.0%
Present value at contractual interest rate					**$ 900,000**
Market yield					4.5%
Fair value (at market yield)					**$ 913,552**

Scenario 1: Bank transfers the right to receive 50% of all cash flows received (including principal and interest)

Bank transfers the right to 50% of all cash flows received from the borrower (including both contractual principal and contractual interest) to Investor. Because the contractual interest rate of 5% is higher than the market rate of 4.5%, Investor pays fair value of $913,552 for the transferred portion to Bank.

The transferred portion meets the second participating interest characteristic ('cash flows received are divided proportionately').

Scenario 2: Bank transfers the right to 50% of contractual principal received and a 4.5% interest rate on those amounts

Bank transfers the right to 50% of the contractual principal (when received) and a 4.5% interest rate on those amounts. Because Investor will receive a market rate of interest on the loan, it pays the $900,000 present value of the transferred portion to Bank. Bank also continues to hold the rights to 0.5% interest on the transferred portion of principal, which represents an I/O strip.

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The transferred portion does not meet the second participating interest characteristic ('cash flows received are divided proportionately'). Therefore, it does not represent a participating interest and is not eligible for sale accounting.

Question 3.4.140

If a transferor holds a contingent call option on a transferred portion, is the second participating interest characteristic met?

Interpretive response: No, not if such a right would result in the transferor having a unilateral ability to repurchase the transferred interest after the contingent event occurs. Further, the transferred portion does not meet the characteristics before the contingency has occurred, even if the contingency is not in the transferor's control. This is because such a right results in the participating interests potentially not being entitled to a proportionate division of cash flows after the initial transfer. As a result, we believe a transferred portion subject to such a right does not meet the participating interest characteristics.

For example, Bank ABC transfers to Bank DEF a 40% interest in a loan receivable. If the borrower defaults on the loan, the transfer agreement permits ABC to elect to repurchase the 40% interest from DEF for its par amount. This transferred portion does not meet the participating interest characteristics.

See also Question 3.4.170 about subordination of cash flows upon borrower default.

Question 3.4.150

Is a transfer of an interest in previously written off financial assets eligible for sale accounting if cash flows are divided disproportionately?

Excerpt from ASC 860-10

• • > Transfer of Bad-Debt Recovery Rights

55-73 A financial institution (transferor) transfers to a third-party transferee the right to an amount of future recoveries from loans previously written off by the transferor as uncollectible. The transferee is entitled to recoveries equal to the purchase price plus a market rate of interest on the unrecovered purchase price. There is no recourse to the transferor. The transferee can initiate its own collection efforts if dissatisfied with the transferor's recovery efforts. The transaction is a secured borrowing (that is, a borrowing secured by the transferred rights).

Interpretive response: No. As discussed in Question 2.3.100, we believe a previously written off asset is a financial asset and that its transfer is in the

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scope of Topic 860. As a result, the transfer of a *portion* of a previously written off financial asset must meet the participating interest characteristics to be eligible for sale accounting. This includes that cash flows received must be divided proportionately.

For example, Bank writes off $75 million related to loans receivable having a $100 million principal balance. Bank later transfers to Company an interest in the loans receivable in exchange for $2 million cash proceeds.

Under the terms of the transaction, Company is entitled to receive a return of the purchase price (i.e. $2 million) out of the first recoveries plus 15% interest on the unrecovered purchase price. Further, Company is permitted to pursue collection on the loans receivable if it is dissatisfied with Bank's efforts.

The transferred item is not a unit of account that is eligible for sale accounting because it is not a transfer of an entire financial asset and does not meet the participating interest characteristics – e.g. because Company does not receive a proportionate share of cash flows received, but instead receives a return of its investment plus 15% interest. Further, Company is entitled to receive cash before (i.e. in priority to) Bank; see section 3.4.40.

3.4.40 Priority of cash flows

The third participating interest characteristic requires the priority of cash flows distributed to participating interest holders to have all of the following characteristics: [860-10-40-6A(c)]

- the rights of each participating interest holder (including the transferor in its role as a participating interest holder) have the same priority;
- no participating interest holder's interest is subordinated to the interest of another participating interest holder;
- the priority does not change in the event of bankruptcy or other receivership of the transferor, the original debtor or any other participating interest holder;
- participating interest holders have no recourse to the transferor (or its consolidated affiliates or its agents) or to each other. That is, no participating interest holder may be entitled to receive cash before any other participating interest holder under its contractual rights as a participating holder. As an exception, the following are permitted:
  - standard representations and warranties;
  - ongoing contractual obligations to service the entire financial asset and administer the transfer contract; and
  - contractual obligations to share in any set-off benefits received by any participating interest holder.

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Question 3.4.160

Does a transferred portion with a LIFO or FIFO provision meet the third participating interest characteristic?

Background: Some arrangements for transferred portions contain provisions that allocate principal payments to one interest holder before allocating principal to the other. For example, principal payments are allocated to the transferee before making allocations to the transferor under a last-in, first-out (LIFO) provision; this results in a more rapid reduction of the transferee's interest, which increases the transferor's risk of credit loss. In contrast, under a first-in, first-out (FIFO) provision, principal payments are allocated first to the transferor.

Interpretive response: No. These types of provisions represent a subordination of a holder's interest in the entire financial asset – e.g. a LIFO provision represents a subordination of the transferor's interest in the entire financial asset. Therefore, the participating interest characteristics are not met when an arrangement includes such a provision. [860-10-40-6A(c)(2), 55-17I]

Question 3.4.170

Does a transferred portion that results in subordination only upon a future contingent event occurring meet the third participating interest characteristic?

Background: Some arrangements contain terms that provide some interest holders a senior claim to the borrower's assets in the event a future event occurs (e.g. a borrower default).

Interpretive response: No. To be considered a participating interest, each interest must have the same priority and no interest holder may be subordinated to another. This includes that the interests may not provide for different priorities (or subordination) upon the occurrence of a future contingent event. Provisions that give some interest holders senior claims result in the transferred portion of the loan not meeting the characteristics to be considered a participating interest. [860-10-40-6A]

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Question 3.4.180

Does a transferred portion meet the third participating interest characteristic if it provides for recourse to the transferor for only a limited period?

Excerpt from ASC 860-10

• • > Application of the Term Participating Interest

55-17L Paragraph 860-10-40-6A(c) addresses the priority of cash flows. In certain transfers, recourse is provided to the transferee that requires the transferor to reimburse any premium paid by the transferee if the underlying financial asset is prepaid within a defined time frame of the transfer date. Such recourse would preclude the transferred portion from meeting the definition of a participating interest. However, once the recourse provision expires, the transferred portion shall be reevaluated to determine if it meets the participating interest definition.

Interpretive response: No. In that situation, the third participating interest characteristic is not met during the limited recourse period. [860-10-40-6A(c)(4)]

For example, a transferor is required to reimburse any premium paid by a transferee if the underlying financial asset is prepaid within a specified period after the transfer date (e.g. 90 days). That recourse precludes the transferred portion from meeting the participating interest characteristics during the recourse period. However, once the recourse provision expires, the transferred portion is reevaluated to determine whether it meets the definition of a participating interest. [860-10-55-17L]

Question 3.4.190

Does a transferred portion with a 'make whole' provision meet the third participating interest characteristic?

Background: Some arrangements for transferred portions contain provisions requiring the transferor to compensate the transferee for losses and expenses incurred as a result of the borrower's default.

Interpretive response: No. These types of provisions represent recourse to the transferor. Therefore, the third participating interest characteristic is not met when an arrangement includes such a provision. [860-10-40-6A(c)(4)]

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Question 3.4.200

Does a third-party guarantee represent recourse that precludes a transferred interest from meeting the third participating interest characteristic?

Excerpt from ASC 860-10

• • > Application of the Term Participating Interest

55-17M Paragraph 860-10-40-6A(c) addresses recourse in a participating interest. Recourse in the form of an independent third-party guarantee shall be excluded from the evaluation of whether the participating interest definition is met. Similarly, cash flows allocated to a third-party guarantor for the guarantee fee shall be excluded from the determination of whether the cash flows are divided proportionately among the participating interest holders.

Interpretive response: No. Third-party guarantees are not included in the analysis of whether a portion of an entire financial asset is a participating interest. A third-party guarantee arrangement does not result in recourse to the transferor or other participating interest holders because a third-party guarantor assumes a participating interest in the event of default. This is the case even if the transferor's participating interest is unguaranteed while one or more other transferred participating interests are guaranteed (or vice versa). [860-10-40-6A(c)(4), FAS 166.A21]

Similarly, cash flows allocated to a third-party guarantor for the guarantee fee are excluded when determining whether cash flows are divided proportionately among the participating interest holders (see section 3.4.30). [860-10-40-6A(c)(4), 55-17M]

Question 3.4.210

What are standard representations and warranties?

Excerpt from ASC 860-10

20 Glossary

Standard Representations and Warranties

Representations and warranties that assert the financial asset being transferred is what it is purported to be at the transfer date.

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• • > Application of the Term Participating Interest

55-17N Examples of **standard representations and warranties** (as used in paragraph 860-10-40-6A(c)) include representations and warranties about any of the following:

a. The characteristics, nature, and quality of the underlying financial asset, including any of the following:
    1. Characteristics of the underlying borrower
    2. The type and nature of the collateral securing the underlying financial asset.
b. The quality, accuracy, and delivery of documentation relating to the transfer and the underlying financial asset
c. The accuracy of the transferor's representations in relation to the underlying financial asset.

Interpretive response: Recourse to the transferor for standard representations and warranties does not preclude a transferred portion from meeting the third participating interest characteristic ('priority of cash flows'). Topic 860 defines standard representations and warranties as representations and warranties that assert the financial asset being transferred is what it is purported to be at the transfer date. [860-10-20, 860-10-40-6A(c)(4)(i)]

Examples include representations and warranties about the following: [860-10-55-17N]

— the characteristics, nature and quality of the underlying financial asset, including the characteristics of the:
    – underlying borrower; and
    – the type and nature of collateral securing the underlying financial asset;
— the quality, accuracy and delivery of documentation relating to the transfer and the underlying financial asset; and
— the accuracy of the transferor's representations in relation to the underlying financial asset.

Question 3.4.220

Can a transferor meet the third participating interest characteristic if it receives servicing fees in priority to other participating interest holders?

Interpretive response: Yes, if those fees are received in the transferor's role as a servicer. However, if the fees are received through contractual rights of the transferor's participating interest (rather than in the transferor's role as a servicer), they result in the interest not meeting the participating interest characteristics. [860-10-40-6A(c)(4)]

Further, if those fees are significantly above the amount that represents adequate compensation, the transferred portion does not meet the second

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participating interest characteristic ('cash flows received are divided proportionately'); see section 3.4.30.

Question 3.4.230

Must all interest holders be restricted from pledging or exchanging the entire financial asset for a transferred portion to meet the third participating interest characteristic?

Interpretive response: Yes. For a portion of an entire financial asset to be considered a participating interest, no party – including the transferor – is permitted to have the right to pledge or exchange the entire financial asset unless all participating interest holders agree to do so. [860-10-40-6A(d)]

Although certain transfer restrictions are required for a transferred portion to meet the participating interest characteristics, restrictions on a transferee's ability to pledge or exchange entire financial assets may result in a transferor not surrendering actual control over a participating interest. See chapter 4 for discussion about whether transfer restrictions result in a transferor maintaining control.

3.4.50 Examples

The following are examples of arrangements involving transfers of portions of loans and considerations for determining whether provisions commonly included in those arrangements meet the participating interest characteristics. Although the provisions are addressed in the context of the arrangements described, a similar evaluation would be appropriate if those provisions are included in other types of arrangements involving transfers of portions of loans.

Example 3.4.60

Loan participations – common provisions

Many financial institutions transfer (participate) a portion of individual loans to other financial institutions to limit credit risk or provide liquidity. As discussed in Question 3.4.30, a loan participation must meet the participating interest characteristics to be eligible for sale accounting. They frequently contain terms that must be carefully evaluated to determine whether the transferred portions of the loan are participating interests.

The following table identifies some common provisions in loan participation agreements and summarizes their impact on whether the participating interest characteristics are met. Although these provisions are addressed in the context of a loan participation, a similar evaluation would be appropriate for any partial transfers of financial assets (e.g. other forms of partial loan sales and securitizations).

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Provision	Impact on meeting participating interest characteristics
Servicing fees (see section 3.4.30)	
Participation agreements often require the transferor to perform the servicing functions related to the participated loan	Cash flows for servicing fees received in the transferor's role as a servicer are not required to be divided proportionately if: — they are not subordinate to the proportionate cash flows of the participating interest; and — they are not for an amount significantly greater than the amount that represents adequate compensation. See further discussion in: — section 3.4.30, including Questions 3.4.120 and 3.4.130; and — section 3.4.40, including Question 3.4.220. In our experience, many servicing fee arrangements that are common in participations do not preclude the transferred portion of the loan from meeting the participating interest characteristics.
Provisions that result in subordination (see section 3.4.40)	
LIFO or FIFO provisions	These are provisions that allocate principal payments to one interest holder in priority to other interest holders. They represent subordination in the entire financial asset. As a result, loan participations with these provisions do not meet the participating interest characteristics. See also Question 3.4.160.
Subordination upon default	These are provisions that give some interest holders a senior claim to the borrower's assets in the event of a default. Loan participations with these provisions do not meet the participating interest characteristics. See also Question 3.4.170.
Compensation for off-market interest rates (see Question 3.4.130)	
Premiums or discounts included in the purchase price	Premiums or discounts included in the purchase price to reflect the effect of off-market interest rates represent proceeds that are not required to be divided proportionately between the participating interest holders. As a result, loan participations with these provisions may meet the participating interest characteristics.
Interest-only strips	I/O strips represent a disproportionate share of cash flows from the transferred asset. As a result, I/O strips result in a loan participation not meeting the participating interest characteristics.
Set-off rights (see Question 3.4.20 and Example 3.4.10)	
Bank's customer relationship may provide for set-off rights in the event of default by a borrower-depositor	Loan participations with these provisions may meet the participating interest characteristics.
Recourse provisions (see section 3.4.40)	
Standard representations and warranties	Loan participations with these provisions may meet the participating interest characteristics. See also Question 3.4.210 about provisions that represent standard representations and warranties.

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Provision	Impact on meeting participating interest characteristics
Make-whole provisions	Under these provisions, the transferor compensates the transferee for losses and expenses incurred as a result of the borrower's default. These provisions represent recourse to the transferor. As a result, loan participations with these provisions do not meet the participating interest characteristics. See also Question 3.4.190.
Third-party guarantees	Third-party guarantees are not included in the analysis of whether a portion of an entire financial asset is a participating interest. As a result, loan participations with these provisions may meet the participating interest characteristics. See also Question 3.4.200. See also Example 3.4.80 about transfers of portions of government-guaranteed loans.
Restrictions on transferor's ability to pledge or exchange entire financial assets (see section 3.4.40)	
No restriction on transferor's ability to pledge or exchange the entire financial asset	For competitive reasons, participation agreements often contain restrictions on the transferee's ability to pledge or exchange its interest in a participated loan and do not permit the transferee to pledge or exchange the entire asset. However, they frequently do not expressly prohibit the transferor from pledging or exchanging the entire loan being participated. To meet the participating interest characteristics, no party is permitted to have the right to pledge or exchange the entire financial asset unless all participating interest holders agree to do so. As a result, loan participations that do not restrict the transferor from pledging or exchanging the loan do not meet the participating interest characteristics. See also Question 3.4.230. See also chapter 4 about the effect on sale accounting of restrictions on a transferee's ability to pledge or exchange its interest.

Example 3.4.70

Transfers to asset-backed commercial paper conduits

A commercial paper conduit (CP conduit) is a special purpose entity whose sole purpose is to engage in securitization or asset-backed financing activities. It issues short-term beneficial interests (generally 270 days or less) and uses the proceeds to obtain financial assets from either one company (single-seller conduit) or multiple companies (multi-seller conduit).

Transfers of receivables to CP conduits can be structured in many different ways. This example describes three common arrangements and how the participating interest characteristics are evaluated under each.

These scenarios assume the following.

— Transferor transfers Trade Receivable A and Trade Receivable B to a bankruptcy-remote entity. Transferor consolidates the bankruptcy-remote entity. That entity then:

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  - **Scenarios 1 and 2:** transfers an interest in the assets (i.e. a portion of the assets) to CP Conduit.
  - **Scenario 3:** transfers the assets in their entirety themselves to CP Conduit.

— Both Trade Receivables have a par value and fair value of $50 (i.e. total par value and fair value of $100).
— CP Conduit issues commercial paper for proceeds of $90 cash. CP Conduit uses those proceeds to fund its purchase of Trade Receivables A and B.
— In the first collection period, CP Conduit collects a total of $50: $45 from Trade Receivable A and $5 from Trade Receivable B.

Scenarios 2 and 3 reflect different forms of what is commonly referred to as a 'deferred purchase price' (or DPP). A DPP effectively represents credit support provided by Transferor to CP conduit because Transferor is only entitled to cash flows after Transferee has received a stated amount of cash flows. Therefore, the practical effect is that Transferor absorbs the first credit losses incurred on the receivables.

Allocation of cash flows in first collection period	Evaluation of participating interest characteristics
Scenario 1: 90% pro rata participation interest in Trade Receivables is transferred from the bankruptcy-remote entity to CP Conduit for $90 cash proceeds	
CP Conduit and Transferor (via the bankruptcy-remote entity) are each entitled to their specified portions of all cash collected: — CP Conduit is entitled to $45[1]. — Transferor is entitled to $5[2].	Because an interest in each financial asset was transferred to CP Conduit (instead of the assets themselves), each interest must meet the participating interest characteristics to be eligible for sale accounting. The transferred interests provide for pro rata ownership interests, cash flows are divided in proportion to those interests, and all participating interests have the same priority. Therefore, they meet the participating interest characteristics and the transfer is eligible for sale accounting.
Scenario 2: 90% interest in Trade Receivables with prioritization is transferred from the bankruptcy-remote entity to CP Conduit for $90 cash proceeds. CP Conduit's interest receives the first $90 of cash collected. Transferor is not entitled to any cash collections until CP Conduit has received $90. After that, Transferor is entitled to all cash flows.	
CP Conduit is entitled to all cash collected because it has not yet received $90. As a result: — CP Conduit is entitled to $50 of cash collected. — Transferor is not entitled to any cash collections.	Because only a portion of the financial assets was transferred to CP Conduit (instead of the financial assets in their entirety), each interest must meet the participating interest characteristics to be eligible for sale accounting. This arrangement effectively puts a ceiling on the cash flows that may be allocated to CP Conduit, while Transferor bears a more significant risk of loss and higher potential returns because it receives no cash flows until CP Conduit has received all of its cash flows. Cash flows in this scenario are not allocated proportionately. The first cash flows received are not allocated 90% to CP Conduit and 10% to Transferor but, instead, are allocated entirely to CP Conduit. Further, CP

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Allocation of cash flows in first collection period	Evaluation of participating interest characteristics
	Conduit is entitled to receive cash flows in priority to Transferor. As a result, the transferred portions do not meet the participating interest characteristics and the transfer of financial assets is not eligible for sale accounting.
Scenario 3: 100% of the Trade Receivables are transferred to CP Conduit for proceeds of $90 cash and a 10% subordinated beneficial interest in CP Conduit. Transferor's subordinated beneficial interest is not entitled to any cash collections until CP Conduit has received $90. After that, Transferor's subordinated beneficial interest is entitled to all cash flows.	
CP Conduit is entitled to all cash collected because it has not yet received $90. As a result: — CP Conduit is entitled to $50 of cash collected. — Transferor is not entitled to any cash collections.	Because Trade Receivables were transferred in their entirety to CP Conduit, the participating interest characteristics do not apply. This is the case even though Transferor receives a beneficial interest in CP Conduit (the transferee) as partial consideration. Instead, the transfer of the financial assets in their entirety is analyzed to determine whether control has been surrendered. This includes consideration of whether CP Conduit should be consolidated (see section 3.2) and whether the control criteria are met (see section 3.5). If CP Conduit is not consolidated and control has been surrendered, Transferor accounts for the transfer as a sale, including measuring the retained interest at its fair value.
Notes: 1. $50 cash collected × 90% pro rata interest. 2. $50 cash collected × 10% pro rata interest.	

Example 3.4.80

Transfers of portions of government-guaranteed loans – common provisions

Transfers of portions of financial assets with government guarantees are common. For example, Small Business Administration (SBA) loans carry government guarantees (typically for 75% to 90% of the balance), and originating entities often transfer the guaranteed portion to third parties – e.g. through a loan participation agreement (see Example 3.4.20) – while retaining the unguaranteed portion.

The following table identifies some common provisions in transfers of portions of government-guaranteed loans participation agreements and summarizes their impact on whether the participating interest characteristics are met.

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Provision	Impact on meeting participating interest characteristics
Recourse provisions (see section 3.4.40)	
Government guarantees	Third-party guarantees are not included in the analysis of whether a portion of an entire financial asset is a participating interest. As a result, loan participations with government guarantees may meet the participating interest characteristics. See also Question 3.4.200.
Standard representations and warranties	Loan participations with these provisions may meet the participating interest characteristics. See also Question 3.4.210 about provisions that represent standard representations and warranties.
Recourse to the transferor for a limited period	Transfers of portions of government-guaranteed loans often provide for limited recourse to Transferor. For example, SBA loan transfers typically contain provisions that require Transferor to return any premium to Transferee if the borrower prepays the loan within 90 days, or if the borrower fails to make the first three monthly payments and enters uncured default within 275 days. As explained in Question 3.4.180, a transferred portion that provides limited recourse to the transferor does not meet the participating interest characteristics during the recourse period. However, once the recourse provisions have expired, the transferred interest is reevaluated to determine whether it does.
Servicing fees (see section 3.4.30)	
Required minimum servicing fee rates	Many government-guaranteed loan programs require a minimum servicing fee rate designed to ensure the servicer is adequately compensated. For example, the minimum servicing fee rate for SBA loans is generally 1%. Transferees purchasing the guaranteed portions of the loan may, however, negotiate a higher minimum servicing-fee rate in exchange for paying a lower premium on the purchase of the guaranteed portion. As discussed in section 3.4.30, cash flows for servicing fees received in the transferor's role as a servicer are not required to be divided proportionately if: — they are not subordinate to the proportionate cash flows of the participating interest; and — they are not for an amount significantly greater than the amount that represents adequate compensation. Topic 860 does not provide a threshold over which a servicing fee is significantly in excess of what would fairly compensate a substitute servicer (see Questions 3.4.110 and 3.4.120). However, because many sales of guaranteed loans (e.g. SBA loan sales) are transacted at the minimum servicing fee rate, an entity should carefully evaluate transfers that result in a servicing fee greater than the minimum servicing fee rate to determine whether the servicing fee results in the

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Provision	Impact on meeting participating interest characteristics
	transferred portion not meeting the participating interest characteristics.
Interest rates	
Different interest rates for guaranteed and unguaranteed portions	Many government-guaranteed loan programs (including SBA loans) permit the loan originator to set different interest rates for the guaranteed and unguaranteed portions of the loan. For example, to mitigate interest rate risk on the portion of the loan that will be retained, a lender may originate a loan that bears a fixed interest rate for the guaranteed portion with a variable interest rate for the unguaranteed portion. For an interest to be a participating interest, as explained in section 3.4.30, all participating interest holders are required to receive proportionate cash flow allocations from the entire financial asset. If the guaranteed portion of the loan and the unguaranteed portion of the loan bear different interest rates (either through one portion having a fixed rate and the other having a variable rate, different fixed rates, or different variable rates), the transferred portion does not meet the participating interest characteristics.
Repurchase rights (see Question 3.4.140)	
Repurchase rights	Some government-guaranteed loan sale programs may permit the transferor to repurchase the previously sold guaranteed portion of a loan. If those provide the transferor with a unilateral right (or a unilateral right upon the occurrence of a contingent event) to repurchase the transferred portion, the participating interest characteristics are not met (see Question 3.4.140). Some such programs require the consent of the participating interest holder and/or the guarantor to consent to the transferor's repurchase after the contingent event has occurred. These repurchase rights do not result in the transferor having a unilateral right to repurchase the transferred portion. As a result, transfers with these provisions may meet the participating interest characteristics. However, if the contingent event occurs and the requisite consent is provided, the transferor has a unilateral right to repurchase the transferred portion and the participating interest characteristics will no longer be met. At that time, the transferor regains control of the transferred portion; see section 7.4.

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3.5 Evaluate control criteria

3.5.10 Overview

Excerpt from ASC 860-10

> Conditions for a Sale of Financial Assets

40-4 The objective of paragraph 860-10-40-5 and related implementation guidance is to determine whether a transferor and its **consolidated affiliates** included in the financial statements being presented have surrendered control over **transferred financial assets** or third-party **beneficial interests**. This determination: …

b. Shall consider the transferor's continuing involvement in the transferred financial assets
c. Requires the use of judgment that shall consider all arrangements or agreements made contemporaneously with, or in contemplation of, the **transfer**, even if they were not entered into at the time of the transfer.

With respect to item (b), all continuing involvement by the transferor, its consolidated affiliates included in the financial statements being presented, or its **agents** shall be considered continuing involvement by the transferor. In a transfer between two subsidiaries of a common parent, the transferor-subsidiary shall not consider parent involvements with the transferred financial assets in applying paragraph 860-10-40-5.

40-5 A transfer of an entire financial asset, a group of entire financial assets, or a participating interest in an entire financial asset in which the transferor surrenders control over those financial assets shall be accounted for as a sale if and only if all of the following conditions are met:

a. Isolation of transferred financial assets. The transferred financial assets have been isolated from the transferor—put presumptively beyond the reach of the transferor and its creditors, even in bankruptcy or other receivership. Transferred financial assets are isolated in bankruptcy or other receivership only if the transferred financial assets would be beyond the reach of the powers of a bankruptcy trustee or other receiver for the transferor or any of its consolidated affiliates included in the financial statements being presented. For multiple step transfers, a **bankruptcy-remote entity** is not considered a consolidated affiliate for purposes of performing the isolation analysis. Notwithstanding the isolation analysis, each entity involved in the transfer is subject to the applicable guidance on whether it shall be consolidated (see paragraphs 860-10-40-7 through 40-14 and the guidance beginning in paragraph 860-10-55-18). A **set-off right** is not an impediment to meeting the isolation condition.
b. Transferee's rights to pledge or exchange. This condition is met if both of the following conditions are met:
    1. Each transferee (or, if the transferee is an entity whose sole purpose is to engage in **securitization** or asset-backed financing activities and that entity is constrained from pledging or exchanging the assets it

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receives, each third-party holder of its beneficial interests) has the right to pledge or exchange the assets (or beneficial interests) it received.

2. No condition does both of the following:

    i. Constrains the transferee (or third-party holder of its beneficial interests) from taking advantage of its right to pledge or exchange

    ii. Provides more than a trivial benefit to the transferor (see paragraphs 860-10-40-15 through 40-21).

If the transferor, its consolidated affiliates included in the financial statements being presented, and its agents have no continuing involvement with the transferred financial assets, the condition under paragraph 860-10-40-5(b) is met.

c. Effective control. The transferor, its consolidated affiliates included in the financial statements being presented, or its agents do not maintain effective control over the transferred financial assets or third-party beneficial interests related to those transferred assets (see paragraph 860-10-40-22A). A transferor's effective control over the transferred financial assets includes, but is not limited to, any of the following:

1. An agreement that both entitles and obligates the transferor to repurchase or redeem the transferred financial assets before their maturity (see paragraphs 860-10-40-23 through 40-25)
2. An agreement, other than through a **cleanup call** (see paragraphs 860-10-40-28 through 40-39), that provides the transferor with both of the following:

    i. The **unilateral ability** to cause the holder to return specific financial assets

    ii. A more-than-trivial benefit attributable to that ability.

3. An agreement that permits the transferee to require the transferor to repurchase the transferred financial assets at a price that is so favorable to the transferee that it is probable that the transferee will require the transferor to repurchase them (see paragraph 860-10-55-42D).

Once the unit of account is determined to be one that is eligible for sale accounting (see sections 3.3 and 3.4), the control criteria are applied to determine if sale accounting is appropriate. The control criteria relate to whether the transferor has surrendered control over the transferred asset.

Question 3.5.10

How does an entity evaluate whether the transferor has surrendered control?

Interpretive response: The broad outline of how an entity evaluates whether a transferor has surrendered control is summarized in the following decision tree. There is no requirement to evaluate these criteria in any particular sequence. [860-10-40-5]

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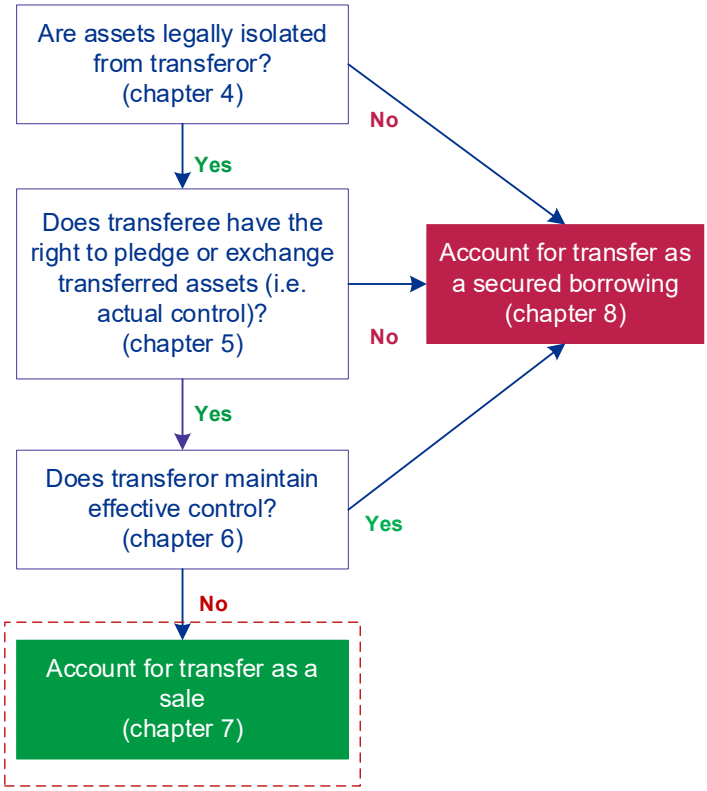

As an exception, Topic 860 requires a repurchase-to-maturity transaction to be accounted for as a secured borrowing, as if the transferor maintains effective control; see Question 6.3.20.

Determining whether a transferor has surrendered control requires judgment. Further, it generally requires considering the transferor's continuing involvement with the transferred financial assets (see section 3.5.20). [860-10-40-4]

The control criteria are evaluated throughout the life of a transferred asset. As a result, a transferred financial asset that initially qualifies for sale accounting may later require re-recognition if the sale criteria cease to be met. Conversely, a transferred financial asset that is initially accounted for as a secured borrowing may later be derecognized if the sale criteria are met at a later date. See section 7.4 for discussion about accounting for changes that result in the transferor regaining control of assets sold.

Question 3.5.20

Is a transferee required to evaluate whether the transferor has surrendered control?

Interpretive response: Yes. Topic 860's approach toward accounting for transfers of financial assets focuses on control. The objective is for each entity that is a party to a transaction to recognize only assets it controls and liabilities it

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has incurred, and to derecognize assets only when control has been surrendered.

As a result, the accounting requirements are intended to result in symmetrical accounting for the transferor and transferee; that is, transfers accounted for as sales by transferors are accounted for as purchases by transferees, and transfers accounted for as secured borrowings by transferors give rise to collateralized loans receivable for transferees.

Although uncommon, a transferor and transferee may reach different conclusions about whether the control criteria are met due to reaching different judgments when applying Topic 860.

Question 3.5.30

Does a transfer of a participating interest that does not meet the control criteria cause an earlier transfer of a participating interest to not be eligible for sale accounting?

Interpretive response: No. The control criteria are applied separately to each transferred participating interest when an entity transfers portions of financial assets that meet the participating interest characteristics to multiple third parties. As a result, a transfer of a participating interest that does not meet the control criteria does not change an entity's determination of whether a previous transfer of a separate participating interest is accounted for as a sale. [860-10-40-6A(a)]

This contrasts with the result if the second transfer does not meet the participating interest characteristics, as explained in Question 3.4.80.

Example 3.5.10

Transfer of participating interest that meets control criteria followed by transfer that does not

Bank originates a loan to Borrower on January 1, Year 1. Bank makes the following transfers of interests in the loan. Both transferred portions qualify as participating interests.

- Year 1: a 50% participating interest to Investor A. The transfer qualifies for sale accounting under the control criteria.
- Year 2: a 30% participating interest to Investor B. The transfer does not qualify for sale accounting under the control criteria because Bank maintains effective control over the participating interest.

Bank accounts for the transfer of the 50% participating interest to Investor A as a sale. That transfer continues to be accounted for as a sale after the transfer of the 30% participating interest to Investor B that does not qualify for sale accounting.

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3.5.20 Continuing involvement with transferred financial assets

Excerpt from ASC 860-10

20 Glossary

Continuing Involvement

Any involvement with the transferred financial assets that permits the transferor to receive cash flows or other benefits that arise from the transferred financial assets or that obligates the transferor to provide additional cash flows or other assets to any party related to the transfer. For related implementation guidance, see paragraph 860-10-55-79A.

• > Application of the Term *Continuing Involvement*

55-79A This implementation guidance addresses the application of the glossary term continuing involvement. All available evidence shall be considered, including, but not limited to, all of the following:

a. Explicit written arrangements
b. Communications between the transferor and the transferee or its beneficial interest holders
c. Unwritten arrangements customary in similar transfers.

55-79B Examples of continuing involvement include, but are not limited to, all of the following:

a. Servicing arrangements
b. Recourse or guarantee arrangements
c. Agreements to purchase or redeem transferred financial assets
cc. Options written or held
d. Derivative instruments that are entered into contemporaneously with, or in contemplation of, the transfer
e. Arrangements to provide financial support
f. Pledges of collateral
g. The transferor's beneficial interests in the transferred financial assets.

Determining whether a transferor has surrendered control requires judgment. Further, it requires considering a transferor's continuing involvement with the transferred financial assets – i.e. a transferor's continuing involvement is considered when evaluating the control criteria. [860-10-40-4]

However, the transferor's continuing involvement is not considered in the following situations.

— When evaluating a transfer between subsidiaries of a common parent, the parent's involvements are not considered (see Question 3.5.60). [860-10-40-4, 55-78]

— A transfer of a financial asset with a related repurchase financing are treated as separate transactions (see section 3.5.30). [860-10-40-4C]

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Question 3.5.40

What is a transferor's 'continuing involvement'?

Interpretive response: Continuing involvement is any involvement with the transferred financial assets that: [860-10-20]

- permits the transferor to receive cash flows or other benefits that arise from the transferred financial assets; or
- obligates the transferor to provide additional cash flows or other assets to any party related to the transfer.

Continuing involvement includes the following. [860-10-40-4, 55-79A]

Parties to consider	Involvement of: — the transferor itself; — the transferor's consolidated affiliates included in the financial statements being presented; and — the transferor's agents.
Arrangements to consider	All arrangements or agreements made contemporaneously with (or in contemplation of) the transfer, even if not entered into at the time of the transfer.
Evidence to consider	All evidence, including: — explicit written arrangements; — communications between the transferor and the transferee or its beneficial interest holders; and — unwritten arrangements customary in similar transfers.

Question 3.5.50

What are some examples of continuing involvement?

Interpretive response: Examples include: [860-10-55-79B]

- servicing arrangements;
- recourse or guarantee arrangements;
- agreements to purchase or redeem transferred financial assets;
- options written or held on the transferred financial assets (or beneficial interests in the transferred assets);
- derivative instruments that are entered into contemporaneously with, or in contemplation of, the transfer;
- arrangements to provide financial support;
- pledges of collateral; and
- the transferor's beneficial interests in the transferred financial assets.

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Question 3.5.60

Are a common parent's involvements considered when evaluating whether control has been surrendered in a transfer between consolidated subsidiaries?

Excerpt from ASC 860-10

• > Recognition of a Sale in Separate-Entity Financial Statements

55-78 A transfer from one subsidiary (the transferor) to another subsidiary (the transferee) of a common parent would be accounted for as a sale in each subsidiary's separate-entity financial statements if both of the following requirements are met:

a. All of the conditions in paragraph 860-10-40-5 (including the condition on isolation of the transferred financial assets) are met.
b. The transferee's assets and liabilities are not consolidated into the separate-entity financial statements of the transferor.

Paragraph 860-10-40-4 states that, in a transfer between two subsidiaries of a common parent, the transferor-subsidiary shall not consider parent involvements with the transferred financial assets in applying paragraph 860-10-40-5.

Background: Assume that Sub A and Sub B are consolidated affiliates of Parent. Sub A transfers a financial asset to Sub B. Sub A and Sub B prepare stand-alone financial statements.

Interpretive response: No, a common parent's involvement is not considered when evaluating whether control has been surrendered in the subsidiaries' stand-alone financial statements. As a result, a transfer from one subsidiary to another subsidiary of a common parent is accounted for as a sale in the subsidiaries' stand-alone financial statements if the following conditions are met: [860-10-40-4, 55-78]

— all conditions for sale accounting are met. When evaluating whether control has been surrendered, the common parent's involvements with the transferred financial assets are not considered; and

— the transferee is not consolidated by the transferor.

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Question 3.5.70

Is a transferor's equity method investee's involvement considered continuing involvement when evaluating whether control has been surrendered?

Background: Assume that a transferor owns an investment in an entity and accounts for that investment using the equity method of accounting. The investment is transferred to a third-party and the transferor's equity method investee has involvements with the transferred financial assets.

Interpretive response: No. An equity method investee is not considered to be a consolidated affiliate. Therefore, the transferor's equity method investee's involvements with transferred financial assets are not considered continuing involvement of the transferor when evaluating whether control has been surrendered. [860-10-55-79]

Question 3.5.80

Can a transfer from an investor to its equity method investee be accounted for as a sale?

Excerpt from ASC 860-10

55-79 If the transferee was an equity method investee of the transferor, only the investment and not the investee's assets and liabilities would be reported in the transferor subsidiary's separate-entity financial statements. Therefore, the transferee would not be a consolidated affiliate of the transferor, and such a transfer could isolate the transferred financial assets and be accounted for as a sale if all other conditions of paragraph 860-10-40-5 are met.

Interpretive response: Yes. A transfer from an investor to its equity method investee is accounted for as a sale if the conditions for sale accounting are met. This is in contrast to a transfer from an investor to its consolidated affiliate. [860-10-55-79]

3.5.30 Transfer of financial asset and related repurchase financing

Excerpt from ASC 860-10

> Conditions for a Sale of Financial Assets

40-4C Items (b) through (c) in paragraph 860-10-40-4 do not apply to a transfer of **financial assets** and a related **repurchase financing**. In transactions

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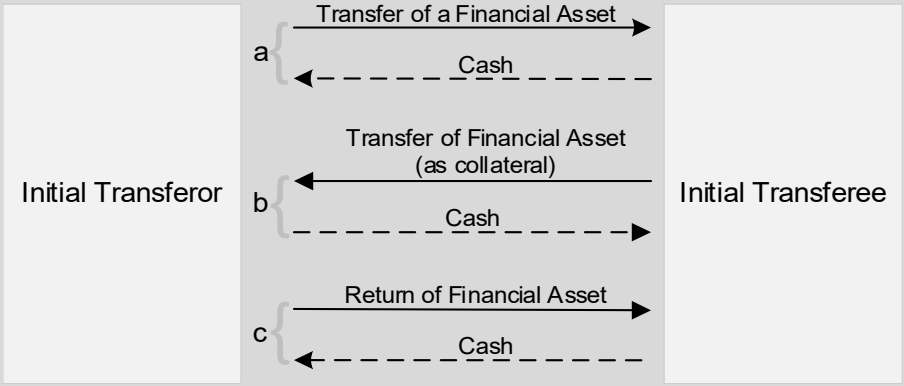
involving a contemporaneous transfer of a financial asset and a repurchase financing of that transferred financial asset with the same counterparty, a transferor and transferee shall separately account for the initial transfer of the financial asset and the related repurchase agreement. Paragraphs 860-10-55-17A through 55-17C provide implementation guidance related to repurchase financings.

• • > Repurchase Financings

55-17A The purpose of this implementation guidance is to illustrate the characteristics of a transaction comprising an initial transfer and a **repurchase financing** and to preclude an analogy to other financing transactions that are outside the scope of the guidance in paragraph 860-10-40-4C, which states that items (b) through (c) in paragraph 860-10-40-4 do not apply to a transfer of financial assets and a related repurchase financing.



55-17B The diagram in the preceding paragraph depicts the following three transfers of a financial asset that typically occur in the transactions within the scope of the guidance in paragraph 860-10-40-4C:

a. The initial transferor transfers a financial asset to the initial transferee in return for cash.
b. The initial transferee enters into a repurchase financing with the initial transferor. The initial transferee transfers the previously transferred financial asset to the initial transferor as collateral for the financing. The initial transferee receives cash from the initial transferor. As part of the repurchase financing, the initial transferee is obligated to repurchase the financial asset (or substantially the same financial asset) at a fixed price within a prescribed time period.
c. The initial transferee makes the required payment to the initial transferor under the terms of the repurchase financing. Upon receipt of payment, the initial transferor returns the transferred asset (or substantially the same asset) to the initial transferee.

55-17C Whether or not the parties agree to net settle the steps in items (a) and (b) of the preceding paragraph shall not affect whether the transactions are within the scope of the guidance for repurchase financings in paragraph 860-10-40-4C.

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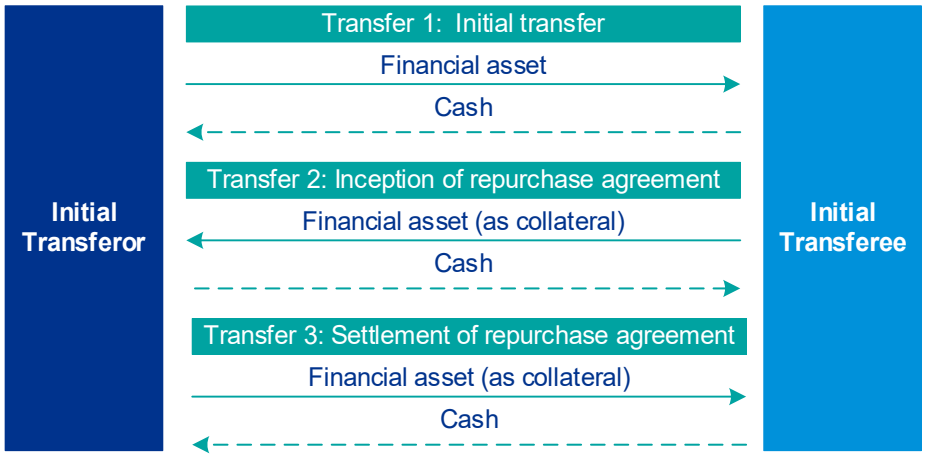
As explained in section 3.5.20, a transferor's continuing involvement in transferred financial assets is considered when evaluating whether the transferor has surrendered control. However, as an exception, an initial transfer of a financial asset and a contemporaneous related repurchase agreement are required to be accounted for separately. [860-10-40-4C]

These types of arrangements involve a financial asset being transferred three times, as shown in the following diagram. [860-10-55-17A – 55-17B]



Even if the Transfers 1 and 2 are net-settled, the initial transfer of the financial asset is accounted for separately from the related repurchase agreement. [860-10-55-17C]

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4. Sale criterion: Legal isolation

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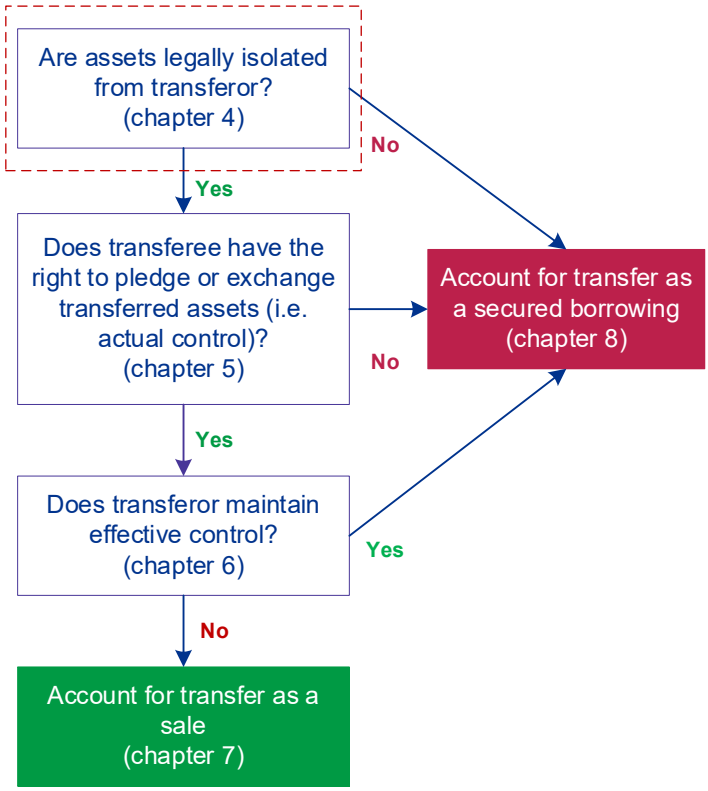
4.1 How the standard works

The broad outline of how an entity evaluates whether a transfer qualifies as a sale is summarized in the following decision tree. There is no requirement to evaluate these criteria in any particular sequence.



The first criterion that must be met to achieve sale accounting is to determine if the transferred financial assets are legally isolated from the transferor and its consolidated affiliates. This requirement is commonly referred to as the legal isolation criterion. The determination about whether the legal isolation criterion has been met is largely a legal analysis.

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4.2 General considerations

4.2.10 Overview

Excerpt from ASC 860-10

> Conditions for a Sale of Financial Assets

40-5 A transfer of an entire financial asset, a group of entire financial assets, or a participating interest in an entire financial asset in which the transferor surrenders control over those financial assets shall be accounted for as a sale if and only if all of the following conditions are met:

a. Isolation of transferred financial assets. The transferred financial assets have been isolated from the transferor—put presumptively beyond the reach of the transferor and its creditors, even in bankruptcy or other receivership. Transferred financial assets are isolated in bankruptcy or other receivership only if the transferred financial assets would be beyond the reach of the powers of a bankruptcy trustee or other receiver for the transferor or any of its consolidated affiliates included in the financial statements being presented. For multiple step transfers, a **bankruptcy-remote entity** is not considered a consolidated affiliate for purposes of performing the isolation analysis. Notwithstanding the isolation analysis, each entity involved in the transfer is subject to the applicable guidance on whether it shall be consolidated (see paragraphs 860-10-40-7 through 40-14 and the guidance beginning in paragraph 860-10-55-18). A **set-off right** is not an impediment to meeting the isolation condition. …

• > Isolation of Transferred Assets

40-7 The guidance in the following paragraphs and the related implementation guidance beginning in paragraph 860-10-55-18 applies to transfers by all entities, including institutions for which the Federal Deposit Insurance Corporation (FDIC) would be the receiver.

40-8 Derecognition of transferred financial assets is appropriate only if the available evidence provides reasonable assurance that the transferred financial assets would be beyond the reach of the powers of a bankruptcy trustee or other receiver for the transferor or any of its consolidated affiliates (that are not bankruptcy-remote entities) included in the financial statements being presented and its creditors (see paragraph 860-10-55-23(c)).

40-9 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, any of its consolidated affiliates (that are not bankruptcy-remote entities) included in the financial statements being presented, and its creditors, either by a single transaction or a series of transactions taken as a whole—depend on the facts and circumstances.

40-10 All available evidence that either supports or questions an assertion shall be considered, including whether the contract or circumstances permit the transferor to revoke the transfer. It also may include consideration of the legal

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consequences of the transfer in the jurisdiction in which bankruptcy or other receivership would take place, including all of the following:

a. Whether a transfer of financial assets would likely be deemed a true sale at law (see paragraph 860-10-55-18A) or otherwise isolated (see paragraph 860-10-55-18C)
b. Whether the transferor is **affiliated** with the transferee
c. Other factors pertinent under applicable law.

A transferor must surrender legal control of a financial asset before it can derecognize the asset. The requirement to surrender legal control is addressed through the legal isolation criterion. [860-10-40-5(a)]

Under this criterion, there must be reasonable assurance that the transferred financial assets are legally isolated before the transferor can derecognize them. Financial assets are legally isolated when they are beyond the reach of the transferor, any of its consolidated affiliates included in the financial statements being presented, the transferor's creditors, or the powers of a bankruptcy (or other receivership) trustee. [860-10-40-8]

Question 4.2.10

Why did the Board develop the legal isolation criterion?

Interpretive response: The legal isolation criterion was developed in large part with reference to securitization transactions. Investors in securitization transactions could be exposed to significant risk in the event of bankruptcy or other receivership of the transferor, its consolidated affiliates, or the securitization entity because payments due to them would be delayed – and they may be forced to accept a pro rata settlement – if receivers can reclaim securitized assets. [FAS 125.BC118, FAS 140.BC152]

As a result, credit rating agencies and investors commonly demand transaction structures that minimize those possibilities and sometimes seek assurances from legal specialists about whether entities can be forced into receivership, what the powers of a receiver might be, and whether the transaction structure would withstand receivers' attempts to reach the securitized assets in ways that would harm investors. [FAS 125.BC118, FAS 140.BC152]

In many securitizations involving the issuance of publicly issued securities, a legal opinion from an external legal specialist is required by participants in the transaction, such as underwriters and rating agencies. See section 4.3 regarding securitization transactions.

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Question 4.2.20

Is the likelihood of bankruptcy considered when evaluating the legal isolation criterion?

Excerpt from ASC 860-10

• > Isolation of Transferred Assets

40-11 The requirement of paragraph 860-10-40-5(a) that transferred financial assets be isolated focuses on whether transferred financial assets would be isolated from the transferor in the event of bankruptcy or other receivership regardless of how remote or probable bankruptcy or other receivership is at the date of transfer. That is, the requirement would not be satisfied simply because the likelihood of bankruptcy of the transferor is determined to be remote.

Interpretive response: No. The likelihood of the transferor's bankruptcy is not considered when evaluating the legal isolation criterion, even if bankruptcy is determined to be remote. Instead, this criterion focuses on whether the transferred assets would be isolated from the transferor in the event of bankruptcy or other receivership, regardless of how remote or probable bankruptcy or other receivership is at the date of transfer. [860-10-40-11]

Question 4.2.30

What are some factors that are relevant when evaluating the legal isolation criterion?

Interpretive response: The nature and extent of evidence required to support a transferor's assertion of legal isolation depends on the facts and circumstances. Whether a transferred financial asset is legally isolated requires an entity to consider all available evidence that either supports or contradicts a legal isolation assertion. [[860-10-40-9 – 40-10]

This involves making judgments about the following factors: [860-10-40–10]

- whether the contract or circumstances permit the transferor to revoke the transfer;
- the legal consequences of the transfer in the jurisdiction in which bankruptcy or other receivership would take place, including:
  - whether the transfer would likely be deemed a true sale at law or otherwise isolated;
  - whether the transferor is affiliated with the transferee; and
  - other factors pertinent under applicable law.

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Question 4.2.40

Do set-off rights preclude the legal isolation criterion from being met?

Background: A set-off right is a common law right of a party that is both a debtor and a creditor to the same counterparty to reduce its obligation to that counterparty if that counterparty fails to pay its obligation. [FAS 166.BC.A39]

Interpretive response: No. Set-off rights are not an impediment to achieving legal isolation. In reaching this conclusion, the Board considered that the existence of set-off rights is not considered by a court when assessing whether a transaction would be deemed to be a true sale. In the event of the bankruptcy or receivership of either the obligor of the financial asset or the transferor of the financial asset, both parties could retain the ability to exercise a set-off right involving a financial asset that had been transferred. In the event of the bankruptcy of the transferor, the transferee may have only an unsecured claim against the transferor for its share of the amount set off. [860-10-40-5(a), FAS 166.BC.A39]

The Board considered whether set-off rights related to transferred financial asset should be severed to meet the legal isolation criterion. However, the Board was informed by legal specialists that it may not be possible to sever these set-off rights. For example, certain consumer protection rules prevent consumers from waiving their ability to exercise set-off rights against a seller of goods financed under a contract with the seller. In other cases, it may be impractical for a transferor to sever set-off rights related to transferred financial assets because doing so might require the involvement of the obligor on the underlying original financial assets. [FAS 166.BC.A40]

The Board was also advised by legal specialists that a court likely would require a transferor that benefited from an exercise of set-off rights on a financial asset to pass through a proportionate share of that benefit to any transferee of a portion of that financial asset. Finally, the price for a transferred financial asset reflects the impact of set-off risks as it does other dilutive risks, such as warranties and returns. [FAS 166.BC.A40]

Example 4.2.10

Consideration of set-off rights

Customer has a loan of $50,000 from Bank and also maintains a deposit account with Bank with a balance of $60,000.

If Customer files for bankruptcy, Bank has the right to reduce Customer's deposit account by up to $50,000 to offset any loss Bank might incur from Customer's failure to repay the loan. In the event of receivership of Bank, Customer has the right to reduce the amount due to Bank under the loan obligation by up to $50,000 to offset any loss that it might incur from Bank's failure to redeem the amount on deposit.

If Bank transfers Customer's loan receivable balance to a third party, the set-off rights of Customer and Bank are typically unaffected by the transfer. As a

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result, if Bank is in receivership, the third-party transferee may have only an unsecured claim against Bank for its share of the amount (if any) set off by Customer.

A set-off right in and of itself does not preclude Bank from achieving legal isolation for the transfer of Customer's loan receivable balance to a third party.

Question 4.2.50

Does a provision that allows the transferor to require the return of a transferred financial asset cause the legal isolation criterion to not be met?

Excerpt from ASC 860-10

• > Isolation of Transferred Assets

40-12 A transferor's power to require the return of the transferred financial assets arising solely from a contract with the transferee, for example, a call option or removal-of-accounts provision, would not necessarily preclude a conclusion that transferred financial assets have been isolated from the transferor. However, such a power might preclude sale treatment if through it the transferor maintains effective control over the transferred financial assets. Some common financial transactions, for example, typical **repurchase agreements** and securities lending transactions, may isolate transferred financial assets from the transferor, although they may not meet the other conditions for surrender of control (see paragraph 860-10-40-5).

Interpretive response: No, not necessarily. A transferor's power to require the return of the transferred financial assets arising solely from a contract with the transferee (e.g. a call option or removal-of-accounts provision) does not necessarily prevent the transferor from concluding it has surrendered legal control over the transferred financial asset(s). Those provisions would be considered continuing involvement and would have to be analyzed by a legal specialist together with other aspects of the transfer to determine if the legal isolation criterion has been met.

Even if provisions like call options do not prevent a transfer from meeting the legal isolation criterion, they may cause the transfer to fail one of the other two derecognition criteria. See chapters 5 and 6. [860-10-40-12]

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Question 4.2.60

If the only form of continuing involvement is representations and warranties, is a legal opinion necessary to support the legal isolation criterion?

Excerpt from ASC 860-10

20 Glossary

Standard Representations and Warranties

Representations and warranties that assert the financial asset being transferred is what it is purported to be at the transfer date.

Background: Standard representations and warranties are representations and warranties that assert the financial asset being transferred is what it is purported to be at the transfer date. [860-10 Glossary]

Interpretive response: It depends. We believe a legal opinion is not necessary to support that the legal isolation criterion has been met if the transfer is a routine transfer of financial assets and the only form of continuing involvement by the transferor, its affiliates and agents is standard representations and warranties. However, if the representations and warranties extend beyond the scope of asserting the financial asset being transferred is what it is purported to be at the transfer date, we believe those provisions should be evaluated to determine whether they constitute continuing involvement, and consequently whether a legal isolation opinion is necessary.

4.2.20 Using legal opinions

Because the legal isolation criterion in large part requires a legal analysis, it is common to obtain a legal opinion to support that the legal isolation criterion is met.

Question 4.2.70

When is a legal opinion necessary to support the legal isolation criterion?

Excerpt from ASC 860-10

• > Isolation of Transferred Assets

40-14 Paragraphs 860-10-55-18 through 55-23 clarify the requirements for transfers by entities subject to the U.S. Bankruptcy Code to meet the condition

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in paragraph 860-10-40-5(a) that the transferred financial assets have been put presumptively beyond the reach of the transferor and its creditors, even in bankruptcy. Paragraphs 860-10-55-24 through 55-25 provide related guidance for entities not subject to the U.S. Bankruptcy Code. The discussion in paragraphs 860-10-55-18 through 55-25 relates only to the isolation condition in paragraph 860-10-40-5(a). The conditions in paragraph 860-10-40-5(b) through (c) also shall be considered to determine whether a transferor has surrendered control over the transferred financial assets.

• > Isolation of Transferred Financial Assets

55-18B A legal opinion may not be required if a transferor has a reasonable basis to conclude that the appropriate legal opinion(s) would be given if requested. For example, the transferor might reach a conclusion without consulting an attorney if either of the following conditions exists:

a. The transfer is a routine transfer of financial assets that does not result in any continuing involvement by the transferor.
b. The transferor had experience with other transfers with similar facts and circumstances under the same applicable laws and regulations.

Interpretive response: We believe a legal opinion should normally be obtained to support that the legal isolation criterion has been met when: [860-10-55-18B]

— the transaction involves complex legal structures – e.g. transactions involving SPEs, multiple transferees, recourse provisions and/or other forms of credit enhancement, guarantees and/or derivatives; or

— the transferor has any continuing involvement with the transferred assets – e.g. servicing responsibilities, participation in future cash flows, recourse obligations.

A legal opinion may not be necessary if a transferor has a reasonable basis to conclude that the appropriate legal opinion(s) would be given if requested. This may be the case if the transferor has experience with other transfers with similar facts and circumstances (e.g. same asset type and key transaction terms) under the same applicable laws and regulations. For example, if an entity obtains a legal opinion on the initial transfer of receivables under a revolving structure, it may determine a legal opinion is not necessary for all transfers under the same program if the key transaction terms, laws and relevant case law have not changed. [860-10-55-18B]

Question 4.2.80

What is the impact of not obtaining a legal isolation opinion?

Interpretive response: If the circumstances described in Question 4.2.70 indicate a legal opinion should be obtained but such opinion is not obtained by the entity, it cannot assume the transfer fails to meet the legal isolation criterion – i.e. that the financial asset should remain on the balance sheet and not be derecognized. Until a legal isolation opinion is obtained, an entity generally would not have a basis to conclude on sale or secured borrowing accounting.

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Further, non-receipt of a legal isolation opinion may be a scope limitation for the independent auditor.

Question 4.2.90

What types of legal isolation opinions are typically necessary?

Excerpt from ASC 860-10

• > Isolation of Transferred Financial Assets

55-18 This implementation guidance addresses the isolation condition in paragraph 860-10-40-5(a) and applies to transfers of all entities, including institutions for which the FDIC would be the receiver.

55-18A In the context of U.S. bankruptcy laws, a true sale opinion from an attorney is often required to support a conclusion that transferred financial assets are isolated from the transferor, any of its consolidated affiliates included in the financial statements being presented, and its creditors. In addition, a nonconsolidation opinion is often required if the transfer is to an affiliated entity. In the context of U.S. bankruptcy laws:

a. A true sale opinion is an attorney's conclusion that the transferred financial assets have been sold and are beyond the reach of the transferor's creditors and that a court would conclude that the transferred financial assets would not be included in the transferor's bankruptcy estate.
b. A nonconsolidation opinion is an attorney's conclusion that a court would recognize that an entity holding the transferred financial assets exists separately from the transferor. Additionally, a nonconsolidation opinion is an attorney's conclusion that a court would not order the substantive consolidation of the assets and liabilities of the entity holding the transferred financial assets and the assets and liabilities of the transferor (and its consolidated affiliates included in the financial statements being presented) in the event of the transferor's bankruptcy or receivership.

Interpretive response: In the context of US bankruptcy laws, there are two types of legal opinions an entity may need to obtain to support that the legal isolation criterion has been met. [860-10-55-18A]

True sale opinion	A legal specialist's conclusion that the transferred financial assets have been sold and are beyond the reach of the transferor's creditors. Such an opinion addresses whether a court would conclude that the transferred financial assets would not be included in the transferor's bankruptcy estate.
Substantive nonconsolidation opinion	A legal specialist's conclusion that a court would recognize that an entity holding the transferred financial assets exists separately from the transferor. It is typically necessary when the transferor transfers financial assets to an affiliate. See Question 4.4.50 for the definition of an affiliate. Such an

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	opinion addresses whether a court would not order the substantive consolidation of the assets and liabilities of the transferee in the transferor's bankruptcy estate.

A true sale opinion provides support that the transferred financial assets have been legally isolated from the transferor. However, it needs to be accompanied by a substantive nonconsolidation opinion when the transferee is an affiliate of the transferor. The substantive nonconsolidation opinion is necessary in this instance because the transferred financial assets potentially could be substantively consolidated into the transferor's bankruptcy estate, thereby making them not legally isolated from the transferor. [AU-C 9620.13]

Question 4.2.100

Are legal isolation opinions necessary when financial assets are transferred between subsidiaries of a common parent?

Excerpt from ASC 860-10

> Conditions for a Sale of Financial Assets

40-4 The objective of paragraph 860-10-40-5 and related implementation guidance is to determine whether a transferor and its **consolidated affiliates** included in the financial statements being presented have surrendered control over **transferred financial assets** or third-party **beneficial interests**. This determination: …

b. Shall consider the transferor's continuing involvement in the transferred financial assets …

With respect to item (b), all continuing involvement by the transferor, its consolidated affiliates included in the financial statements being presented, or its **agents** shall be considered continuing involvement by the transferor. In a transfer between two subsidiaries of a common parent, the transferor-subsidiary shall not consider parent involvements with the transferred financial assets in applying paragraph 860-10-40-5.

Interpretive response: Yes. A transfer of financial assets from one subsidiary (the transferor) to another subsidiary (the transferee) of a common parent is accounted for as a sale in each subsidiary's stand-alone financial statements if the sale criteria are met, including the legal isolation criterion. Similar to transfers between third parties, a legal opinion may be necessary to evidence that the legal isolation criterion has been met (see Question 4.2.70). However, the transferor does not consider the parent's involvements with the transferred financial assets when evaluating the sale criteria. [860-10-40-4]

If the sale criteria are met for subsidiary stand-alone reporting, the effect of the sale accounting applied in the subsidiary's stand-alone financial statements is eliminated in the consolidated financial statements. [860-10-40-5]

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Example 4.2.20
Transfers between subsidiaries of a common parent

Parent has two consolidated operating subsidiaries, Sub 1 and Sub 2. Sub 1 transfers financial assets to Sub 2, and continues to service the transferred assets. Sub 2 immediately transfers the financial assets to an unconsolidated SPE that issues beneficial interests to third-party investors.

Sub 2 receives a subordinated beneficial interest in the transferred financial assets and provides a guarantee of the assets' performance to the SPE.

Parent and Sub 1 both prepare US GAAP financial statements.

Analysis for Parent's consolidated financial statements

For the legal isolation criterion to be met, the transferred financial assets are required to be beyond the reach of the powers of a bankruptcy trustee or other receiver for the transferor or any of its consolidated affiliates included in the financial statements being presented.

The continuing involvement of both Sub 1 and Sub 2 is relevant to Parent's analysis. Therefore, Parent is required to consider both Sub 1's servicing of the transferred financial assets and Sub 2's beneficial interest in and guarantee of the assets performance in determining whether it meets the legal isolation criterion.

Parent's legal isolation opinion takes these factors into account when it addresses whether the financial assets transferred from Sub 2 (legal transferor) to the SPE are beyond the reach of the powers of the bankruptcy trustee or other receiver for Parent.

Analysis for Sub 1's financial statements

For Sub 1's stand-alone financial statements, the legal isolation opinion addresses whether the financial assets transferred from Sub 1 to Sub 2 are beyond the reach of the powers of the bankruptcy trustee or other receiver for Sub 1. The opinion needs to consider only Sub 1's servicing of the transferred financial assets; it does not consider Parent's continuing involvement with the financial assets through Sub 2.

4.3 Legal isolation and securitization transactions

Excerpt from ASC 860-10

20 Glossary

Securitization

The process by which financial assets are transformed into securities.

• > Securitizations

05-7 An originator of a typical securitization (the transferor) transfers a portfolio of financial assets to a securitization entity, commonly a trust. Financial assets

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such as mortgage loans, automobile loans, trade receivables, credit card receivables, and other revolving charge accounts are financial 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.

05-8 Beneficial interests in the securitization entity are sold to investors and the proceeds are used to pay the transferor for the transferred financial assets. 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 entity.

Topic 860 does not just apply to single-step transfers of financial assets between two parties; it also applies to multiple-step transfers that are often used in securitization transactions.

Securitization is the process by which financial assets are transformed into securities. Typically, the originator of a securitization (the transferor) transfers a portfolio of financial assets to a securitization entity, commonly a trust. Beneficial interests in the securitization entity, which are rights to receive all or portions of specified cash inflows of the securitization entity, are sold to investors and the proceeds are used to pay the transferor for the transferred financial assets. [860-10-05-7 – 05-8, 860-10-Glossary]

Question 4.3.10

How are securitization transactions typically structured?

Excerpt from ASC 860-10

• > Isolation of Transferred Assets

40-13 Whether securitizations isolate transferred financial assets may depend on such factors as whether the securitization is accomplished in one-step or multiple-step transfers. That is, the condition can be satisfied either by a single transaction or by a series of transactions considered as a whole. A securitization carried out in one transfer or a series of transfers may or may not isolate the transferred financial assets beyond the reach of the transferor, its consolidated affiliates (that are not bankruptcy-remote entities) included in the financial statements being presented, 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, interest rate, and other risks,

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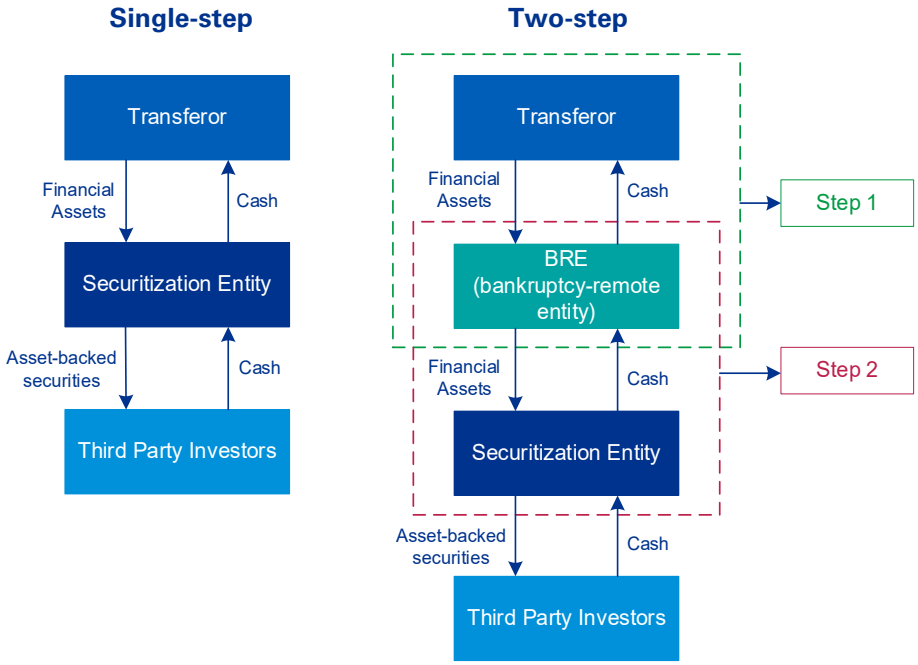
the availability of other financial assets, and the powers of bankruptcy courts or other receivers.

Interpretive response: Following are two common structures for securitization transactions: single-step and two-step securitization structures.



The BRE is commonly consolidated by the transferor for accounting purposes whereas in our experience the securitization entity is often not consolidated.

Whether legal isolation is achieved for a securitization depends on the structure of the transaction taken as a whole, considering factors such as the following: [860-10-40-13]

- type and extent of further involvement of the transferor and its consolidated affiliates in arrangements to protect investors from credit, interest rate and other risks;
- availability of other financial assets; and
- powers of bankruptcy courts or other receivers.

See Question 4.3.20 for how single-step structures are analyzed under these principles and Question 4.3.30 for how two-step structures are analyzed.

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Question 4.3.20

How are single-step securitization transactions analyzed?

Excerpt from ASC 860-10

• > Isolation of Transferred Financial Assets

55-19 In certain securitizations, a corporation that, if it failed, would be subject to the U.S. Bankruptcy Code transfers financial assets to a securitization entity in exchange for cash. The entity 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 financial assets. 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, its consolidated affiliates (that are not bankruptcy-remote entities) included in the financial statements being presented, and its creditors, even in bankruptcy or other receivership.

55-20 In other securitizations, a similar corporation transfers financial assets to a securitization entity in exchange for cash and beneficial interests in the transferred financial assets. That entity raises the cash by issuing to investors commercial paper that gives them a senior beneficial interest in cash received from the financial assets. The beneficial interests obtained by the transferring corporation represent a junior interest to be reduced by any credit losses on the financial assets in the entity. The senior beneficial interests (commercial paper) are highly rated by credit rating agencies only if both the credit enhancement from the junior interest is sufficient and the transferor is highly rated.

55-21 Depending on facts and circumstances, those single-step securitizations often would be judged in the United States as not having isolated the financial 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 financial assets beyond the reach of the transferor, its consolidated affiliates (that are not bankruptcy-remote entities) included in the financial statements being presented, and its creditors in U.S. bankruptcy (see paragraph 860-10-55-46). If the transferor fell into bankruptcy and the transfer was found not to be a true sale at law, investors in the transferred financial 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.

Interpretive response: Single-step securitizations can take different forms. For example, one in which the transferor receives only cash for the transferred financial assets and another in which it receives both cash and a beneficial interest in the transferred financial assets.

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Only cash received

In this form of a single-step securitization, an entity transfers financial assets to the securitization entity and the securitization entity pays the transferor only the cash that it raises by issuing beneficial interests to third-party investors. The securitization entity passes through all cash subsequently received from the transferred financial assets to the third-party investors and the transferor has no further involvement with the securitization entity or the transferred assets.

These securitizations generally have isolated the transferred assets because – in the absence of any continuing involvement – there is reasonable assurance that the transfer would place the financial assets beyond the reach of the transferor, its consolidated affiliates included in the financial statements being presented, and its creditors in the event of bankruptcy of the transferor. [860-10-55-19]

Both cash and a beneficial interest received

In this form of a single-step securitization, an entity transfers financial assets to a securitization entity in exchange for both cash and beneficial interests in the transferred financial assets. To raise the cash, the securitization entity issues commercial paper to investors representing a senior interest in the cash received from the financial assets. The entity (transferor) receives as proceeds beneficial interests representing a junior interest that is reduced by credit losses on the financial assets; therefore, it has continuing involvement with the transferred financial assets. [860-10-55-20]

Depending on the facts and circumstances, under US Bankruptcy Code this type of single-step securitization often does not result in the transferred assets meeting the legal isolation criterion. This is because the nature of the continuing involvement might make it difficult to obtain reasonable assurance that the transfer would place the financial assets beyond the reach of the transferor, its consolidated affiliates included in the financial statements being presented, and its creditors in the event of bankruptcy of the transferor. [860-10-55-21]

Question 4.3.30

How are two-step securitization transactions analyzed?

Excerpt from ASC 860-10

20 Glossary

Bankruptcy-Remote Entity

An entity that is designed to make remote the possibility that it would enter bankruptcy or other receivership.

55-22 Other securitizations use multiple transfers intended to isolate transferred financial assets beyond the reach of the transferor, its consolidated affiliates (that are not bankruptcy-remote entities) included in the financial

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statements being presented, and its creditors, even in bankruptcy. The series of transactions in a typical two-tier structure taken as a whole may satisfy the isolation test because the design of the structure achieves isolation. The two-step securitizations, taken as a whole, generally would be judged under present U.S. law as having isolated the financial assets beyond the reach of the transferor, its consolidated affiliates (that are not bankruptcy-remote entities) included in the financial statements being presented, and its creditors, even in bankruptcy or other receivership. However, each entity involved in a transfer should be evaluated under the consolidation guidance in Topic 810. Accordingly, a transferor could be required to consolidate the trust or other legal vehicle used in the second step of the securitization, notwithstanding the isolation analysis of the transfer.

55-23 For example, two-step structures involve the following:

a. First, the corporation transfers a group of financial assets to a special-purpose corporation that, although wholly owned, is so designed that the possibility is remote that the transferor, its consolidated affiliates (that are not bankruptcy-remote entities) included in the financial statements being presented, or its creditors could reclaim the financial assets. 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 transferred financial assets are likely to be judged beyond the reach of the transferor, its consolidated affiliates (that are not bankruptcy-remote entities) included in the financial statements being presented, or the transferor's creditors even in bankruptcy or other receivership.
b. Second, the special-purpose corporation transfers a group of financial 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 transferor's junior beneficial interest 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 financial 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 financial assets because it has no other assets to substitute for the transferred financial assets.

Interpretive response: A two-step securitization transaction is intended to meet the legal isolation criterion. The series of transactions in a typical two-tier structure, taken as a whole, satisfies the legal isolation criterion if the design of the structure isolates the transferred assets beyond the reach of the transferor and its creditors, even in bankruptcy.

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A typical two-step structure includes the following. [860-10-55-22 – 55-23]

- **Transfer to first entity (bankruptcy-remote entity or BRE).** First, an entity (transferor) transfers financial assets to a wholly owned bankruptcy-remote entity (BRE). This step is designed to be a true sale at law and legally isolate the financial assets from the transferor based on the following.
  - The BRE is designed to make remote the possibility that the transferor, its consolidated affiliates included in the financial statements being presented, or its creditors could reclaim the financial assets.
  - Generally, the BRE's 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.
  - The BRE is dedicated to a single purpose, which is intended to make it extremely unlikely – even if it somehow entered bankruptcy – that a receiver under the US Bankruptcy Code could reclaim the transferred assets because it has no other assets to substitute for them.
  - The transferor does not provide excessive credit or yield protection to the BRE.
- **Transfer to second entity (e.g. trust).** Second, the BRE transfers the assets to a trust or other legal entity (such as a securitization entity). The trust issues senior beneficial interests to third-party investors and junior beneficial interest to the transferor. To obtain a higher credit rating for the third-party investors, credit or yield protection is provided by the junior beneficial interest (held by the transferor) or by other means. As a result of the credit or yield protection, the second transfer might not be judged to be a true sale at law and therefore the transferred assets could theoretically be reached by a bankruptcy trustee for the BRE. However, the BRE 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.

If a BRE is used, it is not considered a consolidated affiliate for purposes of determining if the legal isolation criterion is met, even though it may be consolidated for accounting purposes. A BRE is designed to make remote the possibility that it would enter bankruptcy or other receivership. [860-10-40-5, 860-10 Glossary]

In practice, the series of transactions in a typical two-step structure, taken as a whole, generally would be judged to meet the legal isolation criterion when the following are met:

- true sale opinion and substantive nonconsolidation opinions are obtained for the transfer from the transferor to the BRE (a substantive nonconsolidation is necessary if the BRE is deemed an affiliate of the transferor);
- a substantive nonconsolidation opinion is obtained for the transfer from the BRE to the trust if the trust is deemed an affiliate of the BRE; and
- the trust is not consolidated by the transferor or its consolidated affiliates under the consolidation guidance in Topic 810.

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See Question 4.4.40 regarding the content of a substantive nonconsolidation option, and Question 4.4.50 for the definition of an affiliate.

Question 4.3.40

Are there additional considerations for analyzing legal isolation when an SPE incurs liabilities or provides a guarantee?

Background: In a typical two-step securitization (see Question 9.2.10), a transferor transfers financial assets to an SPE (a bankruptcy-remote entity), which then transfers the financial assets to a securitization trust. The SPE may provide a guarantee to the securitization trust or issue liabilities.

Interpretive response: If an SPE incurs liabilities or provides a guarantee to the securitization trust, we would generally expect to see non-petition language in the organizational documents and/or transaction agreements between the SPE and securitization trust. Nonpetition language prohibits the securitization trust from initiating bankruptcy proceedings against the SPE. Without such language, it may be challenging to determine that the SPE is bankruptcy remote which is often an assumption of the legal isolation opinion.

4.4 Evaluating legal opinions

4.4.10 General considerations

Although Topic 860 may require a legal isolation opinion, there is nothing specific in US GAAP to assist entities in evaluating the appropriateness and sufficiency of that opinion.

Question 4.4.10

Is there any guidance on how to evaluate a legal isolation opinion?

Interpretive response: Yes. In our experience, it is common practice for entities to use the following audit guidance when evaluating a legal isolation opinion:

- US auditing standards AICPA AU-C 9620, Using the Work of an Auditor's Specialist: Auditing Interpretations of Section 620; and
- PCAOB Auditing Interpretation 11, Using the Work of a Specialist: Auditing Interpretations (as Amended for FYE 12/15/2020 and After)

The above provide guidance to assist auditors in assessing the appropriateness and sufficiency of legal opinions obtained by management to support whether the legal isolation criterion has been met.

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Question 4.4.20

Can a legal opinion from an internal legal specialist be obtained to support the legal isolation criterion?

Interpretive response: It depends. We believe the use of a legal opinion from an internal legal specialist would provide persuasive evidence to support the legal isolation criterion when the internal legal specialist possesses the requisite legal expertise. Such expertise includes substantial experience with the type of transaction being addressed and with the law(s) that would be applicable to a bankruptcy or receivership in the relevant jurisdiction. However, in our experience, most entities do not have legal specialists on staff with the requisite legal experience. Therefore, practice generally is to engage an external legal specialist to render legal opinions.

Question 4.4.30

What jurisdictions should a legal opinion address?

Interpretive response: We believe the legal opinion should address the jurisdictions that govern the transfer, which ordinarily are identified in the legal documents. In most cases, the legal opinion will be limited to the laws of specified state jurisdictions, as well as to the US Bankruptcy Code. For example, if the purchase and sale agreement states that the transfer is subject to the laws of New York and New Jersey, the legal opinion should be written, at a minimum, to include those two jurisdictions and the federal bankruptcy laws, as well as any additional jurisdictions identified by the legal specialist.

Entities should also be alert to language that explicitly excludes certain jurisdictions. For example, the legal specialist may include an assumption in the opinion letter that a bankruptcy court would not be bound to follow precedent established in a certain jurisdiction. In such cases, we believe entities should investigate the reasons that the legal specialist has included the assumption and assess whether that assumption constitutes an implicit qualification of the opinion.

Question 4.4.40

When should the legal opinion include an additional paragraph addressing the doctrine of substantive consolidation?

Background: A securitization transaction may involve affiliated parties, including but not limited to the transferee in the first step of a two-step structure as described in Question 4.3.30. In a bankruptcy proceeding involving the transferor, the transferee may be subject to the legal doctrine of substantive consolidation with the transferor. In general, this means that the

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transferee's assets may be available to the bankruptcy court to settle the obligations of the transferor.

Interpretive response: The entity's legal isolation opinion includes an additional paragraph addressing the doctrine of substantive consolidation when the entity to which the assets are transferred is an affiliate of the transferor and may also apply in other situations as noted by the legal specialist. [AU-C 9620.13]

The following excerpt is an example of an additional paragraph addressing the doctrine of substantive nonconsolidation. [AU-C 9620.13]

> Based upon the assumptions of fact and the discussion set forth previously, and on a reasoned analysis of analogous case law, we are of the opinion that in a properly presented and argued case, as a legal matter, in a proceeding under the U.S. Bankruptcy Code,12 in which the Seller is a Debtor, a court would not grant an order consolidating the assets and liabilities of the Purchaser with those of the Seller in a case involving the insolvency of the Seller under the doctrine of substantive consolidation.

Question 4.4.50

Does an entity need to obtain a substantive nonconsolidation opinion when the transferee is an affiliate?

Interpretive response: It depends. We believe a substantive nonconsolidation opinion is needed when the transferee is a legal affiliate over which a bankruptcy court could order the affiliate's assets and liabilities to be consolidated with those of the transferor in the transferor's bankruptcy estate.

Question 4.4.60

How should assumptions included in a legal opinion be addressed?

Interpretive response: Legal opinions generally include background information on the transaction, analysis of relevant cases, and assumptions on which the opinion is predicated. The legal specialist may assume certain facts without investigation, and the legal opinion will be predicated on the accuracy of the assumption. We believe an entity should evaluate the nature, substance and accuracy of the assumptions.

If the legal opinion is based on incorrect facts and assumptions or omits facts and assumptions, it would not provide persuasive evidence that the transferred assets have been put presumptively beyond the reach of the transferor or any of its consolidated affiliates (included in the financial statements being presented) and its creditors, even in bankruptcy or other receivership.

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Example 4.4.10
Assumptions in legal opinion

Bank ABC entered into an agreement to sell loans to Bank DEF. ABC will continue to service the loans after they are transferred. The jurisdiction in which ABC operates requires by law that ABC notify each obligor that the loans have been transferred.

The legal opinion contains an assumption that the obligors have been (or will be) appropriately notified. Because the legal opinion is based on an assumption that the obligors have been notified of the transfer, ABC should verify that notification has occurred. If notification has not occurred, the legal opinion does not provide persuasive evidence about legal isolation, because an assumption on which the legal opinion relies is not accurate.

Question 4.4.70
What level of assurance in a legal isolation opinion provides persuasive evidence that the assets have been legally isolated?

Interpretive response: A legal opinion should provide a *would* level of assurance to provide persuasive evidence that the assets have been legally isolated from the transferor. [AU-C 9620.13]

AU-C 9620.13 provides an example of the conclusion in a legal opinion for an entity subject to the US Bankruptcy Code that provides persuasive evidence to support management's assertion that the transferred financial assets have been put presumptively beyond the reach of the transferor and its creditors, even in bankruptcy or other receivership:

> We believe (or it is our opinion) that in a properly presented and argued case, as a legal matter, in the event the Seller were to become a Debtor, the transfer of the Financial Assets from the Seller to the Purchaser would be considered to be a sale (or a true sale) of the Financial Assets from the Seller to the Purchaser and not a loan and, accordingly, the Financial Assets and the proceeds thereof transferred to the Purchaser by the Seller in accordance with the Purchase Agreement would not be deemed to be property of the Seller's estate for purposes of [the relevant sections] of the U.S. Bankruptcy Code.

Question 4.4.80
Can a legal isolation opinion be based on an assumption that the transfer *will be* accounted for as a sale?

Background. In some cases, the legal opinion may include an assumption that the transfer of assets *will be* treated as a sale for accounting purposes. It is

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sometimes asserted that this assumption is included to corroborate the parties' assertions made in the transaction documents that they intend for the transaction to be a sale.

Interpretive response: No. The purpose of the legal opinion is to support the accounting conclusion that the transfer should be accounted for as a sale. Therefore, we believe an opinion that is predicated on that conclusion contains circular logic and does not provide persuasive evidence. However, a statement that the parties *intend* to or *expect* to treat the transfer as a sale for accounting purposes subject to meeting the applicable accounting requirements does provide persuasive audit evidence.

Question 4.4.90

What level of assurance in a legal isolation opinion does not provide persuasive evidence that the assets have been legally isolated from a transferor?

Interpretive response: Legal opinions that express a lower level of assurance than a *would* level, such as *should* or *reasonably possible*, do not provide persuasive evidence that a transfer of financial assets has been legally isolated from the transferor. [AU-C 9620.15]

Examples of language that do not provide persuasive evidence to support the entity's assertion that the transferred assets have been put presumptively beyond the reach of the transferor and its creditors, even in bankruptcy or other receivership, include: [AU-C 9620.15]

- "We are unable to express an opinion..."
- "It is our opinion, based upon limited facts..."
- "We are of the view..." or "it appears..."
- "There is a reasonable basis to conclude that..."
- "In our opinion, the transfer would *either* be a sale or a grant of a perfected security interest..."
- "In our opinion, there is a reasonable possibility..."
- "In our opinion, the transfer *should* be considered a sale..."
- "It is our opinion that the company will be able to assert meritorious arguments..."
- "In our opinion, it is more likely than not ..."
- "In our opinion, the transfer would *presumptively* be..."
- "In our opinion, it is probable that..."

Question 4.4.100

Does a legal opinion need to refer to a specific transaction?

Interpretive response: Yes. A legal opinion should refer to a specific transaction that has taken place in the past. Conclusions about hypothetical transactions, a single transaction expected to take place in the near future, or a

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series of transactions expected to take in place in the future may not contemplate all of the facts and circumstances or the provisions in the agreements of the transaction and therefore would not provide persuasive evidence that the assets have been legally isolated from the transferor. [AU-C 9620.15]

For example, a transferor may enter into an agreement to transfer trade receivables on a revolving basis – i.e. receivables are transferred over a period of time. The legal opinion should refer to a specific transfer of receivables that has taken place to provide persuasive evidence of legal isolation. Question 4.2.70 discusses whether a legal opinion is needed for every transfer.

Question 4.4.110

How does the existence of continuing involvement affect the evaluation of the legal isolation opinion?

Interpretive response: Continuing involvement by the transferor (e.g. recourse provisions) is a feature of many transfers of financial assets. The type and amount of continuing involvement will affect the legal specialist's ability to conclude that the transferred assets have been legally isolated, even in bankruptcy.

When continuing involvement is present, the legal specialist should consider the entirety of the transferor's involvement, and explicitly document that consideration in the legal opinion, normally as part of the discussion of background and assumptions.

Additionally, legal specialists often discuss in legal opinions how various courts have dealt with different types of continuing involvement (e.g. recourse provisions), sometimes using language that is an explicit or implicit qualification of the opinion. Care should be taken to ascertain that the legal opinion contains no explicit or implicit qualification related to continuing involvement.

Question 4.4.120

Are side agreements considered when evaluating the legal isolation opinion?

Interpretive response: Yes. The legal opinion should explicitly consider all forms of continuing involvement by the transferor and its affiliates with the transferred assets. Continuing involvement may be documented in side agreements that are not directly between the transferor and the transferee. For example, the parent company or affiliate of the transferor may provide a guarantee or other form of recourse to the transferee.

An entity should ensure that the list of all relevant transaction documents, including side agreements, considered by the legal specialist is complete and that the legal opinion specifically addresses legal isolation of the transferred assets from all consolidated affiliates of the transferor. Side agreements

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between the transferor or its consolidated affiliates and the transferee may affect the legal specialist's conclusion about legal isolation.

Question 4.4.130

How does language about inherent limitations affect the evaluation of the legal isolation opinion?

Background: Legal specialists may include language in legal isolation opinions that explains the inherent limitations of a legal opinion about the application of bankruptcy law. These inherent limitations can manifest in several ways, such as through:

- the pervasive equity powers of bankruptcy courts;
- the overriding goal of reorganization to which other legal rights and policies may be subordinated;
- the potential relevance to the exercise of judicial discretion of future-arising facts and circumstances; and
- the nature of the bankruptcy process.

Legal opinions sometimes also make reference to the "Special Report by the Tri-Bar Opinion Committee, Opinions in the Bankruptcy Context: Rating Agency, Structured Financing and Chapter 11 Transactions" (the Tri-Bar language) that further discusses the inherent limitation of such legal opinions.

Interpretive response: It depends on whether the language about inherent limitations explicitly or implicitly constitutes a qualification of the opinion. We believe inherent limitations that instruct those relying on the opinion to perform additional legal analysis constitute a qualification of the opinion and do not provide persuasive evidence; this is because such language implies that the legal specialists did not consider those factors in forming their opinion.

For example, language in the legal opinion stating that "the recipients of this opinion should take [the Tri-Bar] limitations into account in analyzing the bankruptcy risks associated with the transactions described herein" does not provide persuasive evidence because it instructs the recipients to analyze the limitations, implying that they were not considered by the lawyers in forming their opinion. The legal opinion would not provide persuasive evidence if such language appeared in the opinion paragraph or if the opinion paragraph stated that it was subject to such language appearing elsewhere in the letter. For example, a legal opinion would not provide persuasive evidence if it appeared in a section titled "Background and Assumptions" and the opinion paragraph stated "Subject to the Background and Assumptions set forth above…"

However, if the above inherent limitations are included in the legal opinion letter in a manner that does not constitute a qualification of the opinion, we believe that the limitations would not impact the persuasiveness of the evidence provided by the letter.

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Question 4.4.140

Can the auditor rely upon a legal isolation opinion if it includes restrictions as to its use?

Interpretive response: No. The legal isolation opinion generally is the primary audit evidence supporting management's assertion that the financial assets have been legally isolated. The entity should ensure that the legal isolation opinion states that the auditor is permitted to rely on the conclusions reached in the letter as evidential matter that supports management's assertion.

If the permission is not provided in the opinion, the legal specialist will need to provide a letter to the transferor authorizing the transferor to make the opinion available to the auditor to use as audit evidence in support of the auditor's evaluation of management's assertion. If the auditor is not granted permission to use and rely on the legal opinion as audit evidence, the auditor usually will not have sufficient persuasive evidence to conclude that the legal isolation criterion has been met.

Such restriction constitutes a limitation on the scope of the auditor's procedures and the auditor will consider the effect of such restriction on their auditors' report on the entity's financial statements.

The following is an example of language that provides permission for the auditor to use the legal opinion: [AU-C 9620.18]

> Notwithstanding any language to the contrary in our opinions of even date with respect to certain bankruptcy issues relating to the previously referenced transaction, you are authorized to make available to your auditors such opinions solely as audit evidence in support of their evaluation of management's assertion that the transfer of the receivables meets the isolation criterion of Financial Accounting Standards Board Accounting Standards Codification 860-10-40-5(a), provided a copy of this letter is furnished to them in connection therewith. In authorizing you to make copies of such opinions available to your auditors for such purpose, we are not undertaking or assuming any duty or obligation to your auditors or establishing any lawyer-client relationship with them. Further, we do not undertake or assume any responsibility with respect to financial statements of you or your affiliates.

Question 4.4.150

Is the legal isolation criterion required to be met on an ongoing basis?

Interpretive response: The requirements to achieve sale treatment are required to be met throughout the life of the transferred assets. Therefore, the legal isolation criterion is required to be met on an ongoing basis.

Some arrangements include assets with long-dated maturities or involve an initial transfer of financial assets and subsequent transfers of financial assets

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that are revolving in nature. The transferor's process to evaluate the legal isolation criterion includes deciding whether to obtain an update of a previous legal isolation opinion and may include obtaining periodic affirmations from legal specialists that the opinion previously provided remains appropriate. This is particularly important in situations in which:

— the bankruptcy law or case law has changed since the legal isolation opinion was rendered on the initial transfer; or
— there is a change in the structure of the transaction or relationship between the transferor and transferee.

Question 4.4.160

How is the legal isolation criteria evaluated for Government National Mortgage Association (GNMA) securitizations?

Background: GNMA is a wholly owned corporate instrumentality of the United States within the Department of Housing and Urban Development. GNMA guarantees the timely payment of principal and interest on securities that are backed by pools of federally insured or guaranteed mortgages, primarily loans insured by the Federal Housing Administration (FHA) or guaranteed by the Department of Veterans Affairs (VA).

GNMA securitizations are unique from typical MBS vehicles in that there is no trust holding the mortgages backing the GNMA pass-through certificates. Instead, the GNMA MBS programs call for the establishment of custodial pools, whereby the issuer/servicer conveys to GNMA all rights, title and interest to mortgages in the pool. GNMA does not purchase mortgage loans or issue securities. However, under the program the pools of mortgages are assigned to GNMA. Issuers, which are private lending institutions approved by GNMA, originate eligible government loans, pool them into securities, and issue GNMA MBS.

In February 2010, the SEC staff responded to an inquiry by the Mortgage Bankers Association of America (MBA) asking whether Topic 810 requires the issuer to consolidate the legal structure containing the pooled GNMA securities. The staff stated that it would not object to an issuer's conclusion that the pooled GNMA securities reside in a legal structure that would be analyzed for consolidation under Topic 810 and that Topic 810 does not require consolidation by the issuers. As part of the MBA's inquiry, it also submitted to the SEC staff a position that the conveyance to GNMA of rights, title and interest in the pooled mortgage loans constituted a transfer to the legal structures that would be analyzed under Topic 860.

Interpretive response: To support the legal isolation criterion, GNMA issuers commonly obtain legal isolation opinions that contain the following conclusions:

— GNMA has valid power to extinguish any interest of the transferor in the mortgage loans upon the occurrence of an event of issuer default;

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— Upon GNMA's exercise of the extinguishment power, the mortgage loans would become the absolute property of GNMA, subject only to the unsatisfied rights of the holders of the related GNMA MBS; and

— In a bankruptcy case (or, for depository institutions, receivership or conservatorship under the provisions of the Federal Deposit Insurance Act) in which the transferor was the debtor, the mortgage loans, payments thereunder and proceeds thereof would not be the property of the estate.

The legal isolation opinions commonly refer to the unique nature of GNMA securitizations, in that there is no legal transfer of the loans to a third party. The issuer maintains ownership for purposes of servicing the loans, but all of the issuer's interests in the loans are conveyed to GNMA. As a result, the legal isolation opinions generally do not include a conclusion that there was a transfer of the loans that constitutes a true sale at law.

Because of the unique nature of GNMA securitizations, we believe that a legal isolation opinion that includes language as described above provides persuasive evidence to support a conclusion that these transactions isolate such financial assets from the transferor in bankruptcy or receivership. In a GNMA securitization, it is typically not possible for the issuer to obtain an opinion that a true sale at law has occurred (because there is no legal transfer or sale of the loans). Instead, the GNMA issuer conveys to GNMA all rights, title and interest to mortgages in the pool. As a result, the legal opinions generally analyze whether the loans would be considered the property of the issuer or the property of GNMA (under the doctrine of substantive consolidation as discussed below).

In the absence of a conclusion as to whether there is a true sale at law, a legal isolation opinion may provide persuasive evidence that the financial assets have been legally isolated from the transferor, if that opinion otherwise provides evidence that the transferred assets have been legally isolated from the transferor – put presumptively beyond the reach of the transferor and its creditors even in bankruptcy or other receivership. If in other circumstances a loan transfer does occur, a true sale or similar opinion is appropriate and expected.

AU-C 9620 provides example language to illustrate whether (1) a transfer meets the definition of a true sale at law and (2) in bankruptcy or receivership, a court would not order the assets of the purchaser and the seller to be consolidated under the doctrine of substantive consolidation such that the transferred assets would be part of the transferor's estate.

The following statement in AU-C 9620 supports the conclusion that whether a transfer is a true sale at law is a relevant consideration; however, it is one of many factors that may be considered and it is not required in isolation.

> 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... 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,

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whether the transferor is affiliated with the transferee, and other factors pertinent under applicable law. [AU-C 9620.01]

Question 4.4.170

How does a legal isolation opinion address transfers of financial assets in jurisdictions outside the US?

Interpretive response: The purpose of the legal opinion is to obtain evidence supporting the accounting conclusion that the legal isolation criterion has been met based on the laws that apply to the transfer. The legal concepts related to bankruptcy in a foreign jurisdiction may be substantially different from those in the US. Nonetheless, the accounting requirements in Topic 860 remain applicable.

Therefore, the legal isolation opinion needs to provide reasonable assurance that the transferred financial assets would be beyond the reach of the powers of a bankruptcy trustee or other receiver for the transferor or any of its consolidated affiliates (included in the financial statements being presented) and its creditors. In addition, if the foreign jurisdiction that governs the transaction is different from the jurisdiction that governs the transferor in the event of bankruptcy or receivership, the transferor should consider the need to receive a legal opinion that governs both jurisdictions.

For example, Parent of two consolidated subsidiaries, Sub 1 and Sub 2. Sub 1 is located in China and Sub 2 is located in Germany. Sub 1 and Sub 2 each enter into an agreement to transfer financial assets to a third party and each of the transfers are governed by the laws of New York. We generally would expect the legal opinion(s) would consider the laws of New York and the jurisdiction that governs the transferors (China or Germany).

4.4.20 Considerations related to entities subject to the Federal Deposit Insurance Corporation

Excerpt from ASC 860-10

• > Isolation of Transferred Financial Assets

55-18C For entities that are subject to other possible bankruptcy, conservatorship, or other receivership procedures (for example, banks subject to receivership by the Federal Deposit Insurance Corporation [FDIC]) in the United States or other jurisdictions, judgments about whether transferred financial assets have been isolated shall be made in relation to the powers of bankruptcy courts or trustees, conservators, or receivers in those jurisdictions.

55-24 The powers of receivers for entities not subject to the U.S. Bankruptcy Code (for example, banks subject to receivership by the Federal Deposit

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Insurance Corporation [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 financial assets from a transferor subject to such a receiver and its creditors even though it is accomplished by only one transfer directly to a securitization entity 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 financial assets have been isolated need to be made in relation to the powers of bankruptcy courts or trustees, conservators, or receivers in those jurisdictions.

55-24A Depending on the facts and circumstances, transferred financial assets can be isolated from the transferor if the Federal Deposit Insurance Corporation (FDIC) would be the receiver should the transferor fail. In July 2000, the FDIC adopted a final rule (subsequently amended), *Treatment by the Federal Deposit Insurance Corporation as Conservator or Receiver of Financial Assets Transferred by an Insured Depository Institution in Connection with a Securitization or Participation*. The final amended rule modifies the FDIC's receivership powers so that, subject to certain conditions, it shall not recover, reclaim, or recharacterize as property of the institution or the receivership any financial assets transferred by an insured depository institution that meet all conditions for sale accounting treatment under GAAP, other than the *legal isolation* condition in connection with a securitization or participation.

55-24B Financial assets transferred by an entity subject to possible receivership by the FDIC are isolated from the transferor if the FDIC or another creditor either cannot require return of the transferred financial assets or can only require return in receivership, after a default, and in exchange for payment of, at a minimum, principal and interest earned (at the contractual yield) to the date investors are paid.

55-25 Conversely, financial assets transferred by an entity shall not be considered isolated from the transferor if circumstances can arise under which the transferor can require their return, but only in exchange for payment of principal and interest earned (at the contractual yield) to the date investors are paid, unless the transferor's power to require the return of the transferred financial assets arises solely from a contract with the transferee. A noncontractual power to require the return of transferred assets is inconsistent with the limitations in paragraph 860-10-40-5(a) that, to be accounted for as having been sold, transferred financial assets shall be isolated from the transferor. That is the circumstance even if the noncontractual power appears unlikely to be exercised or is dependent on the uncertain future actions of other entities (for example, insufficiency of collections on underlying transferred financial assets or determinations by court of law). Under that guidance, a single-step securitization commonly used by financial institutions subject to receivership by the FDIC and sometimes used by other entities is likely not to be judged as having isolated the assets. One reason for that is because it would be difficult to obtain reasonable assurance that the transferor would be unable to recover the transferred financial assets under the **equitable right of redemption** available to secured debtors, after default, under U.S. law.

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55-25A For entities that are subject to possible receivership under jurisdictions other than the FDIC or the U.S. Bankruptcy Code, whether assets transferred by an entity can be considered isolated from the transferor depends on the circumstances that apply to those types of entities. As discussed in paragraph 860-10-55-24, 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 financial assets have been isolated need to be made in relation to the powers of bankruptcy courts or trustees, conservators, or receivers in those jurisdictions. The same sorts of judgments may need to be made in relation to powers of the transferor or its creditors.

Transferors may be subject to other possible bankruptcy, conservatorship or other receivership procedures besides the US Bankruptcy Code. For example, a transferor may be subject to receivership by the Federal Deposit Insurance Corporation (FDIC) in the United States or other foreign jurisdictions. The powers of receivers for entities not subject to the US Bankruptcy Code vary considerably. Therefore, for entities that are subject to other possible bankruptcy, conservatorship or other receivership procedures in the US or other jurisdictions, judgments about whether transferred financial assets have been isolated need to be made in relation to the powers of bankruptcy courts or trustees, conservators, or receivers in those jurisdictions. [860-10-55-18C, 55-24, 55-25A]

Question 4.4.180

How is the legal isolation criterion analyzed when a transferor is subject to FDIC receivership?

Interpretive response: Insured depository institutions may be subject to receivership by the FDIC. In 2000, the FDIC modified the FDIC's receivership powers to provide a 'safe harbor'. Under this safe harbor, the FDIC will not exercise its statutory powers to recover, reclaim or recharacterize as property of the institution or the receivership any of the insured depository institution's transferred assets in connection with a securitization or participation if the transfer meets all conditions for sale accounting treatment under US GAAP, other than the legal isolation criterion. The FDIC modified the original safe harbor in 2010 to create two types of safe harbors for securitizations and participations depending on whether the transactions are accounted for as sales or secured borrowings. [860-10-55-24B]

Assets transferred by an entity that is subject to possible receivership by the FDIC are considered to be isolated from the transferor if the FDIC or another creditor either: [860-10-55-24B]

- cannot require return of the transferred financial assets; or
- can only require return in receivership, after a default, and in exchange for payment of, at a minimum, principal and interest earned (at the contractual yield) to the date investors are paid.

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These two conditions for isolation only apply to entities subject to possible receivership under the FDIC, due to the unusual nature of the FDIC.

Question 4.4.190

What level of assurance in a legal opinion provides persuasive evidence that the assets have been legally isolated from a transferor subject to FDIC receivership?

Interpretive response: As discussed in Question 4.4.90, a legal opinion should provide a *would* level of assurance to provide persuasive evidence that the assets have been legally isolated from the transferor. [AU-C 9620.15]

AU-C 9620 includes two examples of the conclusions in a legal opinion for an entity that is subject to receivership or conservatorship under provisions of the FDIC that provide persuasive evidence, in the absence of contradictory evidence, to support management's assertion that the transferred financial assets have been put presumptively beyond the reach of the entity and its creditors, even in conservatorship or receivership. The following is the first example. [AU-C 9620.14]

> *We believe (or it is our opinion)* that in a properly presented and argued case, as a legal matter, in the event the Seller were to become subject to receivership or conservatorship, the transfer of the Financial Assets from the Seller to the Purchaser *would be considered to be a sale* (or a true sale) of the Financial Assets from the Seller to the Purchaser and not a loan and, accordingly, the Financial Assets and the proceeds thereof transferred to the Purchaser by the Seller in accordance with the Purchase Agreement would not be deemed to be property of, or subject to repudiation, reclamation, recovery, or recharacterization by, the receiver or conservator appointed with respect to the Seller.

The following additional paragraph applies when the entity to which the assets are sold or transferred (as described in the opinion) is an affiliate of the selling entity; it may also apply in other situations as noted by the legal specialist.

> Based upon the assumptions of fact and the discussion set forth previously, and on a reasoned analysis of analogous case law, *we are of the opinion that* in a properly presented and argued case, as a legal matter, in a receivership, conservatorship, or liquidation proceeding in respect of the Seller, a court *would not* grant an order consolidating the assets and liabilities of the Purchaser with those of the Seller.

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5. Sale criterion: Actual control

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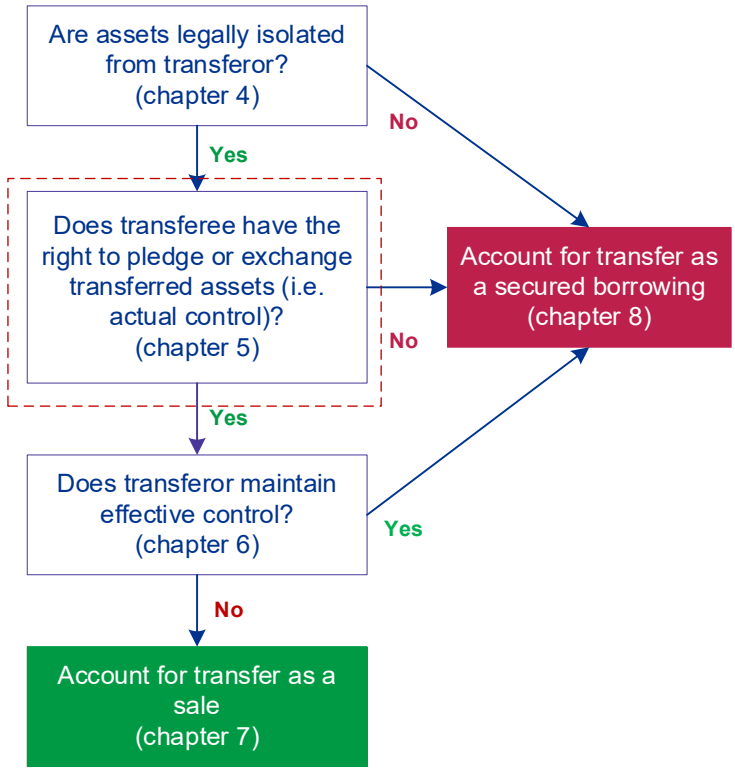
5.1 How the standard works

The broad outline of how an entity evaluates whether a transfer qualifies as a sale is summarized in the following decision tree. There is no requirement to evaluate these criteria in any particular sequence.



The second criterion that must be met to achieve sale accounting is for the transferee to have the ability to pledge or exchange the transferred financial assets. If this criterion is met, the transferor has surrendered actual control of the transferred financial assets.

The criterion is met if:

- the transferor, its consolidated affiliates and its agents have no continuing involvement with the transferred financial assets; or
- the transferor, its consolidated affiliates or its agents have continuing involvement, but
  - the transferee is not constrained in its ability to pledge or exchange the transferred assets; or
  - if the transferee is so constrained, the constraint does not provide a more-than-trivial benefit to the transferor.

Throughout this chapter, the references to 'transferee' and 'financial assets' also apply to third-party beneficial interest holders and beneficial interests, respectively, if the transferee's sole purpose is to engage in securitizations or asset-backed financing arrangements.

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5.2 Overview and transferor continuing involvement

5.2.10 Overview

Excerpt from ASC 860-10

> Conditions for a Sale of Financial Assets

40-5 A transfer of an entire financial asset, a group of entire financial assets, or a participating interest in an entire financial asset in which the transferor surrenders control over those financial assets shall be accounted for as a sale if and only if all of the following conditions are met: …

b. Transferee's rights to pledge or exchange. This condition is met if both of the following conditions are met:

   1. Each transferee (or, if the transferee is an entity whose sole purpose is to engage in **securitization** or asset-backed financing activities and that entity is constrained from pledging or exchanging the assets it receives, each third-party holder of its beneficial interests) has the right to pledge or exchange the assets (or beneficial interests) it received.
   2. No condition does both of the following:

      i. Constrains the transferee (or third-party holder of its beneficial interests) from taking advantage of its right to pledge or exchange
      ii. Provides more than a trivial benefit to the transferor (see paragraphs 860-10-40-15 through 40-21).

   If the transferor, its consolidated affiliates included in the financial statements being presented, and its agents have no continuing involvement with the transferred financial assets, the condition under paragraph 860-10-40-5(b) is met.

The second criterion requires the transferor to surrender actual control of the transferred financial assets. If this criterion is not met, the transferor cannot apply sale accounting to the transferred financial assets. [860-10-40-5(b)]

Question 5.2.10

How does an entity evaluate whether the transferor has surrendered actual control?

Interpretive response: The following decision tree summarizes how an entity evaluates whether actual control has been surrendered. There is no requirement to evaluate these criteria in any particular sequence. If the answer to any of the questions below is 'no' then it results in actual control being surrendered.

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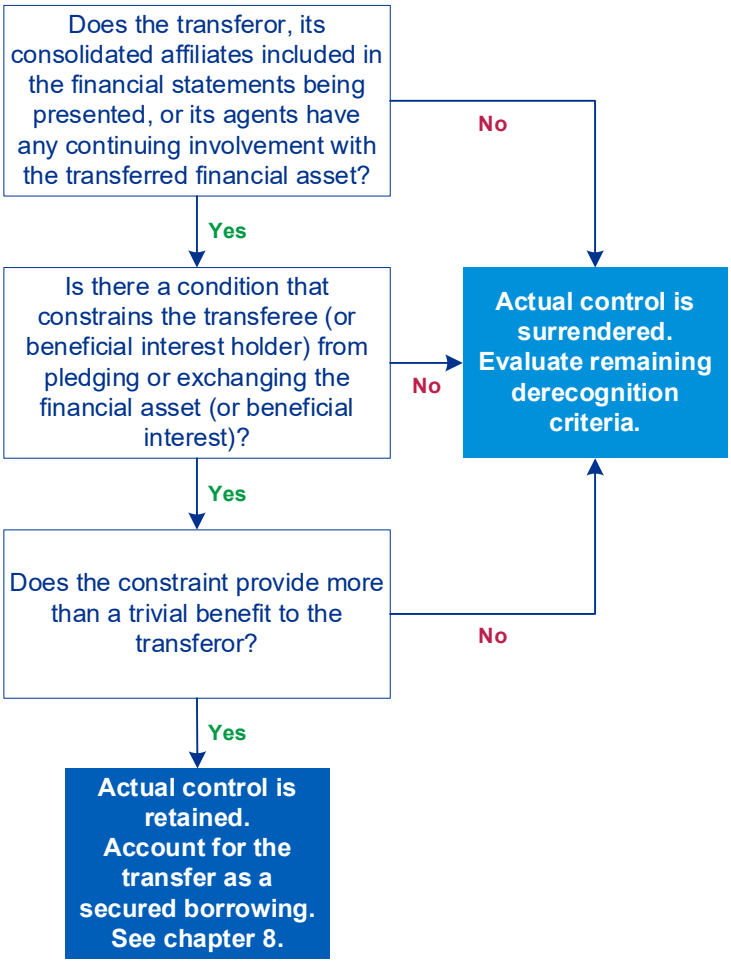

5.2.20 Continuing involvement

Excerpt from ASC 860-10

• > Transferee's Rights to Pledge or Exchange Transferred Financial Assets

40-16A In some circumstances in which the transferor has no continuing involvement with the transferred financial assets, some conditions may constrain a transferee from pledging or exchanging the financial assets. Paragraph 860-10-40-5(b) states that if the transferor, its consolidated affiliates included in the financial statements being presented, and its agents have no continuing involvement with the transferred financial assets, the condition under paragraph 860-10-40-5(b) is met. For example, if a transferor receives only cash in return for the transferred financial assets and the transferor, its consolidated affiliates included in the financial statements being presented, and its agents have no continuing involvement with the transferred financial assets, sale accounting is allowed under paragraph 860-10-40-5(b) even if the

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transferee entity is significantly limited in its ability to pledge or exchange the transferred assets.

• • > Transferee Is Significantly Limited in Its Ability to Pledge or Exchange the Transferred Financial Assets with No Continuing Involvement

55-28 An entity transfers financial assets to a transferee that is significantly limited in its ability to pledge or exchange the transferred financial assets (the transferee is not an entity whose sole purpose is to engage in securitization or asset-backed financing activities). The transferor receives cash in return for the transferred financial assets, and has no **continuing involvement** with the transferred assets. The transfer described in this example meets the condition in paragraph 860-10-40-5(b).

• > Application of the Term *Continuing Involvement*

55-79A This implementation guidance addresses the application of the glossary term *continuing involvement*. All available evidence shall be considered, including, but not limited to, all of the following:

a. Explicit written arrangements
b. Communications between the transferor and the transferee or its beneficial interest holders
c. Unwritten arrangements customary in similar transfers.

55-79B Examples of continuing involvement include, but are not limited to, all of the following:

a. Servicing arrangements
b. Recourse or guarantee arrangements
c. Agreements to purchase or redeem transferred financial assets
cc. Options written or held
d. Derivative instruments that are entered into contemporaneously with, or in contemplation of, the transfer
e. Arrangements to provide financial support
f. Pledges of collateral
g. The transferor's beneficial interests in the transferred financial assets.

The transferor has surrendered actual control (i.e. the second criterion is met) if it, its consolidated affiliates included in the financial statements presented and its agents do not have continuing involvement with the transferred financial asset. If there is continuing involvement, further analysis is required to determine if actual control is surrendered.

Question 5.2.20

Is actual control surrendered when the transferee's ability to pledge or exchange the assets is limited but the transferor has no continuing involvement?

Interpretive response: Yes. The Board reasoned that a transferred financial asset from which the transferor can obtain no further benefits is no longer its financial asset and should be removed from its balance sheet. Without

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continuing involvement, a transferor does not receive any further benefit from the financial asset, even if the transferee is significantly limited in its ability to pledge or exchange the transferred financial assets. [860-10-55-28, FAS 140.BC166]

Question 5.2.30

How does an entity determine if it has continuing involvement?

Interpretive response: Continuing involvement consists of any involvement with the transferred financial assets that: [860-10 Glossary]

- provides the transferor with cash flows or other benefits from the transferred financial assets; or
- obligates the transferor to provide additional cash flows or other assets to any party related to the transfer.

Continuing involvement may be evidenced in explicit written agreements between the transferor and the transferee, in communications between the parties, or unwritten arrangements that are customary in similar transfers. [860-10-55-79A]

Continuing involvement can take many forms, including the following (not exhaustive): [860-10-55-79B]

- servicing arrangements;
- recourse or guarantee arrangements;
- agreements to purchase or redeem transferred financial assets or beneficial interests;
- options written or held;
- derivative instruments that are entered into contemporaneously with, or in contemplation of, the transfer;
- arrangements to provide financial support;
- pledges of collateral; and
- the transferor's beneficial interests in the transferred financial assets.

Section 3.5.20 discusses further what constitutes continuing involvement.

5.3 Rights to pledge or exchange transferred financial assets (beneficial interests)

Excerpt from ASC 860-10

• > Transferee's Rights to Pledge or Exchange Transferred Financial Assets

40-15 Many transferor-imposed or other conditions on a transferee's right to pledge or exchange both constrain a transferee from pledging or exchanging and, through that constraint, provide more than a trivial benefit to the transferor. Judgment is required to assess whether a particular condition

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results in a constraint. Judgment also is required to assess whether a constraint provides a more-than-trivial benefit to the transferor. If the transferee is an entity whose sole purpose is to engage in securitization or asset-backed financing activities, that entity may be constrained from pledging or exchanging the transferred financial assets to protect the rights of beneficial interest holders in the financial assets of the entity. Paragraph 860-10-40-5(b) requires that the transferor look through the constrained entity to determine whether each third-party holder of its beneficial interests has the right to pledge or exchange the beneficial interests that it holds. The considerations in paragraphs 860-10-40-16 through 40-18 apply to the transferee or the third-party holders of its beneficial interests in an entity that is constrained from pledging or exchanging the assets it receives and whose sole purpose is to engage in securitization or asset-backed financing activities.

• • > Transferee Is Significantly Limited in Its Ability to Pledge or Exchange the Transferred Financial Assets with No Continuing Involvement

55-28 An entity transfers financial assets to a transferee that is significantly limited in its ability to pledge or exchange the transferred financial assets (the transferee is not an entity whose sole purpose is to engage in securitization or asset-backed financing activities). The transferor receives cash in return for the transferred financial assets, and has no **continuing involvement** with the transferred assets. The transfer described in this example meets the condition in paragraph 860-10-40-5(b).

55-29 While the condition in paragraph 860-10-40-5(b) is met in the example described in the previous paragraph, in general, for transfers in which the transferor does have any continuing involvement, an evaluation shall be made as to whether the condition in paragraph 860-10-40-5(b) has been met.

If the transferor, its consolidated affiliates included in the financial statements presented or its agents have continuing involvement with the transferred financial assets, it is necessary to determine whether there is a constraint on the transferee's ability to pledge or exchange the financial assets it receives. [860-10-40-5(b)]

Question 5.3.10

How is transferability evaluated when the transferee's sole purpose is securitization or asset-backed financing activities?

Interpretive response: If the transferee is an entity whose sole purpose is to engage in securitization or asset-backed financing activities, it is generally constrained from pledging or exchanging the transferred financial assets; this constraint protects the rights of the beneficial interest holders. As a result, a transferor is required to 'look through' the constrained entity and evaluate whether third-party beneficial interest holders have the right to pledge or exchange their interests. [860-10-40-15]

A third-party holder's right to pledge or exchange beneficial interests in this type of entity is the counterpart of a transferee's right to pledge or exchange the

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transferred financial assets themselves. Therefore, such a constraint on the transferee that issues the beneficial interests does not necessarily indicate that the transferor has retained actual control over the transferred financial assets. [860-10-40-15, 55-29, FAS166.BC.A45]

Question 5.3.20

Has a transferor surrendered actual control if the transferee can pledge the transferred financial assets but not exchange them?

Excerpt from ASC 860-10

• • > Transferee Is Precluded from Exchanging the Transferred Financial Assets but Has the Unconstrained Right to Pledge Them

55-27 In a transaction in which a transferee (that is not an entity whose sole purpose is to engage in securitization or asset-backed financing activities) is precluded from exchanging the transferred financial assets but obtains the unconstrained right to pledge them, the determination of whether the sale condition in paragraph 860-10-40-5(b) is met depends on the facts and circumstances. In a transfer of financial assets, a transferee's right to both pledge and exchange transferred financial assets suggests that the transferor has surrendered its control over those financial assets. However, more careful analysis is warranted if the transferee may only pledge the transferred financial assets.

Interpretive response: It depends. The ability to exchange or pledge an asset as collateral and therefore obtain all or most of the cash inflows that are the primary economic benefits of financial assets is important when determining which party has actual control over a financial asset. [FAS 140.BC161]

A transferee holding the right to both pledge and exchange transferred financial assets suggests that the transferor has surrendered its control over those financial assets. However, more careful analysis is warranted if the transferee may only pledge the transferred financial assets. The key aspect of the analysis is whether the transferee has "the ability to obtain all or most of the cash inflows, either by exchanging the transferred asset or by pledging it as collateral." [860-10-55-27, FAS 140.BC168–BC169]

For example, transferor-imposed contractual constraints that narrowly limit the timing or terms constrain the transferee and presumptively provide the transferor with a more-than-trivial benefit. An example of conditions that narrowly limit timing or terms is allowing a transferee to pledge only on the day the assets are obtained or only on terms agreed to with the transferor. Section 5.4 discusses the evaluation of more-than-trivial benefits. [860-10-40-17]

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Question 5.3.30

Has a transferor surrendered actual control if the transferee can only grant a security interest in the transferred financial assets?

Interpretive response: No. To surrender actual control, the transferee needs to have the ability to obtain all or most of the cash inflows either by exchanging or pledging the transferred financial assets. We believe that granting a security interest in the transferred financial assets and having the right to pledge or exchange are not the same. [FAS 140.BC168–BC169]

A security interest is 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 to satisfy that obligation. However, a pledge involves transferring legal title and custody to the secured party. As a result, we believe permitting the transferee to grant a security interest in – but not to pledge or exchange – the transferred financial asset does not result in the transferor surrendering actual control. [Master Glossary]

Question 5.3.40

What are examples of conditions that do not presumptively constrain the transferee from pledging or exchanging transferred financial assets?

Excerpt from ASC 860-10

• > Transferee's Rights to Pledge or Exchange Transferred Financial Assets

40-18 All of the following are examples of conditions that presumptively would not constrain a transferee from pledging or exchanging the transferred financial asset:

a. A transferor's right of first refusal on the occurrence of a bona fide offer to the transferee from a third party, because the right in itself does not enable the transferor to compel the transferee to sell the financial asset and the transferee would be in a position to receive the sum offered by exchanging the financial asset, albeit possibly from the transferor rather than the third party
b. A requirement to obtain the transferor's permission to sell or pledge that is not to be unreasonably withheld
c. A prohibition on sale to the transferor's competitor if other potential willing buyers exist
d. A regulatory limitation such as on the number or nature of eligible transferees (as in the circumstance of securities issued under Securities Act Rule 144A or debt placed privately)
e. Illiquidity, for example, the absence of an active market …
g. Freestanding rights to reacquire transferred assets that are readily obtainable.

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Interpretive response: The following are examples of conditions that do not presumptively constrain the transferee from pledging or exchanging transferred financial assets. [860-10-40-18]

- A transferor's right of first refusal on an offer to the transferee from a third party; the transferee is not constrained because it is not compelled to sell the assets to the transferor and it would receive the full amount offered from either the transferor or the third party.
- A requirement that the transferee obtain the transferor's permission to sell or pledge the transferred assets if that permission is not unreasonably withheld (see Question 5.3.50).
- A prohibition on the sale of the transferred financial assets to the transferor's competitor if other potential willing buyers exist.
- A regulatory limitation, such as a limit on the number or nature of eligible transferees (e.g. debt placed privately or Securities Rule 144A).
- The lack of an active market for the transferred financial assets.
- Freestanding rights to reacquire transferred assets that are readily obtainable. See Question 6.4.110 for further discussion on determining whether a financial asset is readily obtainable.

Question 5.3.50

How is transferor consent that is not 'unreasonably withheld' evaluated?

Background: An example of a condition that does not presumptively constrain the transferee from pledging or exchanging transferred financial assets is a requirement to obtain the transferor's permission to sell or pledge that is not to be unreasonably withheld (see Question 5.3.40). [860-10-40-18(b)]

Interpretive response: The phrase 'unreasonably withheld' is not defined in Topic 860. Even if the consent of the transferor is not to be unreasonably withheld, we believe an entity needs to determine if the requirement to obtain the transferor's consent results in the transferee being restricted in its ability to pledge or exchange the transferred financial assets. Judgment may be required as part of this evaluation.

For example, an entity should determine whether the time required for the transferor to evaluate the request and provide consent results in a narrow time horizon being imposed on the transferee to pledge or sell the transferred financial assets. As discussed in Question 5.3.20, a condition that narrowly limits the time a transferee has to pledge or exchange constrains the transferee and presumably provides the transferor with a more-than-trivial benefit.

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Question 5.3.60

Is actual control surrendered if there are restrictions on who the transferee can pledge or exchange the financial assets to, or if transferor approval is required?

Excerpt from ASC 860-10

40-19 Judgment is required to assess the significance of some conditions. For example, a prohibition on sale to the transferor's competitor would be a constraint if that competitor were the only potential willing buyer other than the transferor.

• • > Transferor's Approval Required for Transferee's Subsequent Transfers or Pledges

55-31 Judgment is necessary to determine whether a requirement to obtain the transferor's permission to sell or exchange should preclude sale accounting. For example, in certain **loan participation** agreements involving transfers of participating interests, the transferor is required to approve any subsequent transfers or pledges of the interests in the loans held by the transferee. Whether that requirement would be a constraint that would prevent the transferee from taking advantage of its right to pledge or to exchange the transferred financial asset and, therefore, accounting for the transfer as a sale, depends on the nature of the requirement for approval.

55-32 A prohibition on sale to the transferor's competitor may or may not constrain a transferee from pledging or exchanging the financial asset, depending on how many other potential buyers exist. If there are many other potential willing buyers, the prohibition would not be constraining. In contrast, if that competitor were the only potential willing buyer (other than the transferor), then the condition would be constraining.

• • > Transactions Involving Rule 144A Securities

55-33 Issuing beneficial interests in the form of securities issued under Rule 144A presumptively would not constrain a transferee's ability to transfer those beneficial interests for purposes of this Subtopic. The primary limitation imposed by Rule 144A is that a potential buyer must be a sophisticated investor. If a large number of qualified buyers exist, the holder could transfer those securities to many potential buyers and, thereby, realize the full economic benefit of the assets. In such circumstances, the requirements of Rule 144A would not be a constraint that precludes sale accounting under paragraph 860-10-40-5(b).

Interpretive response: It depends. Judgment may be required to assess the significance of a restriction or the requirement to obtain approval. If there are restrictions on who the transferee may pledge or exchange the assets to – but there are many other potential buyers such that the transferee can realize the

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full economic benefit of the assets – then actual control is surrendered. [860-10-55-32]

Examples of prohibitions on the transferee's ability to pledge or exchange the financial assets in which actual control may be surrendered include: [860-10-40-18(d), 55-33]

- can pledge or exchange only to entities that are not the transferor's competitors but there are many other potential willing buyers;
- can pledge or exchange only to sophisticated investors and there are a large number of such investors.

For example, if there is only one other willing buyer (other than the transferor), the condition is a constraint and actual control is not surrendered.

In addition, if the transferor is required to approve any subsequent transfers or pledges of the transferred financial assets, the nature of the requirement for approval is evaluated to determine if the constraint would prevent the transferee from taking advantage of its right to pledge or to exchange the transferred financial assets. [860-10-55-31]

Question 5.3.70

Is actual control surrendered when a restriction on the transferee's ability to pledge or exchange the transferred financial assets expires?

Background: Assume that Transferor transfers trade receivables to Transferee. Transferor restricts Transferee from pledging or exchanging the trade receivables for 60 days from the date of transfer. The restriction provides a more-than-trivial benefit to Transferor.

Interpretive response: Yes. Using the background example, on the date of transfer, Transferor has retained actual control as a result of the restriction on Transferee's ability to pledge or exchange the transferred financial assets. However, once the restriction expires, Transferor has surrendered actual control because Transferee may pledge or exchange the transferred financial assets.

Question 5.3.80

In a commercial mortgage backed securitization, what is the impact of restrictions on the ability of a third-party purchaser to pledge or exchange the risk retention interest on a non-recourse basis?

Background: Under rules required by the Dodd-Frank Act, sponsors of issuances of asset-backed securities are required to retain 5% of the credit risk related to the underlying assets. In a commercial mortgage backed securitization (CMBS) offering, the sponsor may meet the requirements by retaining the risk retention interest or by selling, to a qualified third-party purchaser, the most subordinate class of securities equal to an amount that represents up to 5% of the fair value of all of the CMBS. The third-party

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purchaser is subject to the same requirements that the sponsor would have been subject to, including restrictions on its ability to sell or pledge the risk retention interest on a non-recourse basis.

Interpretive response: On November 6, 2017, the Staff at the SEC's Office of the Chief Accountant responded to a preclearance submission by the Securities Industry and Financial Markets Association (SIFMA). The SEC staff indicated that it would not object to a conclusion that restrictions on the third-party purchaser's ability to pledge or exchange the risk retention interest do not cause the transferor to retain actual control. That is, the criterion requiring surrender of control can be met. [SIFMA letter 12/4/17]

We understand the staff's views were based on:

— the unique facts and circumstances of the CMBS structure that arose due to changes in the regulation of the securitization market due to the Dodd-Frank Act; and

— the documented intention of the third-party purchaser to retain credit risk in order to comply with the regulatory requirements described in the background section.

We also understand that these views should not be analogized to any other fact patterns. Further, the staff views were limited to consideration of the restrictions on the third-party purchaser's interests as they relate to paragraph 860-10-40-5(b).

5.4 Constraints and more-than-trivial benefit

Excerpt from ASC 860-10

• > Transferee's Rights to Pledge or Exchange Transferred Financial Assets

40-16 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.

• • > Transferee Is Significantly Limited in Its Ability to Pledge or Exchange the Transferred Financial Assets with No Continuing Involvement

55-30 For a transfer to fail to meet the condition in paragraph 860-10-40-5(b), the transferee must be constrained from pledging or exchanging the transferred financial asset and the transferor must receive more than a trivial benefit as a result of the constraint.

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If the transferor or a third party imposes a constraint on a transferee's right to pledge or exchange the transferred financial assets, as discussed in section 5.3, the parties need to determine whether the constraint provides a more-than-trivial benefit to the transferor. Judgment may be required to make this determination. [860-10-40-16]

If the constraint provides a more-than-trivial benefit to the transferor, the transferor has not surrendered actual control. Therefore, the second criterion is not met and the transfer is accounted for as a secured borrowing. [860-10-55-30]

Question 5.4.10

What does 'more-than-trivial' mean in Topic 860?

Interpretive response: Topic 860 does not define 'more-than-trivial'. Instead, it provides examples of conditions that constrain the transferee and provide a more-than-trivial benefit to the transferor. In practice, the threshold for more-than-trivial is very low and it is difficult for a transferor with continuing involvement to overcome the more-than-trivial benefit presumption.

Question 5.4.20

What are examples of conditions that constrain the transferee and provide a more-than-trivial benefit to the transferor?

Excerpt from ASC 860-10

• > Transferee's Rights to Pledge or Exchange Transferred Financial Assets

40-17 All of the following are examples of conditions that both constrain the transferee and presumptively provide the transferor with more than trivial benefits:

a. A provision that prohibits selling or pledging a transferred loan receivable. This condition not only constrains the transferee but also provides the transferor with the more-than-trivial benefit of knowing who holds the financial asset (a prerequisite to repurchasing the financial asset) and of being able to block the financial asset from being transferred to a competitor for the loan customer's business.
b. 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 to with the transferor.
c. Some rights or obligations to reacquire transferred financial assets or beneficial interests, including all of the following:

    1. A **freestanding call option** written by a transferee to the transferor. Such an option may benefit the transferor and, if the transferred

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financial assets are not readily obtainable in the marketplace, is likely to constrain a transferee because the transferee might have to default if the call option was exercised and the transferee had pledged or exchanged the financial assets.

1A. A call option to repurchase third-party beneficial interests at the price paid plus a stated return if the third-party holders of its beneficial interests are constrained from pledging or exchanging their beneficial interests due to that call option.

2. A call option written by a transferee to the transferor that is sufficiently deep-in-the-money, if the transferred financial assets are not readily obtainable in the marketplace, because the transferee would be more likely to have to hold the assets to comply with a potential exercise of the call option.

3. A freestanding forward purchase-sale contract between the transferor and the transferee on transferred financial assets not readily obtainable in the marketplace would benefit the transferor and is likely to constrain a transferee.

The following are examples of conditions that presumptively constrain the transferee and provide a more-than-trivial benefit to the transferor.

— A transferor-imposed constraint. A transferee would presumably pay less when an asset is constrained, so the transferor that imposed the constraint presumably incurs that cost for good reason – resulting in a more-than-trivial benefit, absent evidence to the contrary. [860-10-40-16, FAS 140.BC165]

  An example is a provision that prohibits selling or pledging a transferred financial asset. The transferor receives a more-than-trivial benefit from this provision by knowing who holds the financial asset and by being able to block the asset from being transferred to a competitor. [860-10-40-17(a)]

— A contractual constraint that a transferor does not impose because it knows a similar constraint is already imposed on the transferee by a third party. [860-10-40-16]

— A constraint that narrowly limits timing or terms of the sale or pledge of the transferred financial assets. [860-10-40-17(b)]

— Certain rights or obligations to reacquire transferred financial assets (see Question 5.4.40). [860-10-40-17(c)]

Question 5.4.30

Do standard representations and warranties provide a more-than-trivial benefit to the transferor?

Background: Standard representations and warranties are those made by the transferor that assert the financial asset being transferred is what it is purported to be at the transfer date. [860-10 Glossary]

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Interpretive response: No. Although standard representations and warranties represent a form of continuing involvement, we do not believe they provide the transferor with a more-than-trivial benefit.

Question 5.4.40

Do call options and forward purchase agreements result in the transferor retaining actual control?

Excerpt from ASC 860-10

• > Transferee's Rights to Pledge or Exchange Transferred Financial Assets

40-21 As discussed in paragraphs 860-10-40-22 through 40-39, some rights or obligations to reacquire transferred financial assets, regardless of whether they constrain the transferee, may result in the transferor's maintaining effective control over the transferred financial assets, thus precluding sale accounting under paragraph 860-10-40-5(c). For example, an **attached call option** 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. However, an attached call option could result in the transferor's maintaining effective control over the transferred asset(s) because the attached call option gives the transferor the unilateral ability to cause whoever holds that specific asset to return it.

Interpretive response: It depends. The nature and terms of the call option or forward purchase agreement, and whether the transferred financial assets are readily obtainable in the marketplace, affect whether the transferor retains actual control.

The following are some arrangements that both constrain the transferee and presumptively provide the transferor with a more-than-trivial benefit.

— A freestanding call option written by the transferee to the transferor may benefit the transferor and constrain the transferee if the transferred financial assets are not readily obtainable in the marketplace. The transferee might have to default if the call option was exercised and the transferee had pledged or exchanged the financial assets. See Question 6.4.110 for further discussion on determining whether a financial asset is not readily obtainable. [860-10-40-17(c)(1)]

— A deep-in-the-money call option written by the transferee to the transferor if the transferred financial assets are not readily obtainable in the marketplace. The transferee would likely need to hold the asset to comply with a potential exercise of that call option. [860-10-40-17(c)(2)]

— A call option to repurchase third-party beneficial interests at the price paid plus a stated return if the third-party holders of its beneficial interests are constrained from pledging or exchanging their beneficial interests due to that call option. [860-10-40-17(c)(1A)]

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— A freestanding forward purchase-sale contract between the transferor and transferee is likely to require the transferee to hold the assets to comply with the contract when the transferred assets are not readily obtainable in the marketplace. [860-10-40-17(c)(3)]

Alternatively, the following are some arrangements that do not both constrain the transferee and presumptively provide the transferor with a more-than-trivial benefit.

— A freestanding call option written by the transferee to the transferor if the transferred financial assets are readily obtainable in the marketplace. [860-10-40-18(g)]

— A call option that is exercisable by the transferor and attached to the transferred financial assets would not constrain a transferee who is able to obtain substantially all of the assets' economic benefits by exchanging or pledging the assets subject to the call. An attached call option is part of, and is traded with, the underlying instrument. However, in the event an attached call option by itself does not cause a transferor to maintain actual control, it may cause the transferor to maintain effective control. See Question 6.4.40. [860-10-40-21, 860-10 Glossary]

— A call option embedded in the transferred assets and exercisable by the issuer (not the transferor) does not provide a more-than-trivial benefit to the transferor because it is the issuer that holds that call, not the transferor. As discussed in greater detail in Question 6.4.40, an embedded call option is a call option held by the issuer of a financial instrument that is part of and trades with the underlying instrument. [860-10-40-32, 860-10 Glossary]

Question 5.4.50

Is a transferee constrained if the transferor is also the transferee's asset manager?

Background: In some cases, the transferee may use a third party to manage its acquired financial assets. In some of those cases, the asset manager may be the transferor of financial assets to the entity that it manages and, through its role as asset manager, have the ability to decide whether the transferred assets are sold, pledged or exchanged. Typically, the transferor's rights as an asset manager are in a separate contract from the contracts that govern the transfer of financial assets.

Interpretive response: It depends. If a transferor is the transferee's asset manager, and in that role has the unilateral ability to decide when to sell, pledge or exchange the transferee's assets, we believe that ability represents a constraint unless the transferee has a substantive right to remove and replace the asset manager without cause.

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6. Sale criterion: Effective control

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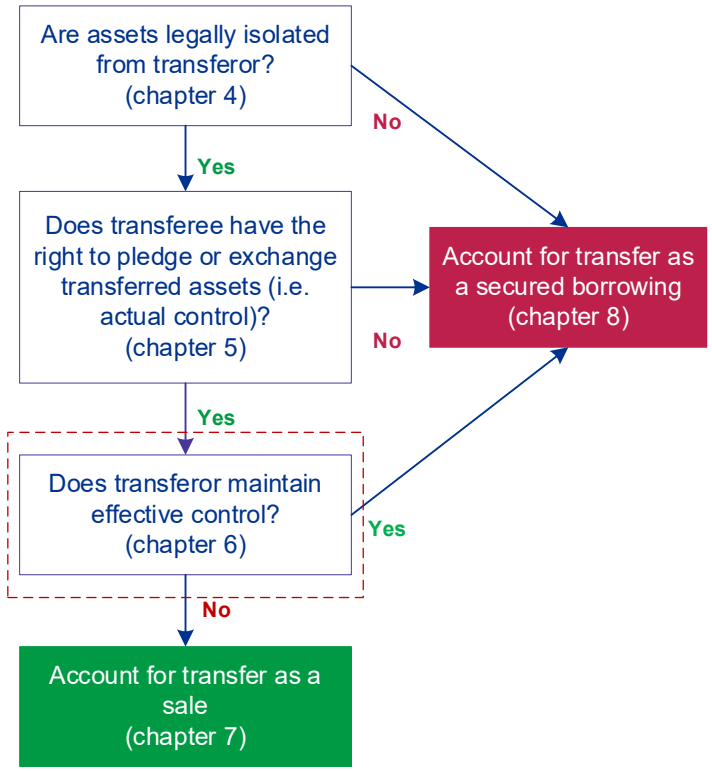
6.1 How the standard works

The broad outline of how an entity evaluates whether a transfer qualifies as a sale is summarized in the following decision tree; there is no requirement to evaluate these criteria in any particular sequence.



This chapter addresses the third criterion – i.e. whether a transferor has maintained effective control. A transferor does not account for a transfer of financial assets as a sale when it has maintained effective control over them (or over third-party beneficial interests related to them). A transferor maintains effective control through any of the following types of agreements.

Type 1	An agreement that both entitles and obligates the transferor to repurchase or redeem the transferred financial assets before their maturity.
Type 2	An agreement that provides the transferor with the following (other than through a cleanup call): — the unilateral ability to cause the holder to return specific financial assets; and — a more-than-trivial benefit attributable to that ability.
Type 3	An agreement that permits the transferee to require the transferor to repurchase the transferred financial assets (i.e. a put option) at a price that is so favorable to the transferee that it is probable the transferee will exercise its right.

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As an exception to the effective control criterion, Topic 860 requires all repurchase-to-maturity transactions to be accounted for as secured borrowings as if the transferor had maintained effective control.

In this chapter, references to a transferred financial asset include beneficial interests issued by a transferee whose sole purpose is to engage in securitizations or asset-backed financing activities, and references to transferees include third-party holders of those beneficial interests.

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6.2 Overview of effective control criterion

Excerpt from ASC 860-10

> Conditions for a Sale of Financial Assets

40-5 A transfer of an entire financial asset, a group of entire financial assets, or a participating interest in an entire financial asset in which the transferor surrenders control over those financial assets shall be accounted for as a sale if and only if all of the following conditions are met: …

c. Effective control. The transferor, its consolidated affiliates included in the financial statements being presented, or its agents do not maintain effective control over the transferred financial assets or third-party beneficial interests related to those transferred assets (see paragraph 860-10-40-22A). A transferor's effective control over the transferred financial assets includes, but is not limited to, any of the following:

   1. An agreement that both entitles and obligates the transferor to repurchase or redeem the transferred financial assets before their maturity (see paragraphs 860-10-40-23 through 40-25)
   2. An agreement, other than through a **cleanup call** (see paragraphs 860-10-40-28 through 40-39), that provides the transferor with both of the following:
      i. The **unilateral ability** to cause the holder to return specific financial assets
      ii. A more-than-trivial benefit attributable to that ability.
   3. An agreement that permits the transferee to require the transferor to repurchase the transferred financial assets at a price that is so favorable to the transferee that it is probable that the transferee will require the transferor to repurchase them (see paragraph 860-10-55-42D).

A transferor does not account for a transfer of financial assets as a sale when it has maintained effective control over them (or over third-party beneficial interests related to them). [860-10-40-5(c)]

The effective control guidance applies to transferred financial assets or to beneficial interests related to transferred assets, if the sole purpose of a transferee that issues the beneficial interests is to engage in securitizations or asset-backed financing activities. In this chapter, references to a transferred financial asset include beneficial interests issued by such an entity, and references to transferees include third-party holders of those beneficial interests. See section 9.2 for discussion about securitization transactions.

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Question 6.2.10

How does a transferor maintain effective control over transferred financial assets?

Interpretive response: A transferor maintains effective control through any of the following types of agreements. [860-10-40-5(c)]

Type 1 **E.g. certain repurchase agreements** (section 6.3)	An agreement that both entitles and obligates the transferor to repurchase or redeem the transferred financial assets before their maturity.
Type 2 **E.g. certain call options** (section 6.4)	An agreement that provides the transferor with the following (other than through a cleanup call): — the unilateral ability to cause the holder to return specific financial assets; and — a more-than-trivial benefit attributable to that ability.
Type 3 **E.g. certain put options** (section 6.5)	An agreement that permits the transferee to require the transferor to repurchase the transferred financial assets (i.e. a put option) at a price that is so favorable to the transferee that it is probable the transferee will exercise its right.

Determining whether a transferor has maintained effective control requires judgment. Further, this determination requires considering the following, as discussed in section 3.5.20: [860-10-40-4, 55-79A]

- all arrangements or agreements made contemporaneously with (or in contemplation of) the transfer, even if not entered into at the time of the transfer; and
- continuing involvement of the following parties:
  - the transferor itself;
  - the transferor's consolidated affiliates included in the financial statements being presented; and
  - the transferor's agents.

Question 6.2.20

How is the effective control analysis affected when a financial asset is transferred subject to a call or put option?

Interpretive response: It depends on whether the option is a call option or a put option. The transfer of a financial asset with a call option may be a Type 2 agreement (see section 6.4) while a transfer with a put option may be a Type 3 agreement (see section 6.5).

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In addition, some call options that do not maintain the transferor's effective control preclude sale accounting because they result in the transferor maintaining actual control. For example, a contingent call option that is not within the transferor's control does not maintain the transferor's effective control but may both constrain the transferee and provide a more-than-trivial benefit to the transferor, resulting in the transferor maintaining actual control. See discussion of actual control in chapter 5.

Further, call or put options represent a transferor's continuing involvement with transferred financial assets that generally results in a need to obtain a legal isolation opinion to conclude whether a transferor has maintained legal control (as discussed in Question 4.2.70).

Question 6.2.30

Are all activities of a transferor's agent considered when assessing whether a transferor has surrendered effective control?

Excerpt from ASC 860-10

• • > Involvement of Agents

40-22A Paragraph 860-10-40-4 states that, to assess whether the transferor maintains effective control over the transferred financial assets, all continuing involvement by the transferor, its consolidated affiliates included in the financial statements being presented, or its agents shall be considered continuing involvement by the transferor. When assessing effective control, the transferor only considers the involvements of an agent when the agent acts for and on behalf of the transferor. If the transferor and transferee have the same agent, the agent's activities on behalf of the transferee shall not be considered in the transferor's evaluation of whether it has effective control over a transferred financial asset. For example, an investment manager may act as a fiduciary (agent) for both the transferor and the transferee; therefore, the transferor need only consider the involvements of the investment manager if it is acting on its behalf.

Interpretive response: No. The transferor only considers the involvement of an agent when the agent is acting for and on the transferor's behalf. [860-10-40-22A]

For example, Investment Manager acts as a fiduciary for both Transferor and Transferee. In its role as a fiduciary for Transferee, Investment Manager has the ability to (in the future) sell a transferred financial asset back to Transferor on Transferee's behalf.

When analyzing whether Transferor has maintained effective control, only Investment Manager's activities on behalf of Transferor are considered and not the activities it is able to perform on behalf of Transferee. Therefore, that analysis does not consider that Investment Manager may in the future sell the

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financial asset back to Transferor on Transferee's behalf and that fact will not (in and of itself) cause Transferor to maintain effective control over the transferred financial asset. [860-10-40-22A]

Question 6.2.40

When does a transferor assess whether effective control is maintained?

Interpretive response: An entity evaluates whether the transferor maintains effective control over a transfer of financial assets throughout the life of the transferred assets – including when a transferor's continuing involvements with the transferred financial assets changes (e.g. a transferor disposes of an involvement); see section 7.4. However, when evaluating whether effective control is maintained through Type 2 or Type 3 agreements (see Question 6.2.10), an entity does not reevaluate how favorable the call or put price is in relation to market prices. [860-10-40-28(a), 55-42D]

For example, after the initial transfer:

- **Call option (Type 2 agreement):** an entity does not reevaluate whether a call option's price is so far out of the money that a transferor will not exercise it (see Question 6.4.30).
- **Put option (Type 3 agreement):** an entity does not reevaluate whether a put option's price is so favorable to the transferee that it is probable the transferee will exercise its right.

For guidance about whether options result in a transferor maintaining effective control, see section 6.4 (call options) and section 6.5 (put options).

6.3 Type 1 agreement – Effective control through both a right and an obligation

6.3.10 Overview

Excerpt from ASC 860-10

• • > Effective Control through both a Right and an Obligation

40-23 Although paragraph 860-10-40-5 sets forth criteria that must be met to achieve sale accounting, this guidance addresses criteria that must be met for a transfer to fail the condition in paragraph 860-10-40-5(c) through an agreement of the type described in paragraph 860-10-40-5(c)(1) and thus preclude sale accounting and result in accounting for the transfer as a secured borrowing.

40-24 An agreement that both entitles and obligates the transferor to repurchase or redeem transferred **financial assets** from the transferee

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maintains the transferor's effective control over those assets as described in paragraph 860-10-40-5(c)(1), if all of the following conditions are met:

a. The financial assets to be repurchased or redeemed are the same or substantially the same as those transferred. To be substantially the same, the financial asset that was transferred and the financial asset that is to be repurchased or redeemed need to have all of the following characteristics:

    1. The same primary obligor (except for debt guaranteed by a sovereign government, central bank, government-sponsored enterprise or agency thereof, in which circumstance the guarantor and the terms of the guarantee must be the same)
    2. Identical form and type so as to provide the same risks and rights
    3. The same maturity (or in the circumstance of mortgage-backed pass-through and pay-through securities, similar remaining weighted-average maturities that result in approximately the same market yield)
    4. Identical contractual interest rates
    5. Similar assets as collateral
    6. The same aggregate unpaid principal amount or principal amounts within accepted good delivery standards for the type of security involved. Participants in the mortgage-backed securities market have established parameters for what is considered acceptable delivery. These specific standards are defined by the Securities Industry and Financial Markets Association and can be found in Uniform Practices for the Clearance and Settlement of Mortgage-Backed Securities and Other Related Securities, which is published by the Securities Industry and Financial Markets Association.

    See paragraph 860-10-55-35 for implementation guidance related to these conditions. …

c. The agreement is to repurchase or redeem the financial assets before maturity, at a fixed or determinable price.

d. The agreement is entered into contemporaneously with, or in contemplation of, the transfer.

A Type 1 agreement (e.g. certain repurchase agreements) that results in a transferor maintaining effective control over transferred financial assets (or over third-party beneficial interests related to them) is an agreement that both entitles and obligates the transferor to repurchase or redeem the transferred financial assets from the transferee. [860-10-40-5(c)(1)]

Question 6.3.10

When does a transferor maintain effective control through an agreement that both entitles and obligates the transferor to repurchase the transferred financial assets?

Interpretive response: A transferor maintains effective control through an agreement that both entitles and obligates the transferor to repurchase the

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transferred financial assets (i.e. a Type 1 agreement) if all of the following conditions are met. [860-10-40-24]

Condition 1	The financial assets to be repurchased or redeemed are the same or substantially the same as those transferred. See section 6.3.20.
Condition 2	The agreement is to repurchase or redeem the financial assets before maturity at a fixed or determinable price.
Condition 3	The agreement is entered into contemporaneously with (or in contemplation of) the transfer.

In our experience, repurchase agreements and securities lending transactions are common transactions that frequently meet these conditions. For further discussion about repurchase agreements, see section 9.3.30.

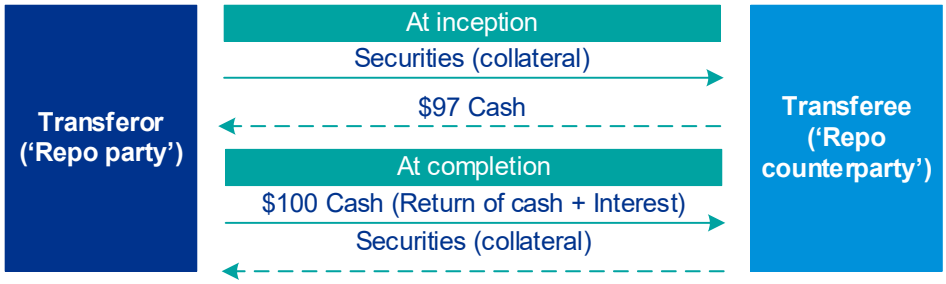
When these conditions are met, the transferor maintains effective control over the transferred financial assets and therefore cannot treat the transfer as a sale.

However, as an exception, a repurchase-to-maturity transaction is treated as if effective control is maintained, even if the above conditions are not met (see Question 6.3.20). [860-10-40-5A, 40-24A]

Example 6.3.10
Repurchase agreements

Transferor transfers Security XYZ (a debt security maturing in five years) to Transferee in exchange for $97. The transfer agreement also requires Transferee to repurchase Security XYZ (i.e. the same security) after one year for a fixed price of $100.

The following diagram shows the transfers.



Transferor has maintained effective control over Security XYZ through an agreement that both entitles and obligates it to repurchase the transferred financial assets. The agreement meets the three conditions in Question 6.3.10 for maintaining effective control.

- The asset to be repurchased is the same as the one transferred (Security XYZ).
- Transferor must repurchase Security XYZ in one year, which is before Security XYZ's maturity date (in five years).

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— The agreement for Transferor to repurchase Security XYZ is entered into contemporaneously with the initial transfer of Security XYZ.

Question 6.3.20

What is the repurchase-to-maturity exception?

Excerpt from ASC 860-10

20 Glossary

Repurchase-to-Maturity Transaction

A repurchase agreement in which the settlement date of the agreement to repurchase a transferred financial asset is at the maturity date of that financial asset and the agreement would not require the transferor to reacquire the financial asset.

40-5A A **repurchase-to-maturity transaction** shall be accounted for as a secured borrowing as if the transferor maintains effective control (see paragraphs 860-10-40-24 through 40-24A).

• • > Exception for a Repurchase-to-Maturity Transaction

40-24A Notwithstanding the characteristic in paragraph 860-10-40-24 that refers to a repurchase of the same (or substantially-the-same) financial asset, a **repurchase-to-maturity transaction** shall be accounted for as a secured borrowing as if the transferor maintains effective control.

Interpretive response: As an exception to the effective control criterion, Topic 860 requires all repurchase-to-maturity transactions to be accounted for as secured borrowings. Under the exception, all repurchase-to-maturity transactions are required to be accounted for as secured borrowings as if the transferor had maintained effective control. [860-10-40-5A, 40-24A]

By definition, a repurchase-to-maturity transaction is a repurchase agreement in which the settlement date for repurchasing a transferred financial asset is at that asset's maturity date. Typically, the settlement is a net cash payment because the repurchase agreement settles on the same day the financial asset matures, meaning the financial asset is no longer available to be returned. In this limited circumstance, the exchange of cash is considered equivalent to the return of the financial asset because cash is the only possible form of settlement once the transferred financial asset has matured. [860-10 Glossary, 860-10-40-24A, ASU 2014-11.BC7, ASU 2014-11.BC15]

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Question 6.3.30

Is effective control maintained through a Type 1 agreement when the transferor has a right or obligation (but not both)?

Excerpt from ASC 860-10

40-25 With respect to the condition in (a) in paragraph 860-10-40-24 to maintain effective control under the condition in paragraph 860-10-40-5(c) as illustrated in paragraph 860-10-40-5(c)(1), the transferor must have both the contractual right and the contractual obligation to repurchase or redeem **financial assets** that are identical to those transferred or substantially the same as those concurrently transferred. Transfers that include only the right to reacquire, at the option of the transferor or upon certain conditions, or only the obligation to reacquire, at the option of the transferee or upon certain conditions, may not maintain the transferor's control, because the option might not be exercised or the conditions might not occur. Similarly, expectations of reacquiring the same securities without any contractual commitments (for example, as in wash sales) provide no control over the transferred securities.

Interpretive response: No. A transferor must have both the contractual right and obligation to repurchase or redeem financial assets that are identical or substantially the same as those being transferred. [860-10-40-25]

For example, the following types of arrangements are not Type 1 agreements that maintain the transferor's effective control because the options in them might not be exercised or the conditions might not occur: [860-10-40-25]

- transfers that include only a call (or contingent call) option (i.e. the right or contingent right) to repurchase at the option of the transferor; and
- transfers that include only a put (or contingent put) option (i.e. the obligation or contingent obligation) to repurchase at the option of the transferee.

Similarly, if a transferor transfers financial assets and expects to repurchase the same securities without any contractual commitments, the transferor does not maintain effective control. A common type of such a transfer is a wash sale (see section 9.4.20). [860-10-40-25]

However, some call or put options result in the transferor maintaining effective control through Type 2 or Type 3 agreements, as discussed in sections 6.4 and 6.5, respectively. In addition, some call options may constrain the transferee and provide a more-than-trivial benefit to the transferor, thereby giving the transferor actual control and precluding sale accounting, as discussed in chapter 5.

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Question 6.3.40

Is a transferor's ability to perform under an agreement considered when determining whether effective control is maintained?

Interpretive response: No. When evaluating whether a transferor has effective control, the transferor's ability to perform under the agreement is not a determining factor.

For example, whether an agreement requires collateral is not relevant to determining whether an entity controls transferred financial assets. As a result, a transferor can still maintain effective control if an agreement does not require the transferor to maintain sufficient collateral to assure its ability to repurchase or redeem the transferred financial assets. [ASU 2011-03.BC12-BC13]

Question 6.3.50

Does a transferor maintain effective control if it has a right and obligation to repurchase a financial asset at fair value at the repurchase date?

Interpretive response: No. The second condition for a repurchase agreement to give the transferor effective control is that the repurchase price must be fixed or determinable. This requires that the repurchase price is: [860-10-40-24(c)]

- stated in the contract; or
- determinable based on the contract's terms.

An asset's future fair value is not fixed or determinable. Therefore, an agreement to repurchase a transferred financial asset for its fair value at a future repurchase date does not result in a transferor maintaining effective control. [860-10-40-24(c)]

6.3.20 Whether securities are substantially the same

Excerpt from ASC 860-10

• • > Whether Securities Exchanged Are Substantially the Same

55-35 This guidance addresses criteria that must be met for a transfer to fail the condition in paragraph 860-10-40-5(c) through an agreement of the type described in paragraph 860-10-40-5(c)(1), precluding sale accounting and resulting, instead, in secured-borrowing accounting. The following are examples of whether securities exchanged are substantially the same as discussed in paragraph 860-10-40-24:

a. The same primary obligor (see paragraph 860-10-40-24(a)(1)). The exchange of pools of single-family loans would not meet this criterion because the

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mortgages comprising the pool do not have the same primary obligor, and would therefore not be considered substantially the same.

b. Identical form and type (see paragraph 860-10-40-24(a)(2)). The following exchanges would not meet this criterion:

   1. GNMA I securities for GNMA II securities
   2. Loans to foreign debtors that are otherwise the same except for different U.S. foreign tax credit benefits (because such differences in the tax receipts associated with the loans result in instruments that vary in form and type)
   3. Commercial paper for redeemable preferred stock.

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) (see paragraph 860-10-40-24(a)(3)). The exchange of a fast-pay GNMA certificate (that is, a certificate with underlying mortgage loans that have a high prepayment record) for a slow-pay GNMA certificate would not meet this criterion because differences in the expected remaining lives of the certificates result in different market yields.

d. Similar assets as **collateral** (see paragraph 860-10-40-24(a)(5)). Mortgage-backed pass-through and pay-through securities must be collateralized by a similar pool of mortgages, such as single-family residential mortgages, to meet this characteristic.

For an arrangement to represent a Type 1 agreement maintaining the transferor's effective control, one of the conditions is that the financial assets to be repurchased are the same or substantially the same (see Question 6.3.10).

Question 6.3.60

When are financial assets transferred substantially the same as those to be repurchased or redeemed?

Interpretive response: To be substantially the same, the financial asset transferred and the financial asset to be repurchased or redeemed must have all of the following characteristics.

Characteristic	Additional guidance
Same primary obligor (or the same guarantor for certain debt) [860-10-40-24(a)(1), 55-35(a)]	Debt guaranteed by a sovereign government, central bank, government-sponsored enterprise or agency thereof meets this characteristic if the guarantor and the terms of the guarantee are the same. An example of an exchange that does *not* meet this characteristic is an exchange of pools of single-family loans that are either unguaranteed or do not have the same guarantor. This is because the mortgages in the pool do not have the same primary obligor.

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Characteristic	Additional guidance
Identical form and type [860-10-40-24(a)(2), 55-35(b)]	The form and type of transferred asset and the asset to be repurchased or redeemed must provide the same risks and rights. The following examples of exchanges do *not* meet this characteristic: — GNMA I securities for GNMA II securities; — loans to foreign debtors that are otherwise the same except for different US foreign tax benefits; and — commercial paper for redeemable preferred stock.
Same maturity (or similar remaining weighted-average maturities for certain securities) [860-10-40-24(a)(3), 55-35(c)]	Mortgage-backed pass-through and pay-through securities have similar remaining weighted-average maturities if they have approximately the same market yield. An example of an exchange that does *not* meet this characteristic is an exchange of a fast-pay GNMA certificate (which has underlying mortgage loans with a high prepayment record) for a slow-pay GNMA certificate. This is because differences in the expected remaining lives of the certificates result in different market yields.
Identical contractual interest rates [860-10-40-24(a)(4)]	The contractual interest rates of the transferred financial asset and the asset to be repurchased or redeemed must be identical.
Similar assets as collateral [860-10-40-24(a)(5), 55-35(d)]	For example, mortgage-backed pass-through and pay-through securities must be collateralized by a similar pool of mortgages (e.g. single-family residential mortgages) to meet this characteristic.
Same aggregate unpaid principal amount(s) within accepted good delivery standards for the type of security [860-10-40-24(a)(6)]	Participants in the MBS market have established parameters for what is considered acceptable delivery. These specific standards can be found in Uniform Practices for the Clearance and Settlement of Mortgage-Backed Securities and Other Related Securities, which is published by the Securities Industry and Financial Markets Association (SIFMA).

6.4 Type 2 agreement – Ability to unilaterally cause the return of specific transferred assets

6.4.10 Overview

A Type 2 agreement (e.g. certain call options) that results in a transferor maintaining effective control over transferred financial assets (or over third-party beneficial interests related to them) is an agreement that provides the

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transferor with a repurchase right. The repurchase right must give the transferor: [860-10-40-5(c)(2)]

— the unilateral ability to cause the holder to return specific financial assets (see section 6.4.20); and
— a more-than-trivial benefit (see section 6.4.30).

As an exception, an agreement that represents a cleanup call does not result in a transferor maintaining effective control, even if it provides both of the above to the transferor. Cleanup calls are discussed in section 6.4.50. [860-10-40-5(c)(2)]

Further, a call option that does not maintain a transferor's effective control may result in a transferor maintaining legal or actual control over the transferred financial assets (see Question 6.2.20).

Question 6.4.10

What conditions are evaluated when determining whether an agreement with a repurchase right provides the transferor with effective control through a Type 2 agreement?

Interpretive response: The following decision tree summarizes the conditions to be evaluated when determining whether an agreement with a physically-settled repurchase right provides the transferor with effective control. For cash-settled repurchase rights, see Question 6.4.20.

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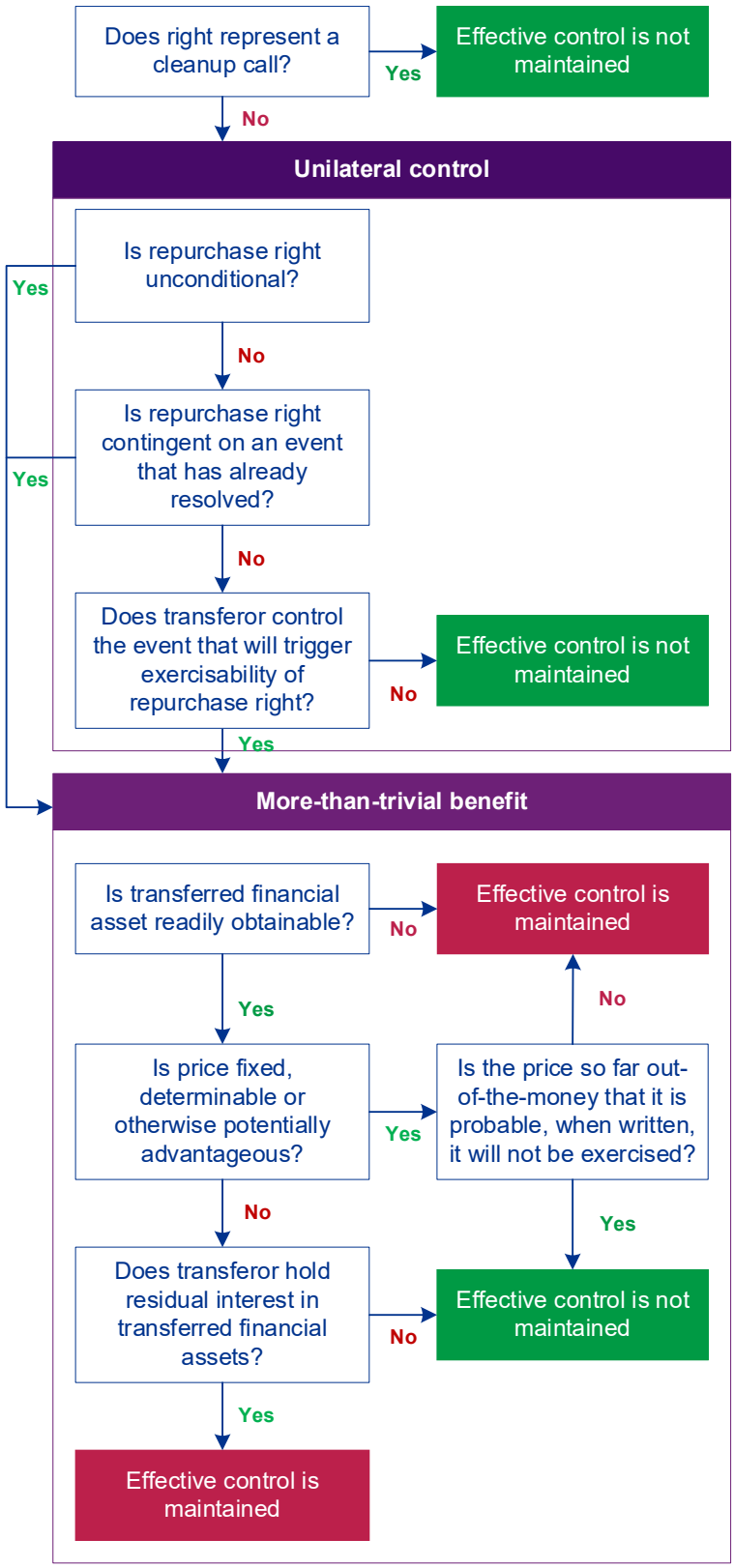

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6.4.20 Unilateral ability

Excerpt from ASC 860-10

20 Glossary

Unilateral Ability

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

• • > Effective Control through Unilateral Ability

40-28 This guidance addresses whether any of the following agreements maintain effective control under paragraph 860-10-40-5(c)(2):

a. A call option or other right conveys more than a trivial benefit (that is, fails the condition in paragraph 860-10-40-5(c)(2)(ii)) 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.
b. A transferor's unilateral ability to cause a securitization entity to return to the transferor or otherwise dispose of specific transferred financial assets, for example, in response to its decision to exit a market or a particular activity, has the characteristic in paragraph 860-10-40-5(c)(2)(i) and, thus, would provide the transferor with effective control over the transferred financial assets if it also has the characteristic in paragraph 860-10-40-5(c)(2)(ii)—that is, if it also provides more than a trivial benefit to the transferor.
c. A call option on readily obtainable assets at fair value may not provide the transferor with more than a trivial benefit.

Paragraph 860-10-40-35 provides an example in which, due to the combination of arrangements, the transferor would maintain effective control.

40-30 See paragraphs 860-10-55-39 through 55-42C for implementation guidance addressing how different types of rights of a transferor to reacquire (call) transferred financial assets affect sale accounting under this Subtopic.

• • • > Call Options

40-31 Cash-settled call options do not constrain the transferee, nor do they result in the transferor maintaining effective control because they do not provide the transferor with an opportunity to reclaim the transferred financial assets. Therefore, this guidance addresses call options that can be physically settled.

• • > Transfer Involving Certain Transferor Powers

55-67 If the transferor has the ability to dissolve a securitization entity (for example, through the beneficial interests that it holds) and reassume control of the financial assets at any time, the transferor is precluded from accounting for the transfer as a sale for the following reason: …

b. The transferor's current ability to dissolve the securitization entity and reassume control of the transferred financial assets entitles it to unilaterally

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cause the return of the transferred financial assets, indicating that the transferor has maintained control over the transferred financial assets which precludes sale accounting under paragraph 860-10-40-5(c).

• • > Transferor Option to Repurchase Individual Financial Assets

55-68 In certain transactions, the transferor is entitled to repurchase a transferred amortizing, individual (specific) financial asset when its remaining principal balance reaches some specified amount, for example, 30 percent of the original balance. To exercise that call option, the transferor would pay the remaining principal balance. Paragraph 860-10-40-5(c)(2) states that a transferor maintains effective control through a call option, other than through a cleanup call, that provides the transferor with both:

a. The unilateral ability to cause the holder to return specific financial assets
b. A more-than-trivial-benefit attributable to that ability.

55-68A Such a call option on the remaining portion of an entire financial asset precludes sale accounting for the entire financial asset. Paragraph 860-10-40-5 applies to an entire financial asset, a group of entire financial assets, or a participating interest. Paragraph 860-10-40-4A states that, to be eligible for sale accounting, an entire financial asset cannot be divided into components before a transfer unless all of the components meet the definition of a participating interest. That paragraph states also that an entity shall not account for a transfer of an entire financial asset or a participating interest in an entire financial asset partially as a sale and partially as a secured borrowing.

55-70 If a transferor holds a call option to repurchase at any time a few specified, individual loans from an entire group of loans transferred in a securitization transaction, then sale accounting is precluded only for the specified loans subject to the call option, not the whole group of loans. In contrast, if the transferor holds a call option to repurchase from the group any loans it chooses, up to some specified limit, then sale accounting is precluded for the transfer of the entire group while that option remains outstanding. See paragraphs 860-10-55-39 through 55-42 for related guidance.

For a transfer to maintain effective control through a Type 2 agreement, a right to repurchase must give the transferor the unilateral ability to cause the holder to return specific financial assets. [860-10-40-5(c)(2)]

Question 6.4.20

Does a unilateral repurchase right that settles in cash provide the transferor with effective control?

Interpretive response: No. Cash-settled repurchase rights (e.g. call options that are cash-settled based on the difference between the strike price and the fair value of the related financial assets) do not result in the transferor maintaining effective control because they do not provide the transferor with an opportunity to reclaim the transferred financial assets. Therefore, the guidance in this section applies only to rights that can be physically settled. [860-10-40-31]

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Question 6.4.30

Does a contingent right to repurchase assets provide the transferor with the unilateral ability to cause the holder to return specific assets?

Interpretive response: Whether a right that is contingent or conditional provides the transferor with a unilateral ability to repurchase assets depends on the following considerations. [860-10-40-5(c)(2)]

Whether the contingent event is within transferor's control	If the contingent event is within the transferor's control, the transferor has the unilateral ability to repurchase the transferred assets. In contrast, if the contingency is out of the transferor's control (e.g. a repurchase agreement that can be exercised only in response to a third party's action such as a default), the transferor does not have the unilateral ability to cause the holder to return specific assets unless the contingency is resolved. See Example 6.4.10 for an example of a contingent event that is within the transferor's control.
Whether the contingency has been resolved	Once the contingency is resolved, the transferor has the unilateral ability to cause the return of the specific assets and has then regained effective control as a result (see section 7.4).

As discussed in Question 6.2.40, an entity evaluates whether the transferor maintains effective control over a transfer of financial assets throughout the life of the transferred assets. That includes that an entity evaluates whether contingent rights provide the transferor with the unilateral ability to repurchase assets throughout the life of the contingent rights.

Question 6.4.40

How does the type of call option (embedded, attached, freestanding) affect whether the transferor retains effective control?

Excerpt from ASC 860-10

40-21 As discussed in paragraphs 860-10-40-22 through 40-39, some rights or obligations to reacquire transferred financial assets, regardless of whether they constrain the transferee, may result in the transferor's maintaining effective control over the transferred financial assets, thus precluding sale accounting under paragraph 860-10-40-5(c). For example, an **attached call option** 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. However, an attached call option could result in the transferor's maintaining effective control over the transferred asset(s) because the attached call option

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gives the transferor the unilateral ability to cause whoever holds that specific asset to return it.

• • • > Call Options

40-32 An **embedded call option** would not result in the transferor's maintaining effective control because it is the issuer rather than the transferor who holds the call option and the call option does not provide more than a trivial benefit to the transferor. For example, a call embedded by the issuer of a callable bond or the borrower of a prepayable mortgage loan would not provide the transferor with effective control over the transferred financial asset.

Interpretive response: A repurchase right is commonly in the form of a call option. A call option may be embedded in a financial asset, attached to a financial asset or freestanding. How the nature of the call option affects whether the transferor retains effective control over transferred financial assets through the call option is summarized in the following table.

Description	Impact on effective control
Embedded	
A call option held by the *issuer* of a financial instrument that is part of and trades with the underlying instrument. As the name suggests, an embedded call option forms part of the original financial asset and its holder does not change when the asset is transferred. An embedded call option trades with and diminishes the value of the financial instrument subject to the call. [860-10 Glossary] For example, a callable bond or prepayable mortgage loan has an embedded call option held by the issuer – i.e. the debtor/borrower under the bond or loan. [860-10-40-32].	The financial asset's issuer is the holder of the embedded call option throughout the asset's life. As a result, a transferor who is not the issuer of the financial asset does not maintain effective control over the transferred financial asset – i.e. it does not provide the transferor with a unilateral ability to repurchase the transferred asset. [860-10-40-32]
Attached	
A call option held by the *transferor* of a financial asset that becomes part of and is traded with the underlying instrument. Like an embedded call option, an attached call option is traded with and diminishes the value of the underlying instrument transferred subject to the call option. [860-10 Glossary] For example, a call option held by a transferor on third-party beneficial interests in a transferred financial asset is generally considered an attached call option. See also Question 6.4.90. [860-10-40-28A]	Because the transferor is the holder of the attached option, it may result in a transferor maintaining effective control over the transferred asset, depending on its terms. The transferor maintains effective control if the attached call option provides the transferor with the unilateral ability to repurchase the specific financial asset and a more-than-trivial benefit. See also Question 6.4.80.

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Description	Impact on effective control
Freestanding	
A call option that is not embedded in or attached to an asset subject to the call. [860-10 Glossary] A freestanding call option is a unit of account separate from the financial asset and may be traded separately.	A freestanding call option that is held by a transferor may result in the transferor maintaining effective control. The transferor maintains effective control if the freestanding call option provides the transferor with the unilateral ability to repurchase the specific financial asset and a more-than-trivial benefit.

Question 6.4.50

What is a removal of accounts provision (ROAP)?

Excerpt from ASC 860-10

• • • > Removal-of-Accounts Provisions

40-36 Many transfers of financial assets that involve transfers of a group of entire financial assets to an entity whose sole purpose is to engage in securitization or asset-backed financing activities empower the transferor to reclaim assets subject to certain restrictions. Such a power is sometimes called a removal-of-accounts provision. Whether a removal-of-accounts provision precludes sale accounting depends on whether the removal-of-accounts provision results in the transferor's maintaining effective control over transferred financial assets.

Interpretive response: In many transfers of groups of entire financial assets to entities whose sole purpose is to engage in securitization or asset-backed financing activities, the transferor receives the right to repurchase assets subject to certain restrictions. This right is called a removal-of-accounts provision (ROAP), which is a call option related to securitization or asset-backed financing activities. [860-10-40-36]

A transferor maintains effective control over transferred financial assets through a ROAP if it provides the transferor with: [860-10-40-5(c)(2), 40-36]

— the unilateral ability to cause the holder to return specific financial assets; and
— a more-than-trivial benefit.

As with other repurchase rights, a ROAP does not result in a transferor maintaining effective control if it can be exercised only in response to a third party's action that has not yet occurred (see Question 6.4.20). [860-10-40-39, 860-10-55-41]

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Question 6.4.60

Does a call option on a prepayable asset provide the transferor with a unilateral right to repurchase the asset?

Interpretive response: Yes. Although the financial asset may be prepaid before the transferor exercises its call option (effectively terminating the transferor's call option), a financial asset's embedded prepayment feature does not impact whether a call option provides the transferor with a unilateral right to reclaim it. As a result, such a call option results in the transferor maintaining effective control if it also provides the transferor with a more-than-trivial benefit.

Note: A prepayment feature is a call option that is embedded in the financial asset and is held by the asset's issuer instead of the transferor; Question 6.4.40 discusses embedded call options, including prepayment features. [860-10-40-32]

Question 6.4.70

Must a transferor intend to exercise a unilateral right to repurchase a financial asset to maintain effective control?

Interpretive response: No. Regardless of whether a transferor intends to exercise its right, the existence of a unilateral right to require the return of transferred financial assets results in the transferor maintaining effective control. As a result, sale accounting is precluded.

Example 6.4.10

Call option contingent on transferor filing mechanic's lien

Transferor transfers trade receivables to Investor (a third-party transferee). The receivables relate to contractual services (e.g. repairs, maintenance, installation) performed by Transferor for its customers. Under the trade receivable sale agreement, Transferor may repurchase a customer's receivable from Investor if Transferor files a mechanic's lien against the customer's property.

Transferor can file a mechanic's lien against a customer's property at any time once it has performed contractual services. However, Transferor generally files a mechanic's lien only if the customer's creditworthiness becomes uncertain (e.g. upon default, delinquency or slow payment).

Transferor has the unilateral ability to cause the holder to return specific financial assets because Transferor has the ability to file a mechanic's lien – Transferor controls the contingent event that allows it to repurchase the receivable – at any time after it performs the contractual service, because no third party's action is required. The fact that Transferor generally only files a mechanic's lien when a customer's creditworthiness becomes uncertain is not

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relevant to whether Transferor holds a unilateral right to repurchase specific assets.

Question 6.4.80

Does a transferor maintain effective control over all transferred financial assets if it has a unilateral right to repurchase only a portion of them?

Interpretive response: A unilateral right to reclaim specific transferred financial assets maintains the transferor's effective control only for the assets that the transferor has the unilateral right to repurchase. The examples in the following table demonstrate this concept.

For each example, it is presumed that the repurchase right provides a more-than-trivial benefit to the transferor (see section 6.4.30).

Type of repurchase right	Description of transferor's unilateral right	Transferred financial assets for which effective control is maintained
Non-contingent call option	Call option to repurchase – at any time – a few specified, individual loans from an entire group of loans transferred in a securitization transaction.	Only the specified loans subject to the call option, and not the whole group of loans. [860-10-55-70]
Non-contingent call option	Call option to repurchase – from an entire group of loans transferred in a securitization transaction – any loans it chooses, up to some specified limit (e.g. number of loans or dollar amount).	The entire group, until the earlier of when: [860-10-55-70] — the option expires; or — the limit is reached.
Call option with an exercise contingency based on principal paydowns	Right to repurchase a transferred, amortizing, individual (specific) financial asset when its remaining principal balance reaches some specified amount (e.g. 30% of the original balance).	The entire financial asset, unless the right represents a cleanup call. This is because, to be eligible for sale accounting, an entire financial asset cannot be divided into components before a transfer unless each of the components meets the definition of a participating interest (see section 3.4). [860-10-55-68 – 55-68A]
Call option with an exercise contingency within the transferor's control	Contingent right to cause a securitization entity to return to the transferor – or otherwise dispose of – specific transferred financial assets (e.g. in response to the transferor's decision to exit a market or a particular activity).	The specific assets subject to the right. [860-10-40-28(b)]

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Type of repurchase right	Description of transferor's unilateral right	Transferred financial assets for which effective control is maintained
Indirect repurchase right; see also Question 6.4.90	Right to dissolve a securitization entity (e.g. through the beneficial interests that it holds) and reassume control of the financial assets at any time.	All transferred financial assets. This is because the transferor is entitled to unilaterally cause the return of the transferred financial assets through its ability to dissolve the securitization entity. [860-10-55-67]

Question 6.4.90

Can an indirect right to repurchase transferred financial assets maintain the transferor's effective control?

Excerpt from ASC 860-10

• • > Effective Control through Unilateral Ability

40-28A Effective control over transferred financial assets can be present even if the right to reclaim is indirect. For example, if a call allows a transferor to buy back the beneficial interests at a fixed price, the transferor may maintain effective control of the financial assets underlying those beneficial interests. If the transferee is an entity whose sole purpose is to engage in securitization or asset-backed financing activities, that entity may be constrained from choosing to pledge or exchange the transferred financial assets. In that circumstance, any call held by the transferor on third-party beneficial interests is effectively an attached call on the transferred financial assets. Depending on the price and other terms of the call, the transferor may maintain effective control over the transferred financial assets.

Interpretive response: Yes, a right to reclaim transferred financial assets can maintain the transferor's effective control even if that right is indirect. [860-10-40-28A]

For example, Transferor holds a non-contingent call option that allows it to buy back all beneficial interests issued by Transferee to third parties at a fixed price. Transferee is an entity whose sole purpose is to engage in securitization or asset-backed financing activities, and it is constrained from pledging or exchanging the transferred financial assets. Therefore, Transferor's call option on the third-party beneficial interests is effectively an attached call on the transferred financial assets. Therefore, Transferor maintains effective control through the attached call option if it provides Transferor with a more-than-trivial benefit (see section 6.4.30). [860-10-40-28A]

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Another example of an indirect repurchase right that can also maintain the transferor's effective control is when a transferor has the unilateral right to dissolve a securitization entity and reassume control of the financial assets at any time (see Question 6.4.80).

6.4.30 More-than-trivial benefit

For a transfer to maintain effective control through a Type 2 agreement, a right to repurchase must give the transferor a more-than-trivial benefit. [860-10-40-5(c)(2)]

Question 6.4.100

How does an entity evaluate whether the transferor was provided with a 'more-than-trivial benefit'?

Interpretive response: Topic 860 does not define 'more-than-trivial'. However, in the context of evaluating effective control, it indicates that a call option or other right provides the transferor with a 'more-than-trivial' benefit if: [860-10-40-28(a), (c), 55-67]

- the call option is on an asset that is not readily obtainable (see Question 6.4.110); or
- the price to be paid is fixed, determinable or otherwise potentially advantageous. However, even if these conditions are met, the benefit is not more-than-trivial if it is probable when the option is written that the transferor will not exercise it because the price is so far out of the money or for other reasons.

Judgment about all relevant facts and circumstances is required when evaluating whether a transferor receives a more-than-trivial benefit. In practice, the threshold for more-than-trivial is very low.

Question 6.4.110

How does an entity evaluate whether an asset is 'readily obtainable'?

Interpretive response: Topic 860 does not define the term 'readily obtainable'. Although the Board has indicated that assets must be marketable and not unique to be readily obtainable, judgment is required to determine whether a financial asset is readily obtainable. [FSP FAS 140-3.A13 – A14]

If there are quoted prices in an active market for the specific asset, we believe the asset is readily obtainable. Otherwise, we believe other factors including the following should be evaluated.

- **Number of market participants.** A market with many participants willing to transact at fair value is an indicator that the asset is readily obtainable; an asset with few such participants is an indicator that it is not.

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— **Volume and nature of market transactions.** A high volume of orderly transactions is an indicator that the asset is readily obtainable; a low volume of transactions comprising forced transactions or distressed sales are an indicator that it is not.

Changing market conditions (e.g. when markets experience illiquidity) can impact whether an asset is readily obtainable. As a result, the evaluation of whether an asset is readily obtainable may change over time.

Question 6.4.120

Does a transferor receive a more-than-trivial benefit through a unilateral right to repurchase a financial asset for its fair value at the repurchase date?

Excerpt from ASC 860-10

• • • > Call Options

40-35 A right to reclaim specific transferred financial assets by paying their fair value when reclaimed generally does not maintain effective control if 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 financial assets. See paragraph 860-10-55-42A for discussion of a related example.

Interpretive response: Generally, no. However, in either of the following circumstances, such a right (called a fair value call option) held by the transferor provides it with a more-than-trivial benefit and therefore with effective control. [860-10-40-35]

Transferor holds the residual interest in the transferred assets	For example, Transferor holds both of the following: — the residual interest in securitized financial assets; and — an option to reclaim the transferred financial assets upon windup of the securitization entity by purchasing them in an auction. In this situation, Transferor maintains effective control because Transferor can pay any price it chooses in the auction and recover any excess paid over fair value through its residual interest in the transferred financial assets. [860-10-40-35, 860-10-55-42A]
Transferred assets are not readily obtainable	If the transferred assets are not readily obtainable, a fair value call option provides a more-than-trivial benefit to the transferor and causes the transferor to maintain effective control. We believe the call option provides the transferor with the more-than-trivial benefit of having knowledge of who holds the transferred assets and being able to block the assets from being transferred to a competitor. [860-10-40-28(c), 55-42(f)]

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Question 6.4.130

Does a repurchase price based on a formula intended to represent fair value represent a fair value call option?

Interpretive response: Not necessarily. Some agreements that allow the transferor to require the return of a specific asset include a formula for determining the repurchase price that is intended to result in the repurchase price approximating the asset's fair value on the repurchase date. However, those formulas may not represent fair value or capture all potential changes in fair value after the agreement's inception, and therefore they may not equate to a fair value call option.

As a result, an entity needs to consider whether such a formula results in the transferor being provided a more-than-trivial benefit – and therefore results in the transferor maintaining effective control.

Example 6.4.20

Tender option bonds – residual interest holder can require redemption of beneficial interests

Transferor (a Mutual Fund) acquires a municipal bond with a five-year term. Transferor transfers it to Tender Option Bond Trust (TOB Trust, the transferee). TOB Trust is constrained from pledging or exchanging the bond.

To fund the purchase of the bond, TOB Trust issues the following, which have an aggregate fair value equal to the price TOB Trust pays to purchase the bond.

Beneficial interests / other arrangements	Description / additional information
Floating rate certificates are issued to third parties	— The certificates bear a short-term interest rate that resets based on an index or a periodic auction. — Holders of the certificates have the option to tender them to TOB Trust for redemption at par.
Residual interest certificates issued to Transferor	The holder of the residual interest certificates has the right to do the following at each interest rate reset date: — purchase the floating rate certificates; — combine them with the residual interest certificates; and then — present them to TOB Trust for redemption in exchange for the municipal bond held by the TOB Trust.
Shortfall (liquidity) agreement is entered with Transferor	— Upon redemption of certificates (i.e. beneficial interests), the shortfall (liquidity) provider is required to make TOB Trust whole. — Redemption of certificates can occur if: – the residual holder exercises its rights to force a tender;

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Beneficial interests / other arrangements	Description / additional information
	– there is a failed remarketing; or – on other specified termination events.

Transferor maintains effective control over the transferred municipal bond because it holds the right to call all beneficial interests in exchange for the municipal bond held by the trust. Those rights effectively represent a fixed price call option on the municipal bond – i.e. Transferor can pay the beneficial interests' par amount for the municipal bond.

Even if Transferor was required to pay fair value to call the municipal bond, Transferor would maintain effective control. This is because Transferor holds the residual interest in TOB Trust and, as a result, it would effectively pay a fixed amount to reclaim the municipal bond (see Question 6.4.90).

Example 6.4.30

Tender option bonds – shortfall (liquidity) provider can require redemption of beneficial interests

Assume the same facts as in Example 6.4.20, except that:

— Transferor does not hold the residual interest; and

— the shortfall (liquidity) provider has a unilateral right to force redemption of the beneficial interests, instead of that right being held by the residual interest holder.

This arrangement would maintain Transferor's effective control because Transferor is the shortfall (liquidity) agreement provider. As that provider, Transferor effectively holds a fixed price call on the transferred municipal bond – i.e. Transferor can pay the beneficial interests' par amount for the municipal bond.

Note: All facts and circumstances need to be considered in determining whether a shortfall (liquidity) agreement provider has the unilateral ability to require the return of specified assets. For example, a shortfall agreement provider may not have that unilateral ability if the third-party beneficial interest holders have a substantive removal right over the shortfall agreement provider.

6.4.40 Additional examples

This section provides additional examples of agreements with repurchase rights, and whether such agreements result in the transferor maintaining effective control.

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Example 6.4.40
Call options and effective control

The following table provides examples of whether effective control has been maintained for various call options or other rights. It is based on guidance in paragraphs 860-10-40-32 and 860-10-55-42 to 55-42A.

Effective control is maintained (sale accounting is precluded)	**Effective control is *not* maintained (sale accounting is *not* precluded)**
— The combination of the following in a securitization because it creates the same kind of effective control as a scheduled auction provision (see Question 6.4.100): [860-10-55-42(d)] – call options are embedded in third-party beneficial interests; and – the transferor holds the residual interest in the securitization.	— Call options embedded in transferred financial assets (e.g. callable bonds, prepayable mortgage loans) when the call is held by the issuer (instead of the transferor). [860-10-40-32]
— The transferor in a securitization transaction holds a call option permitting it to reclaim all transferred financial assets from the securitization entity, unless the following conditions are met: [860-10-55-42(b)] – the call option is a fair value call option on financial assets that are readily obtainable in the marketplace; and – the transferor does not hold a residual beneficial interest in the transferred financial assets.	— Call options embedded in beneficial interests whose exercise is not controlled by the transferor. For example, a securitization entity has a 'turbo provision' whereby principal payments and prepayments received during a specified amortization period are distributed to one class of third-party beneficial interests before any payments are made to other classes. [860-10-55-42(e)] In that situation, the call option embedded in the beneficial interests mirrors the call option embedded in the transferred financial assets. As a result, the call options embedded in the beneficial interests are effectively held by the underlying issuers (borrowers) and not by the transferor. [860-10-55-42(e)]
— A call option on a participating interest in a loan participation that allows the transferor to repurchase the transferred financial asset, even if the transferee has transferred it to another party. [860-10-55-42(a)] For example, Lead Bank transfers a participating interest to Participating Bank. Participating Bank can resell the asset, but that transfer is subject to Lead Bank's right to repurchase the asset at any time from whoever holds it.	

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Example 6.4.50
Impact of ROAPs on effective control

The following tables provides examples of whether effective control has been maintained for various ROAPs. In all examples, the ROAP is assumed to provide the transferor with a more-than-trivial benefit. The examples are based on guidance in paragraphs 860-10-40-37 to 40-38 and 860-10-55-41.

Effective control is maintained (sale accounting is precluded)	
Description	**Example**
An unconditional ROAP that allows the transferor to specify the financial assets that may be removed from a group of financial assets. [860-10-40-37(a)]	Transferor has the right to remove up to 10% of the fair value of the financial assets transferred and each of the financial assets is individually less than 10%. Effective control is maintained over the entire group of financial assets because none of the transferred assets are beyond Transferor's reach. However, once Transferor has fully exercised its rights under the ROAP, it no longer has effective control over the remaining financial assets through the ROAP. [860-10-55-41(a)]
A ROAP conditioned (contingent) on an action within the transferor's control. [860-10-40-37(b), 55-41(c)]	ROAP whose exercise is contingent upon Transferor's decision to exit some portion of its business – e.g. by canceling an affinity relationship, spinning off a business segment, or accepting a third party's bid to purchase a specified portion of Transferor's business. [860-10-40-37(b), 55-41(c)]

Effective control is not maintained (sale accounting is not precluded)	
Description	**Example**
A ROAP for random removal of excess financial assets, if it is sufficiently limited that the transferor cannot remove specific transferred financial assets.	— A ROAP that is limited to the amount of Transferor's interests and to one removal per month. [860-10-40-38(a)] — A ROAP that provides Transferor the right to random removal of excess financial assets (i.e. Transferor has no ability to select which specific assets will be repurchased) from a group of transferred financial assets up to 10% of the fair value of the financial assets transferred, if Transferor has no other interest in the group. This is the case even if all financial assets in the group are less than 10% of the fair value of the transferred financial assets. In essence, Transferor has obtained a 10% beneficial interest in the group and should account for it as such. The ROAP is considered sufficiently limited because: [860-10-55-41(b)] – Transferor cannot unilaterally specify which financial assets are to be removed; and – Transferor cannot control the timing of the removal (i.e. Transferor does not control when the excess develops) or the individual assets

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Effective control is not maintained (sale accounting is not precluded)	
Description	**Example**
	being removed (which are randomly determined).
A ROAP that does not allow the transferor to unilaterally reclaim specific financial assets from the transferee.	For example, a ROAP that obligates Transferor to repurchase transferred financial assets from a securitization only after either of the following: [860-10-40-38(d), 55-41(f)] — a failure of a third-party servicer to properly service the transferred financial assets that could result in the loss of a third-party guarantee. However, once the servicer has failed to properly service the transferred financial assets, Transferor gains the unilateral ability to remove the related financial assets; or — third-party beneficial interest holders require a securitization entity to repurchase that beneficial interest.
Other ROAPs that are contingent on a third party's action.	— A ROAP for defaulted receivables (commonly referred to as a 'default ROAP'), because repurchase is allowed only after default on the transferred assets, which cannot be caused unilaterally by Transferor. However, once a receivable has defaulted, Transferor gains the unilateral ability to remove specific defaulted financial assets, causing Transferor to regain control of those assets. See section 7.4 for additional guidance when a transferor regains control. [860-10-40-38(b), 55-41(d)] — A ROAP that is conditioned (contingent) on a third-party cancellation or expiration without renewal, because the third party's action (cancellation) or decision not to act (expiration) cannot be caused unilaterally by Transferor. However, once the cancellation or expiration has occurred, Transferor gains the unilateral ability to remove specific financial assets, causing Transferor to regain control of those assets. See section 7.4 for additional guidance when a transferor regains control. [860-10-40-38(c), 55-41(e)]

Example 6.4.60

Transfer of portfolio of readily obtainable assets subject to fair value call option

Transferor owns and services a portfolio of readily obtainable financial assets. It transfers the portfolio to Transferee, an unrelated party, as part of a broader ten-year agreement.

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Transferee has the right to pledge or exchange the assets previously transferred, although this right is subject to a fair value call option on the transferred assets that is held by Transferor. Transferor may unilaterally exercise the call on conclusion of the ten-year agreement.

Transferor does not have a residual interest in the transferred assets.

Transferor does not maintain effective control over the transferred assets since the call option does not convey a more-than-trivial benefit to Transferor. This is because the call option is a fair value call option on assets that are readily obtainable and Transferor does not have a residual interest in the transferred assets.

FASB examples

Excerpt from ASC 860-10

• • • > Removal-of-Accounts Provisions

40-37 The following are examples of removal-of-accounts provisions that preclude transfers from being accounted for as sales:

a. An unconditional removal-of-accounts provision or repurchase agreement that allows the transferor to specify the financial assets that may be removed and that provides a more-than-trivial benefit to the transferor, because such a provision allows the transferor unilaterally to remove specific financial assets
b. A removal-of-accounts provision conditioned on a transferor's decision to exit some portion of its business that provides a more-than-trivial benefit to the transferor, 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 financial assets.

40-38 The following are examples of removal-of-accounts provisions that do not preclude transfers from being accounted for as sales:

a. A removal-of-accounts provision for random removal of excess financial assets, if the provision is sufficiently limited so that the transferor cannot remove specific transferred financial assets, for example, by limiting removals to the amount of the transferor's interests and to one removal per month
b. A removal-of-accounts provision 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 removal-of-accounts provision 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
d. A removal-of-accounts provision that does not allow the transferor to

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unilaterally reclaim specific financial assets from the transferee. For related implementation guidance, see paragraph 860-10-55-41.

40-39 A removal-of-accounts provision 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 financial assets potentially subject to that removal-of-accounts provision.

• • • > Removal-of-Accounts Provisions

55-41 The following are examples of application of effective control principles to removal-of-accounts provisions:

a. An unconditional removal-of-accounts provision that allows the transferor to specify the financial assets that may be removed from a group of financial assets precludes sale accounting for all financial assets in the group that might be specified if such a provision allows the transferor unilaterally to remove specific financial assets and provides a more-than-trivial benefit to the transferor (see paragraph 860-10-40-37(a)), even if the transferor's right to remove specific financial assets from a group of transferred financial assets is limited, for example, to 10 percent of the fair value of the financial assets transferred and all of the financial assets are smaller than that 10 percent. In that circumstance, none of the transferred financial assets would be derecognized at the time of transfer because no transferred financial asset is beyond the reach of the transferor. If the transferor reclaims all the financial assets it can and thereby extinguishes its option, its control has expired and the rest of the financial assets have been sold at that time.
b. A removal-of-accounts provision that provides the right to random removal of excess financial assets from a group of transferred financial assets up to 10 percent of the fair value of the financial assets transferred (all financial assets in the group are less than this 10 percent of the fair value of transferred financial assets) does not preclude sale accounting if the transferor has no other interest in the group. The transferor has, in essence, obtained a 10 percent beneficial interest in the group and should account for it as such. This treatment is permitted because the removal-of-accounts provision is sufficiently limited and the transferor cannot unilaterally remove specific transferred financial assets, because the timing of the removal (when the excess develops) and the assets being removed (which are randomly determined) are not under the control of the transferor (see paragraph 860-10-40-38).
c. A removal-of-accounts provision conditioned on a transferor's decision to exit some portion of its business precludes sale accounting for all financial assets that might be affected, because it permits the transferor unilaterally to remove specific financial assets and provides a more-than-trivial-benefit to the transferor (see paragraph 860-10-40-37(b)).
d. A removal-of-accounts provision for defaulted receivables does not preclude sale accounting at the time of transfer, because the removal would be allowed only after a third party's action (default) and could not be caused unilaterally by the transferor (see paragraph 860-10-40-38(b)). However, once the default has occurred, the transferor would have the unilateral ability to remove those specific financial assets and would need to recognize the defaulted receivable if that ability provides a more-than-trivial benefit to the transferor.

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e. A removal-of-accounts provision conditioned on a third-party cancellation, or expiration without renewal, of an affinity or private-label arrangement does not preclude sale accounting at the time of transfer, 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 (see paragraph 860-10-40-38(c)). However, once the cancellation or expiration has occurred, the transferor would have the unilateral ability to remove specific financial assets and would need to recognize those financial assets if that ability provides a more-than-trivial benefit to the transferor.
f. Because the transferor could not cause the reacquisition unilaterally a transferor does not maintain effective control through a removal-of-accounts provision that obligates the transferor to reacquire transferred financial assets from a securitization entity only after either:

    1. A specified failure of the servicer to properly service the transferred financial assets that could result in the loss of a third-party guarantee
    2. Third-party beneficial interest holders require a securitization entity to repurchase that beneficial interest.

• • • > Call Options

55-42 The following are other examples of the application of effective control principles:

a. In a loan participation, the lead bank (that is also the transferor) allows the participating bank to resell but reserves the right to call at any time from whoever holds it and can enforce the call option by cutting off the flow of interest at the call date; such a call option precludes sale accounting.
b. In a securitization, a call option permits the transferor to reclaim all of the transferred financial assets from the securitization entity at any time; such a call option precludes sale accounting unless both of the following conditions exist:

    1. The call option is an option to call, at fair value, a financial asset that is readily obtainable in the marketplace.
    2. The transferor does not hold a residual beneficial interest in the transferred financial assets (see paragraph 860-10-40-35).

c. A transferor-servicer transfers a group of entire financial assets to a securitization entity and has the right to call all of the financial assets when the group amortizes to 20 percent of its value (determined at the date of transfer). The transferor-servicer determines that at that level of financial assets, its cost of servicing them would not be burdensome in relation to the benefits of servicing, and therefore that the call option is not a cleanup call. Such a call option precludes sale accounting for the entire group of transferred financial assets (see paragraph 860-10-55-70).
d. If the third-party beneficial interests contain an embedded option and the transferor holds the residual interest in the securitization entity, the combination has the same kind of effective control as a scheduled auction provision if the transferor holds a residual beneficial interest. Sale accounting would be precluded for all of the transferred financial assets affected by the call option.
e. If the third-party beneficial interests in a securitization entity pay off first (a so-called turbo structure, where principal payments and prepayments are

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allocated on a non–pro rata basis, as discussed in paragraph 860-10-05-13), the transferor may not maintain effective control over transferred financial assets (see paragraph 860-10-40-32). To some extent, these repayments are contractual cash flows of the underlying assets, but repayments also result from prepayments in the underlying assets (that is, the prepayment options in the underlying assets are mirrored in the third-party beneficial interests). In this circumstance, call options embedded in the third-party beneficial interests result from the options embedded in the underlying assets (that is, they are held by the underlying borrowers rather than the transferor), and thus do not preclude sale accounting.

f. A transferor's contractual right to repurchase, at any time, a loan that is not a readily obtainable financial asset would preclude sale accounting, because the transferor's contractual right to repurchase is effectively a call option of the type described in paragraph 860-10-40-17(c)(2).

55-42A This guidance illustrates the concept in paragraph 860-10-40-35 that a transferor maintains effective control if it has a right to reclaim specific transferred assets by paying fair value and also holds the residual interest in the transferred financial assets. If a transferor holds the residual interest in securitized financial assets and can reclaim the transferred financial assets at termination of the securitization entity by purchasing them in an auction, and thus at what might appear to be fair value, then sale accounting for the transfer of those financial assets it can reclaim would be precluded. Such circumstances provide the transferor with a more-than-trivial benefit and effective control over the financial assets, because it can pay any price it chooses in the auction and recover any excess paid over fair value through its residual interest in the transferred financial assets.

6.4.50 Cleanup calls and servicing arrangements

Excerpt from ASC 860-10

20 Glossary

Cleanup Call Option

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 an entity (or in a series of beneficial interests in transferred financial assets within an entity) if the amount of outstanding financial 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.

40-34 Paragraph 860-10-40-5(c)(2) excludes a cleanup call from the general principle that a transferor maintains effective control over transferred financial assets if the transferor has the unilateral ability to cause the holder to return specific financial assets and that ability provides more than a trivial benefit to the transferor. A cleanup call on beneficial interests in the transferred financial assets is permitted because burdensome costs in relation to benefits may

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arise when the remaining financial assets or beneficial interests fall to a small portion of their original level. Parties other than the servicer cannot hold the option, because only the servicer is burdened when the amount of outstanding financial assets falls to a level at which the cost of servicing the financial assets becomes burdensome—the defining condition of a cleanup call—and any other party would be motivated by some other incentive in exercising a call.

55-42B Sale accounting is not appropriate if a cleanup call on a group of financial assets in a securitization entity is held by a party other than the servicer. A transferor's call option on the transferred financial assets in the securitization entity is not a cleanup call for accounting purposes because it is not the servicer or an affiliate of the servicer. in which the fair value of beneficial interests obtained by a transferor of financial assets that is not the servicer or an affiliate of the servicer is adversely affected by the amount of transferred financial assets declining to a low level.

55-42C In a securitization transaction involving not-readily-obtainable financial assets, a transferor that is also the servicer may hold a cleanup call if it enters into a subservicing arrangement with a third party without precluding sale accounting. Under a subservicing arrangement, the transferor remains the servicer from the perspective of the securitization entity because the securitization entity does not have an agreement with the subservicer (that is, the transferor remains liable if the subservicer fails to perform under the subservicing arrangement). However, if the transferor sells the servicing rights to a third party (that is, the agreement for servicing is between the securitization entity and the third party after the sale of the servicing rights), then the transferor could not hold a cleanup call without precluding sale accounting.

A cleanup call does not result in the transferor maintaining effective control when a transferor is also the servicer of transferred financial assets. This is an exception to a Type 2 agreement that results in a transferor maintaining effective control. Therefore, there is no effective control in this case even if the cleanup call would otherwise result in the transferor maintaining effective control by providing the transferor the unilateral ability to cause the holder to return specific financial assets and a more-than-trivial benefit. [860-10-40-5(c)(2)]

Question 6.4.140

What is a 'cleanup call'?

Interpretive response: Topic 860 defines a cleanup call as an option that allows the servicer or its affiliate to purchase the remaining transferred financial assets when the outstanding amount falls to a level at which the cost of servicing those assets becomes burdensome in relation to the benefits of servicing. [860-10 Glossary]

This definition also applies to options that allow – based on the same circumstances – the repurchase of remaining beneficial interests not held by

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the transferor, its affiliates or its agents in an entity (or in a series of beneficial interests in transferred financial assets within an entity). [860-10 Glossary]

Question 6.4.150

Can a transferor hold a cleanup call if it is not the servicer?

Interpretive response: No. A cleanup call can only be held by a servicer or its affiliate because only the servicer (or its affiliate) can be burdened by the costs of servicing. Therefore, any call held by a party that is not the servicer (or its affiliate) is not eligible for the cleanup call exception. [860-10-40-34, 55-42B]

If the transferor is not the servicer (or its affiliate), any call it holds is not a cleanup call and is evaluated under the guidance in sections 6.4.10 to 6.4.30.

Question 6.4.160

Does a transferor hold a cleanup call if it contracts with another entity to subservice the transferred financial assets?

Interpretive response: Yes, as long as the transferor is contractually obligated to service the assets.

For example, Transferor is also the servicer in a securitization transaction involving financial assets that are not readily obtainable. Transferor enters into a subservicing arrangement with Subservicer (a third party). Under the arrangement, Transferor remains liable if Subservicer fails to perform under the subservicing agreement. Transferor remains the servicer from the securitization entity's perspective because the securitization entity does not have an agreement Subservicer. Therefore, Transferor may hold a cleanup call without precluding sale accounting.

In contrast, if Transferor sells the servicing rights to Subservicer such that the servicing agreement is between the securitization entity and Subservicer, Transferor does not hold a cleanup call. [860-10-55-42C]

Question 6.4.170

Does Topic 860 establish a percentage threshold under which a call is considered a cleanup call?

Interpretive response: No. Topic 860 does not specify the level at which the amount of outstanding financial assets or beneficial interests has fallen to a level at which the cost of servicing those assets or beneficial interests becomes burdensome in relation to the benefits of servicing.

As a result, we believe an entity must use judgment when determining the level that is considered burdensome. Further, that judgment may differ

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between entities and should consider all relevant factors (e.g. the type of financial asset being serviced).

It is not appropriate for an entity to assume that the cost of servicing becomes burdensome for all securitization transactions at the same percentage threshold – e.g. to assume all calls are cleanup calls if they are exercisable when the assets or beneficial interest are equal to or less than 10% of their carrying amount on the date of transfer.

Instead, an entity should consider whether the facts and circumstances of different securitization transactions would result in a different threshold. For example, an entity may conclude that different thresholds are appropriate for different asset classes (e.g. residential versus commercial mortgage loans). This is because if a call is exercisable at a level of assets at which the servicer (or its affiliate) determines the costs of servicing the assets would *not* be burdensome, the call is not a cleanup call and should be accounted for using the guidance on call options discussed in sections 6.4.10 to 6.4.30. [860-10-40-34]

For example, Transferor-Servicer transfers a group of entire financial assets to a securitization entity and has the right to call all of the transferred financial assets when the group amortizes to 20% of its carrying amount (determined at the date of transfer). The call is not a cleanup call if Transferor-Servicer's cost of servicing the transferred financial assets would not be burdensome in relation to the benefits of servicing at that level of assets. If it is not a cleanup call, sale accounting would be precluded. [860-10-40-34, 55-42(c)]

6.5 Type 3 agreement – Transferee ability to require the transferor to repurchase transferred financial assets

Excerpt from ASC 860-10

• • • > Other Arrangements

55-42D This implementation guidance addresses the application of paragraph 860-10-40-5(c)(3) through the following examples:

a. A put option written to the transferee generally does not provide the transferor with effective control over the transferred financial asset under paragraph 860-10-40-5(c)(3).
b. A put option that is sufficiently deep in the money when it is written would, under that paragraph, provide the transferor effective control over the transferred financial asset because it is probable that the transferee will exercise the option and the transferor will be required to repurchase the transferred financial asset.
c. A sufficiently out-of-the-money put option held by the transferee would not provide the transferor with effective control over the transferred financial asset if it is probable when the option is written that the option will not be exercised.

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d. A put option held by the transferee at fair value would not provide the transferor with effective control over the transferred financial asset.

• • > Transfer of a Short-Term Loan Made Under a Long-Term Credit Commitment

55-71 A financial institution involved in commercial lending makes a short-term loan (for example, 90 days) to a borrower under a long-term credit commitment (for example, 5 years). The financial institution transfers the short-term loan, without recourse, to a third-party purchaser for the remaining term of the loan. The risk of loss relating to the short-term loan is legally transferred to the purchaser, and the financial institution has no contractual obligation to repurchase the short-term loan. Under the long-term credit commitment, the financial institution may, at the maturity of the short-term loan, relend to the borrower. However, the financial institution may refuse to relend to the borrower based on a current credit evaluation or if any covenant under the long-term commitment is not satisfied.

55-72 To the extent that the transfer of the short-term loan made under a long-term credit commitment as described above is accounted for as the transfer of a receivable with a put option, it would be required to be accounted for as a sale if the conditions of paragraph 860-10-40-5 are met. The terms of the put option should be analyzed to determine whether it meets the definition of a derivative instrument under Subtopic 815-10.

A Type 3 agreement (e.g. certain put options) that results in a transferor maintaining effective control over transferred financial assets (or over third-party beneficial interests related to them) is an agreement that permits the transferee to require the transferor to repurchase the transferred financial assets (i.e. a put option) at a price that is so favorable to the transferee that it is probable that the transferee will exercise its right. [860-10-40-5(c)(3)]

Further, a put option that does not maintain a transferor's effective control may result in a transferor maintaining legal or actual control over the transferred financial assets; see Question 6.2.20.

Question 6.5.10

What condition results in a transferor maintaining effective control through a put option?

Interpretive response: A transferor maintains effective control if the price of exercising the put option is so favorable (i.e. deep in the money) when written that it is probable the transferee will exercise it, requiring the transferor to repurchase the transferred financial asset. In this situation, the put option is essentially considered to be equivalent to a forward contract. [860-10-40-5(c)(3)]

In contrast, a transferor does not maintain effective control through a put option that is: [860-10-55-42D]

— sufficiently out of the money when written that it is probable that the transferee will not exercise it; or
— a fair value put option.

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Further, the following generally do not directly affect whether a transfer is accounted for as a sale:

— the existence of multiple transferee put options to the transferor; or
— the remaining life of a put option.

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7. Accounting for sales of financial assets

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7.1 How the standard works

This chapter addresses the accounting by both the transferor and transferee for a transfer to which sale accounting applies. The accounting for a transfer accounted for as a sale is as follows.

Transferor	— Derecognizes an entire financial asset or group of entire financial assets. — For a participating interest: – allocates the carrying amount of the entire financial asset between the participating interest sold and participating interest retained based on their relative fair values at the date of transfer and recognizes any participating interest(s) retained based on its allocated carrying amount (i.e. the retained participating interest is not remeasured to its fair value); and – derecognizes the carrying amount of the participating interest sold. — Recognizes all assets obtained and liabilities incurred in the sale at fair value. — Recognizes a gain or loss on sale.
Transferee	— Generally, recognizes all assets acquired and liabilities incurred at fair value.

This chapter also addresses the accounting when a transfer initially qualifies as a sale but subsequently no longer qualifies as a sale. This occurs if:

— the transferor regains control of the transferred financial asset; or
— the transferred financial asset was a participating interest at the time of the transfer but no longer qualifies as one.

Chapter 8 discusses the accounting by both the transferor and transferee for a transfer that does not qualify as a sale.

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7.2 Transferor – Recognition and initial measurement

7.2.10 Overview

Excerpt from ASC 860-20

05-1 This Subtopic provides guidance on the accounting for a **transfer** of **financial assets** that satisfies the conditions for sale accounting in paragraph 860-10-40-5 and the accounting if a **transferor** regains control of assets previously sold.

15-1 This Subtopic follows the same Scope and Scope Exceptions as outlined in the Overall Subtopic, see Section 860-10-15

25-1 Section 860-20-40 provides derecognition guidance a **transferor (seller)** applies upon completion of a **transfer** of **financial assets** that satisfies paragraph 860-10-40-5's conditions to be accounted for as a sale. Upon completion of such a transfer, the transferor (seller) shall also recognize any assets obtained or liabilities incurred in the sale, including, but not limited to, any of the following:

a. Cash
b. Servicing assets
c. Servicing liabilities
d. In a sale of an entire financial asset or a group of entire financial assets, any of the following:
    1. The transferor's beneficial interest in the **transferred financial assets**
    2. Put or call options held or written (for example, guarantee or recourse obligations)
    3. Forward commitments (for example, commitments to deliver additional receivables during the revolving periods of some **securitizations**)
    4. Swaps (for example, provisions that convert interest rates from fixed to variable).

See Examples 1, 2, and 5 (paragraphs 860-20-55-43 through 55-59) for illustration of this guidance.

30-1 The **transferor** shall initially measure at fair value any asset obtained (or liability incurred) and recognized under paragraph 860-20-25-1.

> Sale of a Participating Interest

40-1A Upon completion of a **transfer** of a **participating interest** that satisfies the conditions in paragraph 860-10-40-5 to be accounted for as a sale, the **transferor (seller)** shall:

a. Allocate the previous carrying amount of the entire **financial asset** between both of the following on the basis of their relative fair values at the date of the transfer:
    1. The participating interest(s) sold
    2. The participating interest that continues to be held by the transferor.

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b. **Derecognize** the participating interest(s) sold
c. Apply the guidance in paragraphs 860-20-25-1 and 860-20-30-1 on recognition and measurement of assets obtained and liabilities incurred in the sale
d. Recognize in earnings any gain or loss on the sale
e. Report any participating interest(s) that continue to be held by the transferor as the difference between the following amounts measured at the date of the transfer:

    1. The previous carrying amount of the entire financial asset
    2. The amount derecognized.

For the transfer of a participating interest in a financial asset included in a closed portfolio hedged in an existing portfolio layer method hedge in accordance with Topic 815 on derivatives and hedging, when applying the guidance in (a) through (e) an entity shall not include any portion of the hedge basis adjustment that is maintained on the closed portfolio basis in accordance with paragraphs 815-20- 25-12A(b) and 815-25-35-1(c).

> Sale of an Entire Financial Asset or Group of Entire Financial Assets

40-1B Upon completion of a transfer of an entire financial asset or a group of entire financial assets that satisfies the conditions in paragraph 860-10-40-5 to be accounted for as a sale, the transferor (seller) shall:

a. Derecognize the **transferred financial assets**
b. Apply the guidance in paragraphs 860-20-25-1 and 860-20-30-1 on recognition and measurement of assets obtained and liabilities incurred in the sale
c. Recognize in earnings any gain or loss on the sale

If the transferred financial asset was accounted for under Topic 320 as available for sale before the transfer, item (a) requires that the amount in other comprehensive income be recognized in earnings at the date of transfer. If the transferred financial asset was included in a closed portfolio hedged in an existing portfolio layer method hedge in accordance with Topic 815 before the transfer, when applying the guidance in (a) through (c) an entity shall not include any portion of the hedge basis adjustment that is maintained on the closed portfolio basis in accordance with paragraphs 815-20-25-12A(b) and 815-25-35-1(c).

Sale accounting can apply to transfers of an entire financial asset, a group of entire financial assets or a participating interest in an entire financial asset. If the transferred interest is less than an entire financial asset (a component of a financial asset), it must meet all of the characteristics of a participating interest (see section 3.4) to potentially qualify for sale accounting. Sale accounting applies to these transfers if certain criteria are met, which are discussed in chapters 4, 5 and 6.

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Question 7.2.10

How does a transferor account for a transfer of financial assets that qualifies as a sale?

Interpretive response: A transferor accounts for the transfer of financial assets that qualifies as a sale as follows.

Step 1	For an entire financial asset (or group of entire financial assets), **derecognizes** the transferred financial assets. [860-20-40-1B(a)] For a participating interest: [860-20-40-1A(a) – 40-1A(b)] — **allocates** the carrying amount of the entire financial asset between the participating interest sold and participating interest retained based on their relative fair values at the date of transfer; — **derecognizes** the carrying amount of the participating interest sold. Any participating interest(s) that is retained is measured based on its allocated carrying amount. The retained portion is not remeasured to fair value. [860-20-40-1A(e)]
Step 2	**Recognizes** assets obtained and liabilities incurred (net proceeds) in the sale at fair value. Assets obtained or liabilities incurred may include cash, beneficial interests retained, servicing assets or liabilities, put or call options held or written, guarantee or recourse obligations. See section 7.2.50. [860-20-40-1A(c), 40-1B(b)]
Step 3	**Recognizes any gain or loss** in earnings, calculated as the difference between the net proceeds received in Step 2 and the carrying amounts of the financial assets derecognized in Step 1. [860-20-40-1A(d), 40-1B(c)] A transferor recognizes the gain or loss at the time of sale and may not elect to defer recognition of such amount.

If an entity transfers an entire financial asset, a group of entire financial assets or a participating interest in an entire financial asset that was included in an existing portfolio layer method hedge prior to the transfer, the hedge basis adjustment is not included as part of the above steps. For further guidance on the portfolio layer method, see section 7.3.100 of KPMG Handbook, Derivatives and hedging.

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Question 7.2.20

Is a transfer that qualifies as a sale recognized on the trade date or the settlement date?

Excerpt from ASC 860-20

25-2 Although a transfer of securities may not be considered to have reached completion until the settlement date, this Subtopic does not modify other generally accepted accounting principles (GAAP) that require accounting at the trade date for certain contracts to purchase or sell securities.

Excerpt from ASC 940-320

25-1 The statement of financial condition shall reflect all **regular-way trades** on an accrual or trade-date basis. Risk, benefits, and economic potentials are created and conveyed at the trade date (that is, the inception of the contract), which is when the major terms have been agreed to by the parties. To properly reflect the economic effects of purchase and sale transactions for financial instruments (that is, to reflect the assumption of the risks and rewards resulting from changes in the value of financial instruments), broker-dealers shall account for the changes in value relating to all proprietary or principal transactions on a trade-date basis.

Excerpt from ASC 942-325

> Regular-Way Securities

25-2 Regular-way purchases and sales of securities shall be recorded on the trade date. Gains and losses from regular-way security sales or disposals shall be recognized as of the trade date in the statement of operations for the period in which securities are sold or otherwise disposed of. See paragraph 815-10-15-15 for a definition of regular-way security trades.

Excerpt from ASC 946-320

> Effective Date of Transactions

• > Trade Date Recognition for Securities Purchases and Sales Other Than Private Placements and Tender Offers

25-1 An investment company shall record security purchases and sales as of the trade date, the date on which the investment company agrees to purchase or sell the securities, so that the effects of all securities trades entered into by

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or for the account of the investment company to the date of a financial report are included in the financial report.

Excerpt from ASC 815-10

• • > Regular-Way Security Trades

15-15 Regular-way security trades are defined as contracts that provide for delivery of a security within the period of time (after the trade date) generally established by regulations or conventions in the marketplace or exchange in which the transaction is being executed. For example, a contract to purchase or sell a publicly traded equity security in the United States customarily requires settlement within three business days. If a contract for purchase of that type of security requires settlement in three business days, the regular-way security trades scope exception applies, but if the contract requires settlement in five days, the regular-way security trades scope exception does not apply unless the reporting entity is required to account for the contract on a trade-date basis.

Interpretive response: It depends. Transfers of financial assets are generally recognized on the settlement date. Settlement date is the date the seller is required to deliver, and the purchaser is required to pay for, the financial instrument(s). However, trade date accounting may be applied for certain industries and financial assets. Subtopic 860-20 does not modify other US GAAP that requires trade date accounting for sales of securities for certain industries – e.g. depository and lending entities, broker-dealers, investment companies. [860-20-25-2, 940-320-25-1, 942-325-25-2, 946-320-25-1]

For regular-way security trades, if industry specific guidance requiring trade date accounting does not apply to the transferor, we believe the transferor may elect an accounting policy to use either trade date or settlement date. Regular-way security trades are contracts that provide for delivery of a security within the period generally established by regulations or conventions in the marketplace or exchange in which the transaction is being executed. [815-10-15-15]

However, we believe trade date accounting should not be applied to trades that are not regular-way or if there are any conditions required for closing that have not been met. In practice, securitization transactions generally are recognized on the settlement date because they are not typically regular-way securities trades.

Question 7.2.30

When AFS securities are transferred in a sale transaction, how are amounts in AOCI treated?

Interpretive response: When AFS securities are transferred in a transaction that qualifies to be accounted for as a sale, a transferor derecognizes the

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transferred financial asset upon completion of the transfer. As a result, the amount in AOCI is recognized in earnings at the date of transfer. [860-20-40-1B]

Question 7.2.40

How does a transferor account for unamortized discounts and premiums when sale accounting is applied?

Excerpt from ASC 860-20

• > Transfer of a Bond Purchased at a Premium

55-25 Assume an entity transfers a bond to an unconsolidated entity for cash and beneficial interests. When the transferor purchased the bond, it paid a premium for it (or bought it at a discount), and that premium (or discount) was not fully amortized (or accreted) at the date of the transfer. In other words, the carrying amount of the bond included a premium (or discount) at the date of the transfer. If the transfer of the bond is accounted for as a secured borrowing under Subtopic 860-30, the transferor would continue to amortize (or accrete) the premium (or discount) because paragraph 860-30-25-2 requires that the transferor continue to report the transferred financial assets in its statement of financial position with no change in their measurement (that is, basis of accounting). If the transfer of the bond satisfies the conditions to be accounted for as a sale, any beneficial interests received as proceeds would be initially recognized at fair value. As a result, the previously existing premium (or discount) would not continue to be amortized (or accreted); rather, the unamortized (or nonaccreted) amount would be included in the calculation of the gain (or loss) as of the transfer date.

Interpretive response: If a transferred financial asset was previously purchased at a premium or discount, a transferor does not continue to amortize (accrete) any remaining premium (discount). Instead, it includes the unamortized (unaccreted) amount in the gain (loss) calculation. [860-20-55-25]

Question 7.2.50

How does a transferor classify a gain (loss) when sale accounting is applied?

Interpretive response: We believe the appropriate classification of the gain (loss) depends on the nature of the entity and the type of financial assets sold, as reflected in the following table.

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Nature of entity	Type of financial asset sold	Appropriate classification
Financial institution	All types	Noninterest income or expense
Nonfinancial institution	Trade receivables	Operating expense. Gains (losses) are either presented in a separate line item or included in either other operating expense or selling, general and administrative expense.
	Financial assets other than trade receivables	Classification is based on the nature of the financial assets and the entity's business operations.

We do not believe it is appropriate for a nonfinancial institution to classify gains or losses on transfers of financial assets as interest income or interest expense because the transfer is a sale by definition, not a financing activity. Similarly, it is not appropriate to classify gains or losses on transfers of financial assets as cost of goods sold because the transfer of a receivable is unrelated to the transaction originally generating that receivable.

The transferor must adopt, disclose and consistently apply an accounting policy for classifying gains and losses on the sale of financial assets.

Chapter 10 of KPMG Handbook, Statement of cash flows, discusses the statement of cash flows treatment for securitizations and other transfers of financial assets.

Question 7.2.60

How are transaction costs accounted for when sale accounting is applied?

Excerpt from ASC 860-20

> Transaction Costs

35-10 Transaction costs relating to a sale of the receivables may be recognized over the initial and reinvestment periods in a rational and systematic manner unless the transaction results in a loss. Transaction costs for a past sale are not an asset and thus are part of the gain or loss on sale. In a credit card **securitization**, however, some of the transaction costs incurred at the outset relate to the future sales that are to occur during the revolving period, and thus can qualify as an asset.

Background: Common transaction costs incurred in connection with a transfer of financial assets include lawyers' fees, accountants' fees, rating agencies'

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fees, costs to print and circulate the legal offering documents, fees paid to the SEC to register the transaction and other administrative costs.

Interpretive response: When a transferor expects to recognize a gain on sale, we believe it should defer direct upfront transaction costs until the date of sale. At the date of sale, it recognizes the previously deferred costs as a reduction of proceeds in determining the gain on sale. We do not believe the transferor should allocate those costs between the assets sold, other interests it continues to hold, and servicing assets. Further, we do not believe the transferor may capitalize or defer any direct transaction costs related to those assets past the date of sale unless the financial assets are transferred in a revolving structure, and the transferor expects to recognize a gain on future transfers under that revolving structure. If so, it defers the transaction costs and recognizes them over the revolving period. [860-20-35-10]

When a transferor expects to recognize a loss on sale, we believe it should expense the direct upfront transaction costs when incurred. For example, a loss on sale usually arises on transfers of noninterest bearing financial assets, such as trade receivables.

7.2.20 Examples

The following examples illustrate how to account for transfers of financial assets that qualify as sales under different circumstances.

- Subtopic 860-20's Example 1 illustrates how to account for a transfer of a group of entire financial assets for proceeds of cash, derivatives and other liabilities.
- Subtopic 860-50's Example 1, Case A illustrates how to account for a transfer of financial assets for proceeds of cash, a beneficial interest and a servicing asset.
- Example 7.2.10 illustrates how to account for a transfer of a group of entire financial assets for proceeds of cash, beneficial interests and a servicing liability.
- Subtopic 860-20's Example 2 illustrates how to account for a transfer of a participating interest.
- Example 7.2.20 illustrates how to account for a transfer of a participating interest with proceeds of cash and a servicing liability.
- Example 7.2.30 illustrates how to account for a factoring arrangement.

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Excerpt from ASC 860-20

> Illustrations

• > Example 1: Recording Transfers with Proceeds of Cash, Derivative Instruments, and Other Liabilities

55-43 This Example illustrates the guidance in paragraphs 860-20-25-1 and 860-20-30-1. Entity A transfers entire loans with a carrying amount of $1,000 to an unconsolidated securitization entity and receives proceeds with a fair value of $1,030, and the transfer is accounted for as a sale. Entity A undertakes no obligation to service and assumes a limited recourse obligation to repurchase delinquent loans. Entity A agrees to provide the transferee a return at a variable rate of interest even though the contractual terms of the loan are fixed rate in nature (that provision is effectively an interest rate swap).

55-44 This Example has the following assumptions.

Fair Values	
Cash proceeds	$1,050
Interest rate swap asset	40
Recourse obligation	60

Net Proceeds	
Cash received	$1,050
Plus: Interest rate swap asset	40
Less: Recourse obligation	(60)
Net proceeds	$ 1,030

Gain on Sale	
Net proceeds	$ 1,030
Less: Carrying amount of loans sold	(1,000)
Gain on sale	$ 30

55-45 The following journal entry is made by Entity A.

Journal Entry		
Cash	$ 1,050	
Interest rate swap asset	40	
Loans		$ 1,000
Recourse obligation		60
Gain on sale		30

To record transfer

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Excerpt from ASC 860-50

> Illustrations

• > Example 1: Sale of Receivables with Servicing Obtained by the Transferor

55-20 The following Cases illustrate the guidance in paragraph 860-50-25-1:

a. Transferor continues to service the loans (Case A). …
c. Future benefits of servicing do not provide adequate compensation (Case C).

55-21 Entity A originates $1,000 of loans that yield 10 percent interest income for their estimated lives of 9 years. Entity A transfers the entire loans to an unconsolidated entity and the transfer is accounted for as a sale.

• • > Case A: Transferor Continues to Service the Loans

55-22 Entity A receives as proceeds $1,000 cash, a beneficial interest to receive 1 percent of the contractual interest on the loans (an interest-only strip receivable), and an additional 1 percent of the contractual interest as compensation for servicing the loans. The fair values of the servicing asset and the interest-only strip receivable are $40 and $60, respectively. This Case illustrates Entity A's (the transferor's) accounting for a sale with the servicing obtained by Entity A (the transferor), as follows.

Fair Values		
Cash proceeds	$1,000	
Servicing asset	40	
Interest-only strip receivable	60	
Net Proceeds		
Cash proceeds	$1,000	
Servicing asset	40	
Interest-only strip receivable	60	
Net proceeds	$ 1,100	
Gain on Sale		
Net proceeds	$ 1,100	
Less: Carrying amount of loans sold	(1,000)	
Gain on sale	$ 100	
Journal Entries		
Cash	$ 1,000	
Interest-only strip receivable	60	
Servicing asset	40	
Loans		$ 1,000
Gain on sale		100
To record transfer and to recognize interest-only strip receivable and servicing asset		

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Example 7.2.10
Sale of a group of entire financial assets

ABC Corp. transfers a group of receivables with an unpaid principal balance of $100,000 to an unconsolidated securitization entity for $98,000 in cash and a beneficial interest in the securitization trust. ABC continues to service the transferred receivables. The $100,000 of receivables have unamortized deferred origination costs (net) of $5,000 resulting in a carrying amount of $105,000.

ABC determines that it will recognize a servicing asset because the benefits of servicing are greater than adequate compensation (see section 10.3.20). ABC measures the fair values of the beneficial interest and servicing asset as $10,000 and $2,000, respectively.

ABC determines the transfer meets the criteria to be accounted for as a sale.

Fair value of assets obtained in the sale (and calculation of net proceeds)	
Cash	$ 98,000
Beneficial interest	10,000
Servicing asset	2,000
Fair value of assets obtained (net proceeds)	**$110,000**

Calculation of the gain (loss) on sale	
Fair value of assets obtained in the sale (net proceeds)	$ 110,000
Less: Carrying amount of transferred receivables	(105,000)
Gain on sale of receivables	**$ 5,000**

ABC records the following journal entry to account for the transfer of these receivables.

	Debit	*Credit*
Cash	98,000	
Beneficial interest	10,000	
Servicing asset	2,000	
Receivables		100,000
Deferred origination costs (net)		5,000
Gain on sale		5,000
To derecognize carrying amount of assets sold, recognize fair value of assets obtained and recognize gain on sale.		

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Excerpt from ASC 860-20

• > Example 2: Recording Transfers of Participating Interests

55-46 This Example illustrates the guidance in paragraph 860-20-25-1. This Example assumes the conditions for a sale in paragraph 860-10-40-5 are met. Entity B transfers a nine-tenths participating interest in a loan with a fair value of $1,100 and a carrying amount of $1,000, and the transfer is accounted for as a sale. The servicing contract has a fair value of zero because Entity B estimates that the benefits of servicing are just adequate to compensate it for its servicing responsibilities.

55-47 This Example has the following assumptions.

Fair Values

Cash proceeds for nine-tenths participating interest sold ($1,100 x 9/10)	$ 900
One-tenth participating interest that continues to be held by the transferor ($1,100 x 1/10)	110

Allocated Carrying Amount Based on Relative Fair Values

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

Gain on Sale

Net proceeds	$ 990
Less: Carrying amount of loans sold	(900)
Gain on sale	$ 90

55-48 The following journal entry is made by Entity B.

Journal Entry

Cash	$ 990	
Loans		$ 900
Gain on sale		90
To record transfer		

Example 7.2.20

Sale of a participating interest in an entire financial asset

ABC Corp. transfers a 55% participating interest in a commercial loan with an unpaid principal balance of $15 million to DEF Corp. for $8.5 million in cash. ABC will continue to service the loan, but will not receive a fee to perform the servicing. At the time of the transfer, the $15 million loan had unamortized deferred origination costs of $1 million.

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ABC determines that it will recognize a servicing liability because the benefits of servicing are less than adequate compensation (see section 10.3.20). The fair value of the servicing liability is $100,000.

ABC determines that the transfer meets the criteria to be accounted for as a sale and the portion of the loan sold meets the definition of a participating interest.

The relative fair values of the participating interests are as shown in the table below.

Allocate carrying amount of entire financial asset (based on relative fair values)			
Unit of account	**Fair value**	**Relative fair value %[1]**	**Allocated carrying value[2]**
Participating interest sold	$ 8,500,000	55%	$ 7,700,000
Participating interest retained	6,954,545	45%	6,300,000
Total	**$15,454,545**	**100%**	**$14,000,000**

Notes:

1. Fair value of the unit of account ÷ total fair value of $15,454,545.
2. Relative fair value % for the unit of account × total carrying value of $14,000,000.

Carrying amount of transferred financial assets	
Unpaid principal balance[1]	$8,250,000
Deferred origination costs (net)[2]	550,000
Carrying amount of transferred loan	**$8,800,000**

Notes:

1. Total unpaid principal balance ($15,000,000) × 55% relative fair value % of participating interest sold.
2. Total unamortized deferred costs (net) ($1,000,000) × 55% relative fair value % of participating interest sold.

Fair value of assets obtained or liabilities incurred in the sale (and calculation of net proceeds)	
Cash	$8,500,000
Servicing liability	(100,000)
Fair value of assets obtained or liabilities incurred in the sale (net proceeds)	**$8,400,000**

Calculation of the gain (loss) on sale	
Fair value of assets obtained or liabilities incurred in the sale (net proceeds)	$ 8,400,000
Less: Carrying amount of transferred loan	(8,800,000)
Loss on sale of loan	**$ (400,000)**

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ABC records the following journal entry to account for the transfer of a participating interest in the loan.

	Debit	*Credit*
Cash	8,500,000	
Loss on sale	400,000	
Servicing liability		100,000
Loan		8,250,000
Deferred origination costs		550,000
To derecognize carrying amount of assets sold, recognize fair value of assets obtained and liabilities incurred and recognize loss on sale.		

Example 7.2.30
Factoring of accounts receivable

To raise cash, ABC Corp. sells $15 million of trade receivables (in their entirety) to DEF Corp. at a 5% discount rate through a factoring arrangement.

ABC determines the transfer meets the criteria to be accounted for as a sale.

Calculation of the gain (loss) on sale	
Cash proceeds	$ 14,250,000
Less: Carrying amount of trade receivables	(15,000,000)
Loss on sale	**$ (750,000)**

ABC records the following journal entry to account for the factoring arrangement.

	Debit	*Credit*
Cash	14,250,000	
Loss on sale	750,000	
Receivables		15,000,000
To derecognize carrying amount of assets sold and recognize loss on sale.		

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7.2.30 Sales-type and direct financing lease receivables

Excerpt from ASC 860-20

• > Sales or Securitizations of Lease Receivables

55-26 A transferor of lease receivables shall allocate the gross investment in receivables between lease payments, residual values guaranteed at commencement, and residual values not guaranteed at commencement using the individual carrying amounts of those components at the date of transfer. Those transferors also shall record a servicing asset or liability in accordance with Subtopic 860-50, if appropriate.

55-27 See paragraph 860-10-55-6 for further discussion of lease receivables.

Topic 860 applies to transfers of lease receivables and residual values that are guaranteed at lease commencement (see Question 2.3.20). However, transfers of unguaranteed residual values and residual values guaranteed after the commencement of the lease are not in the scope of Topic 860.

If a transfer of lease receivables meets the sale criteria, the transferor allocates its gross investment in the receivables between the following using the individual carrying amounts of those components at the date of transfer: [860-20-55-26]

— the lease payments;
— residual values guaranteed at commencement; and
— residual values not guaranteed at commencement.

Subtopic 860-20's Example 5 (reproduced below) illustrates how to account for a transfer of a participating interest in a lease receivable with residual values.

Excerpt from ASC 860-20

• > Example 5: Transfer of Lease Receivables with Residual Values

55-58 This Example illustrates the guidance in paragraph 860-20-25-1. At the beginning of the second year in a 10-year sales-type lease, Entity E transfers for $505 a nine-tenths participating interest in the lease receivable to an independent third party, and the transfer is accounted for as a sale. Entity E retains a one-tenth participating interest in the lease receivable and a 100 percent interest in the unguaranteed residual asset, which is not subject to the requirements of this Subtopic as discussed in paragraph 860-10-55-6 because it is not a financial asset and, therefore, is excluded from the analysis of whether the transfer of the nine-tenths participating interest in the lease receivable meets the definition of a participating interest. The servicing asset has a fair value of zero because Entity E estimates that the benefits of servicing are just adequate to compensate it for its servicing responsibilities. The carrying amounts and related gain computation are as follows.

Carrying Amounts

Lease receivable	$	540

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Unearned income related to lease receivable			370
Gross investment in lease receivable			910
Unguaranteed residual asset	$	30	
Unearned income related to unguaranteed residual asset		60	
Gross investment in unguaranteed residual asset			90
Total gross investment in lease receivable			$ 1,000

Gain on Sale

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

55-59 The following journal entry is made by Entity E.

Journal Entry

Cash	$	505		
Unearned income		333		
Lease receivable			$	819
Gain on sale				19

To record sale of nine-tenths of the lease receivable at the beginning of Year 2

7.2.40 Accrued interest receivable

Excerpt from ASC 860-20

• > Accrued Interest Receivable

55-17 The receivables for accrued fee and finance charge income on an investors' portion of the transferred credit card receivables, whether billed but uncollected or accrued but unbilled, are commonly referred to as accrued interest receivable. The following addresses how the accrued interest receivable related to securitized and sold receivables should be accounted for and reported under this Subtopic. This guidance applies to credit card securitizations as well as other kinds of securitizations.

55-18 The right to receive the accrued interest receivable, if and when collected, is transferred to the securitization trust. Generally, if a securitization transaction meets the criteria for sale treatment and the accrued interest receivable is subordinated either because the asset has been isolated from the transferor (see paragraph 860-10-40-5) or because of the operation of the cash flow distribution (or waterfall) through the securitization trust, the total accrued interest receivable should be considered to be one of the components of the sale transaction. Therefore, under the circumstances described, the accrued interest receivable asset should be accounted for as a transferor's interest. It is inappropriate to report the accrued interest receivable related to securitized

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and sold receivables as loans receivable or other terminology implying that it has not been subordinated to the senior interests in the securitization.

55-19 While, under the circumstances described, the accrued interest receivable is a transferor's interest, it is not required to be subsequently measured like an investment in debt securities classified as available for sale or trading under Topic 320 or the Transfers and Servicing Topic because the accrued interest receivable cannot be contractually prepaid or settled in such a way that the owner would not recover substantially all of its recorded investment. Entities should follow existing applicable accounting standards, including Topic 326 on measurement of credit losses, in subsequent accounting for the accrued interest receivable asset.

Topic 860 provides guidance on the accounting for accrued interest receivable associated with sold receivables.

Question 7.2.70

How is accrued interest receivable related to securitized and sold receivables accounted for?

Background: Accrued interest receivable refers to accrued fee and finance charge income on an investors' portion of transferred receivables, whether it is billed or unbilled. A transferor can transfer the right to receive the accrued interest receivable, if and when collected, to a third party – e.g. to a securitization trust that is not consolidated. [860-20-55-17 – 55-18]

Interpretive response: Generally, if a transfer of receivables meets the criteria to qualify for sale accounting and the accrued interest receivable is subordinated, the total accrued interest receivable is considered to be one of the components of the sale transaction and is accounted for as an interest retained by the transferor. Accrued interest receivable related to sold receivables is not reported as a loan receivable or other terminology implying that it has not been subordinated to the senior interests in the securitization. [860-20-55-18]

The accrued interest receivable may be subordinated as a result of: [860-20-55-18]

- the transferred financial asset being isolated from the transferor; or
- the operation of the cash flow distribution (or waterfall) through the securitization trust.

The accrued interest receivable (the retained interest) is not subsequently measured like an investment in debt securities classified as AFS or trading because it cannot be contractually prepaid or settled in such a way that the owner would not recover substantially all of its recorded investment. See section 7.3.20. Instead it is subsequently measured using other US GAAP, including the credit impairment standard (see KPMG Handbook, Credit impairment). [860-20-55-19]

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7.2.50 Assets obtained and liabilities incurred

Excerpt from ASC 860-20

20 Glossary

Beneficial Interests

Rights to receive all or portions of specified cash inflows received by a trust or other entity, including, but not limited to, all of the following:

a. Senior and subordinated shares of interest, principal, or other cash inflows to be passed-through or paid-through
b. Premiums due to guarantors
c. Commercial paper obligations
d. Residual interests, whether in the form of debt or equity

Proceeds

Cash, beneficial interests, servicing assets, derivative instruments, or other assets that are obtained in a transfer of financial assets, less any liabilities incurred.

> Assets Obtained and Liabilities Incurred as Proceeds

25-4 The proceeds from a sale of financial assets consist of the cash and any other assets obtained, including beneficial interests and separately recognized servicing assets, in the transfer less any liabilities incurred, including separately recognized servicing liabilities. Any asset obtained is part of the proceeds from the sale. Any liability incurred, even if it is related to the transferred financial 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.

30-1 The transferor shall initially measure at fair value any asset obtained (or liability incurred) and recognized under paragraph 860-20-25-1.

A transferor obtains (incurs) some combination of the following assets (liabilities) as proceeds (or a reduction in proceeds) in return for the financial assets it is transferring: [860-20 Glossary, 860-20-25-1]

— cash;
— beneficial interests in the transferred assets (as defined in Subtopic 860-20's glossary);
— derivatives (held or written) entered into contemporaneously with the transfer – e.g. swaps, put options, call options and credit derivatives;
— servicing assets or liabilities;
— forward sale contracts;
— recourse obligations; and
— guarantees.

The assets obtained and liabilities incurred are measured at fair value under Topic 820. [860-20-25-4, 30-1]

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Question 7.2.80

How does the transferor in revolving-period securitizations recognize forward sale contracts?

Excerpt from ASC 860-20

> Forward Contracts in Revolving-Period Securitizations

55-29 The requirement that all financial assets obtained and liabilities incurred by the transferor of a securitization that qualifies as a sale shall be recognized and measured as provided in this Subtopic includes the implicit forward contract to sell additional financial assets during a revolving period. Such a forward contract may become valuable or onerous to the transferor as interest rates and other market conditions change.

55-30 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.

55-31 Gain or loss recognition for revolving-period receivables sold to a securitization trust is limited to receivables that exist and have been sold.

Background: In a revolving-period securitization, the transferor enters into a forward agreement to sell receivables to a third party – e.g. transfers of trade receivables, or a credit card securitization.

Interpretive response: The forward agreement is considered an asset obtained or liability incurred by the transferor as proceeds for the transfer. Therefore, the transferor initially recognizes the forward agreement at fair value. The fair value of the forward is based on the difference between the rate of return that investors will receive on the beneficial interest and current market rates on similar investments. This means the forward may be valuable or onerous. [860-20-55-29 – 55-30]

Further, the gain or loss the transferor recognizes for revolving-period receivables sold to a third party is limited to receivables that exist and have been sold. [860-20-55-31]

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Question 7.2.90

How does a transferor characterize the exposure to credit risk in transferred financial assets?

Excerpt from ASC 860-20

> Distinguishing New Interests Obtained from Part of a Beneficial Interest Obtained

25-6 In determining whether credit risk is a separate liability or part of a beneficial interest that has been obtained by the transferor, the transferor should focus on the source of cash flows in the event of a claim by the transferee. If the transferee can only look to cash flows from the underlying financial assets, the transferor has obtained a portion of the credit risk only through the interest it obtained and a separate obligation shall not be recognized. Credit losses from the underlying assets would affect the measurement of the interest that the transferor obtained. In contrast, if the transferor could be obligated for more than the cash flows provided by the interest it obtained and, therefore, could be required to reimburse the transferee for credit-related losses on the underlying assets, the transferor shall record a separate liability. It is not appropriate for the transferor to defer any portion of a resulting gain or loss (or to eliminate gain on sale accounting, as it is sometimes described in practice).

• > Credit Risk Associated with Transferred Assets

55-24 A transferor may hold some portion of the credit risk associated with a transfer of an entire **financial asset** or group of entire financial assets. For example, a transferor may incur a liability to reimburse the **transferee**, up to a certain limit, for a failure of debtors to pay when due (a recourse liability). In that circumstance, a liability should be separately recognized and initially measured at fair value. That liability should be subsequently measured according to guidance in other Topics for measuring similar liabilities. In other circumstances, a transferor may provide credit enhancement through its ownership of a beneficial interest in the **transferred financial assets** if that beneficial interest is not paid until the other investors in the transferred financial assets are paid, thereby resulting in the transferor absorbing much of the related credit risk. As a result, the beneficial interests that are obtained by the transferor should be initially recognized according to paragraph 860-20-25-1.

Background: A transferor may continue to hold some portion of the credit risk associated with transferred financial assets. For example, a transferor may agree to reimburse the transferee, up to a certain limit, for debtors' failure to make payments when they become due. When it continues to hold a portion of the credit risk, the transferor must determine if it has incurred a separate liability or has received (as proceeds) a beneficial interest that is subordinate to the other beneficial interests. [860-20-25-6, 55-24]

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Interpretive response: The determination of whether a particular exposure to credit risk is part of a beneficial interest or a separate liability incurred depends on whether the transferor could be obligated to reimburse the transferee for credit-related losses. [860-20-25-6]

Nature of exposure	Transferor has risk through
Transferee may only look to cash flows from the underlying asset.	Beneficial interest
Transferor is obligated to reimburse the transferee beyond the cash flows provided by the beneficial interest that was obtained by the transferor – i.e. the transferor may be required to 'write a check' to the transferee.	Separate recourse obligation for the contingent obligation

Question 7.2.100

How does a transferor classify debt securities received as proceeds from a transfer of financial assets?

Excerpt from ASC 860-10

• > Classification of Transferred Debt Securities

55-75 An entity may transfer debt securities to an unconsolidated entity that has a predetermined life in exchange for cash and the right to receive proceeds from the eventual sale of the securities. For example, a third party holds a beneficial interest that is initially worth 25 percent of the fair value of the assets of the entity at the date of transfer. The entity is required to sell the transferred securities at a predetermined date and liquidate the entity at that time. Assume the facts in that example and the following additional facts:

a. The beneficial interests are issued in the form of debt securities.
b. Before the transfer, the debt securities were accounted for as available-for-sale securities in accordance with Topic 320.

55-76 In that example, whether the transferor may classify the debt securities as trading at the time of the transfer depends on whether the transfer is accounted for as a sale or as a secured borrowing:

a. Sale. If a transfer of a group of entire financial assets satisfies the conditions to be accounted for as a sale, Subtopic 860-20 requires that any assets obtained or liabilities incurred in the transfer be recognized (see paragraph 860-20-25-1) and initially measured at fair value (see paragraph 860-20-30-1). If the transfer in the example is accounted for as a sale, the transferor would account for the debt securities received as new assets and would have the option to classify the debt securities received as trading securities.

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b. Secured borrowing. If the transfer is accounted for as a secured borrowing, paragraph 860-30-25-2 requires the transferor to continue to report the transferred debt securities in its statement of financial position with no change in their measurement (that is, basis of accounting). Paragraph 320-10-35-12, which explains that transfers into or from the trading category should be rare, would continue to apply.

55-77 If the transferred financial assets were not securities subject to the guidance in Topic 320 before the transfer that was accounted for as a sale but the beneficial interests were issued in the form of debt securities, then the transferor would have the opportunity to decide the appropriate classification of the beneficial interests received as proceeds from the sale.

Background: Assume a transferor transfers financial assets to an unconsolidated entity in exchange for cash and beneficial interests in the transferred financial assets. The beneficial interests are in the form of debt securities and they convey the right to receive proceeds from the eventual sale of the transferred financial assets. The transferee (unconsolidated entity) is required to sell the transferred financial assets at a predetermined date and liquidate itself at that time. Question 7.3.20 discusses when a beneficial interest is accounted for as a debt security.

Interpretive response: It depends on whether the transfer is accounted for as a sale or a secured borrowing. The following table summarizes the accounting for each circumstance. [860-10-55-75 – 55-77]

Sale accounting	Secured borrowing accounting
The transferor initially measures the beneficial interests at fair value. Beneficial interests received are classified as trading, AFS or held-to-maturity, as appropriate based on Topic 320, and whether they can contractually be prepaid or otherwise settled in such a way that the holder would not recover substantially all of its recorded investment.	The transferor continues to report the transferred financial assets with no change in their measurement – i.e. no change in basis of accounting. Transfers to and from the trading category should be rare.

Question 7.2.110

How does the transferor account for a put option embedded in a transferred marketable security?

Excerpt from ASC 860-20

• > Options Embedded in Transferred Securities

55-20 This guidance addresses transactions that involve the sale of a marketable security to a third-party buyer, with the buyer's having an option to

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put the security back to the seller at a specified future date or dates for a fixed price. Because of the put option, the seller generally receives a premium price for the security.

55-21 If the transfer is accounted for as a sale, a put option that enables the holder to require the writer of the option to reacquire for cash or other assets a marketable security or an equity instrument issued by a third party should be accounted for as a derivative by both the holder and the writer, provided the put option meets the definition of a derivative in paragraph 815-10-15-83 (including meeting the net settlement requirement, which may be met if the option can be net settled in cash or other assets or if the asset required to be delivered is readily convertible to cash). If multiple put options exist, recognition of the multiple put options as liabilities, and initial measurement at fair value, are required.

55-22 A put option that is issued as part of a transfer being accounted for as a sale that is not accounted for as a derivative under Subtopic 815-10 would be considered a guarantee under paragraph 460-10-55-2(b) and would be subject to its initial recognition, initial measurement, and disclosure requirements. If the written put option is accounted for as a derivative under Subtopic 815-10 by the seller-transferor, then the put option would be subject to only the disclosure requirements of Topic 460.

Background: Assume a transferor transfers a marketable security to a third party together with an option for the transferee to require the transferor to repurchase the security in the future at a fixed price (i.e. a fixed-price put option). The transferor receives a premium for the security because of the put option and accounts for the transfer as a sale. See Question 8.2.70 if the transfer is accounted for as a secured borrowing. [860-20-55-20]

Interpretive response: It depends. The put option is analyzed to determine whether it is a derivative or a guarantee. If multiple put options exist, the analysis is completed for each option. [860-20-55-21]

The put option is accounted for as a derivative by the writer (transferor) if it meets the definition of a derivative in Topic 815 (derivatives and hedging) and does not qualify for a scope exception. For further guidance on the scope exceptions and definition of a derivative, see chapters 2 and 3, respectively, of KPMG Handbook, Derivatives and hedging. If the put option is accounted for as a derivative, it is subject to only the disclosure requirements of Topic 460 (guarantees). [860-20-55-21, 860-20-55-22]

If the put option is not accounted for as a derivative by the transferor, it is a guarantee subject to the initial recognition, measurement and disclosure requirements of Topic 460. [860-20-55-22]

See Question 7.5.10 for the transferee accounting for the put option.

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7.3 Transferor – Subsequent measurement of assets obtained and liabilities incurred

7.3.10 Overview

Subsequent measurement of assets obtained and liabilities incurred is generally prescribed by other applicable US GAAP. However, Topic 860 provides subsequent measurement guidance for certain assets obtained and liabilities incurred. Some of that guidance in Topic 860 is incremental to other applicable US GAAP.

Common assets obtained and liabilities incurred include the following.

Assets obtained and liabilities incurred	Reference to discussion
Beneficial interests	Section 7.3.20
Servicing assets and liabilities	Chapter 10
Credit enhancements and guarantees (that do not meet the definition of a derivative)	Topic 460 Question 7.3.10
Derivatives	Topic 815
Recourse obligations (that do not meet the definition of a derivative and are not guarantees in the scope of Topic 460)	Topic 450

If the transferor receives assets and liabilities as proceeds, it considers whether such amounts may be offset and reported net based on the guidance in Topic 210 (balance sheet).

Question 7.3.10

What factors are considered when subsequently measuring credit enhancements ?

Excerpt from ASC 860-20

> Credit Enhancements

35-8 While this Subtopic does not specifically address the subsequent measurement of credit enhancements, there are some factors to consider. Factors such as how much cash the transferor will receive from, for example, a cash reserve account, and when it will receive cash inflows depend on the performance of the transferred financial assets. Entities shall regularly review those assets for impairment because of their nature. Entities shall look to other guidance for subsequent measurement including guidance for impairment based on the nature of the credit enhancement.

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Interpretive response: Subtopic 860-20 does not specifically address subsequent measurement of credit enhancements. However, factors that an entity considers when subsequently measuring credit enhancements include how much cash the transferor will receive from a cash reserve account and when it will receive cash inflows based on the performance of the transferred financial assets. [860-20-35-8]

A cash reserve account is sometimes used in securitization transactions to collect cash flows on the underlying assets that would have otherwise been payable to the residual interest holder. Distributions from the cash reserve account are made to other beneficial interest holders or the residual interest holder depending on whether certain targets or metrics are met.

7.3.20 Beneficial interests

The following decision tree summarizes how a transferor analyzes beneficial interests. [860-20-35-2 –35-3, 35-9, 325-40-15-3]

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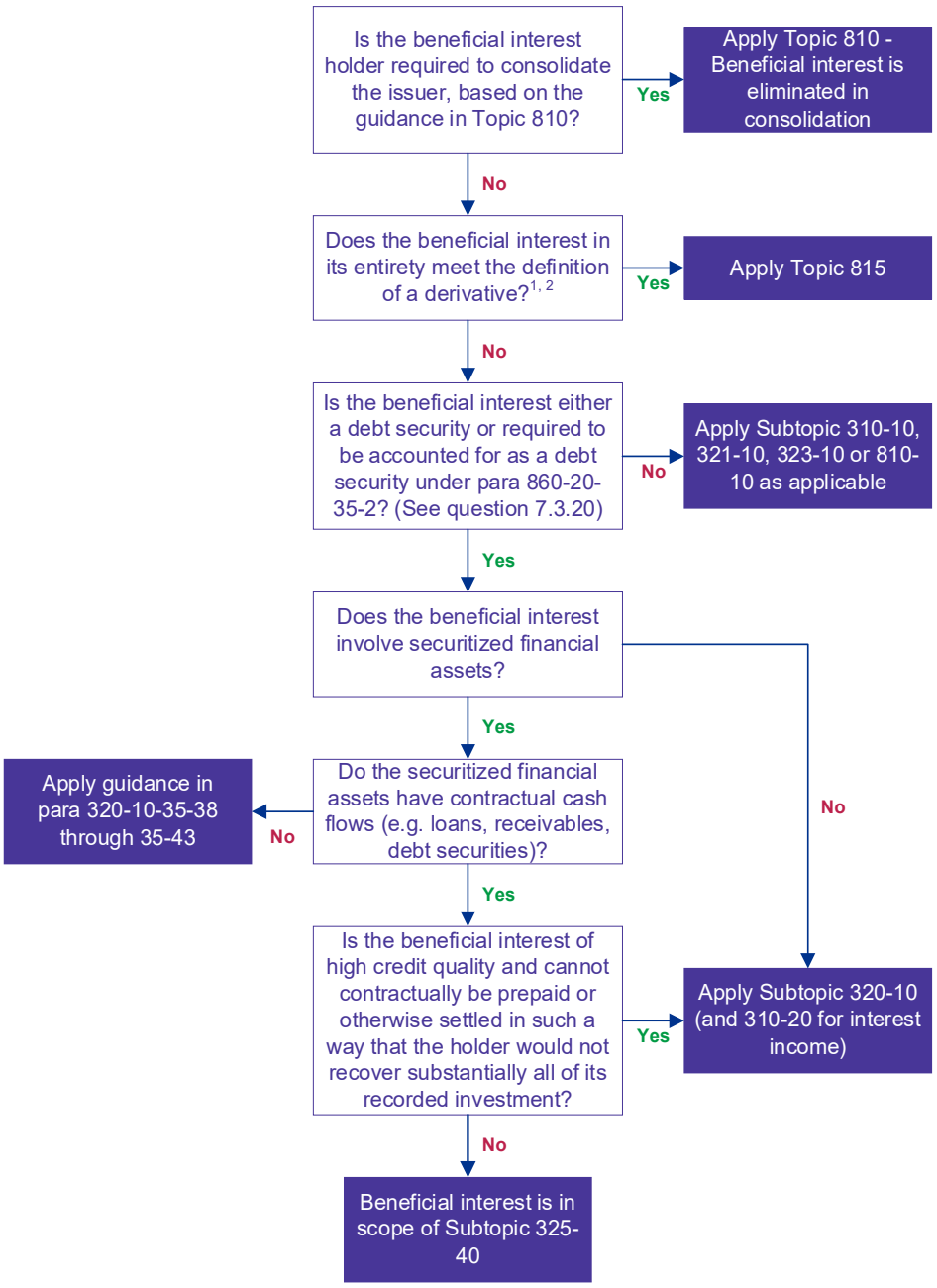

Notes:

1. Certain items, including certain I/O and P/O strips, are outside the scope of Topic 815. See section 2.12 of KPMG Handbook, Derivatives and hedging, for additional discussion of the I/O and P/O strip scope exception.
2. A beneficial interest that is not a derivative in its entirety and is not subsequently measured at fair value through earnings, is evaluated to determine if it contains an embedded derivative that requires bifurcation. If an embedded derivative is bifurcated, it is accounted for under Topic 815 and the host contract continues to be evaluated through the flowchart. In contrast, if the embedded derivative is not bifurcated, the entire hybrid instrument continues to be evaluated through the flowchart.

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Question 7.3.20

When is a transferor required to account for a beneficial interest like a debt security?

Excerpt from ASC 860-20

> Financial Assets Subject to Prepayment

35-2 Financial assets, except for instruments that are within the scope of Subtopic 815-10, that can contractually be prepaid or otherwise settled in such a way that the holder would not recover substantially all of its recorded investment shall be subsequently measured like investments in debt securities classified as available for sale or trading under Topic 320. Examples of such financial assets include, but are not limited to, **interest-only strips**, other beneficial interests, loans, or other receivables. Interest-only strips and similar interests that meet the definition of **securities** are included in the scope of that Topic. Therefore, all relevant provisions of that Topic (including the disclosure requirements) shall be applied. See related implementation guidance beginning in paragraph 860-20-55-33.

35-3 Interest-only strips and similar interests that are not in the form of securities are not within the scope of Topic 320 but shall be measured like investments in debt securities classified as available for sale or trading. In that circumstance, all of the measurement provisions of that Topic, as well as the provisions of Topic 326 on measurement of credit losses, shall be followed. However, other provisions of Topics 320 and 326, such as those addressing disclosures, are not required to be applied. Paragraph 320-10-15-9 explains that, for debt securities within its scope, Subtopic 325-40 provides incremental guidance on accounting for and reporting discount and credit losses.

35-5 A financial asset that can be contractually prepaid or otherwise settled in such a way that the holder would not recover substantially all of its recorded investment shall not be classified as held-to-maturity even if the investor concludes that prepayment or other forms of settlement are remote. The probability of prepayment or other forms of settlement that would result in the holder's not recovering substantially all of its recorded investment is not relevant in deciding whether the provisions of paragraph 860-20-35-2 apply to those financial assets.

> Beneficial Interests

35-9 Beneficial interests shall be evaluated for credit losses, including at the time paragraphs 860-20-25-8 through 25-10 are applied. See Section 325-40-35 for guidance on credit losses applicable to beneficial interests in securitized financial assets.

Interpretive response: A transferor accounts for a beneficial interest (that is not a derivative) like a debt security and classifies it as trading or AFS if the interest can contractually be prepaid or otherwise settled in such a way that the

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holder would not recover substantially all of its recorded investment. [860-20-35-2 – 35-3]

If the beneficial interest is classified as AFS, the transferor applies the subsequent measurement guidance in Topic 320, Topic 325 (if applicable) and Topic 326. See KPMG Handbook, Credit impairment, for guidance on Topic 326. [860-20-35-3, 35-9]

Examples of financial assets to which debt security guidance may apply include I/O strips, other beneficial interests that are accounted for under Subtopic 325-40 (beneficial interests in securitized financial assets), loans or other receivables. [860-20-35-3]

A transferor may not classify a beneficial interest as held-to-maturity if it can contractually be prepaid or otherwise settled in such a way that the holder would not recover substantially all of its recorded investment, even if the probability of prepayment or other forms of settlement is remote. [860-20-35-5]

Question 7.3.30

Can a transferor classify a debt security as held-to-maturity?

Interpretive response: It depends. We believe a transferor can initially classify a debt security as held-to-maturity if the security cannot be contractually prepaid or otherwise settled in such a way that the holder would not recover substantially all of its recorded investment.

For example, if the only way the entity would not recover substantially all of its recorded investment is in response to the borrower's default, the debt security could be classified as held-to-maturity; this is because the borrower's default on its contractual obligation is not a contractual settlement.

However, the transferor may use the held-to-maturity classification only if it has the positive intent and ability to hold the security to maturity. [320-10-25-1(c)]

Question 7.3.40

What does a transferor evaluate when determining whether a financial asset can be contractually prepaid or settled such that the holder would not recover substantially all of its recorded investment?

Excerpt from ASC 860-20

> Financial Assets Subject to Prepayment

35-4 The requirement in paragraph 860-20-35-2 does not apply to situations in which events that are not the result of contractual provisions, for example, borrower default or changes in the value of an instrument's denominated

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currency relative to the entity's functional currency, cause the holder not to recover substantially all of its recorded investment.

35-6 The guidance in this Subtopic does not specifically address the subsequent measurement of a transferor's beneficial interests that cannot be contractually prepaid or settled in such a way that the owner would not recover substantially all of its recorded investment.

• > Financial Assets Subject to Prepayment

55-32 The following is implementation guidance related to the subsequent measurement of various types of financial assets subject to prepayment, specifically:

a. Instruments that can be prepaid or otherwise settled in such a way that the holder would not recover substantially all of the recorded investment
b. Loan that can be prepaid or otherwise settled in such a way that the holder would not recover substantially all of the recorded investment at initial acquisition
c. Classification of a residual tranche in a securitization as held to maturity.

• • > Instruments That Can Be Prepaid or Otherwise Settled in Such a Way That the Holder Would Not Recover Substantially All of the Recorded Investment

55-33 The following discusses whether the following types of instruments are subject to the subsequent measurement guidance in paragraph 860-20-35-2:

a. A **financial asset** that is not a debt security denominated in a foreign currency
b. A note for which the repayment amount is indexed to the creditworthiness of a party other than the issuer.

55-34 Investing in a financial asset that is denominated in a foreign currency often exposes an entity to foreign currency exchange rate risk; however, that risk is not addressed in paragraph 860-20-35-2.

55-35 A financial asset that is not a debt security under Topic 320 is not subject to the requirements of paragraph 860-20-35-2 because it is denominated in a foreign currency.

55-36 An entity is not required to measure such an investment like a debt security under paragraph 860-20-35-2 unless it has provisions that allow it to be contractually prepaid or otherwise settled in such a way that the holder would not recover substantially all of its recorded investment, as denominated in the foreign currency. For example, an investment denominated in deutsche marks by an entity with a U.S. dollar functional currency would not be subject to that paragraph if the contract requires that substantially all of the invested deutsche marks be repaid.

55-37 A note for which the repayment amount is indexed to the creditworthiness of a party other than the issuer is subject to the provisions of paragraph 860-20-35-2 because the event that might cause the holder to receive less than substantially all of its recorded investment is based on a contractual provision, not on a default by the borrower (that is, the issuer of the note). That contractual provision indexes the payment terms of the note to a default by a third party unrelated to the issuer of the note. If that note is within

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the scope of Subtopic 815-10 the guidance of paragraph 860-20-35-2 would not apply.

• • > Classification of a Residual Tranche in a Securitization as Held to Maturity

55-39 Whether a residual tranche debt security in a securitization of financial assets (for example, receivables) using a securitization entity can be classified as held to maturity depends on the facts and circumstances. If the contractual provisions of the residual tranche debt security provide that the residual tranche can contractually be prepaid or otherwise settled in such a way that the holder would not recover substantially all of its recorded investment, paragraph 860-20-35-2 precludes the residual tranche debt security from being accounted for as held to maturity. In contrast, if the only way that the holder of the residual tranche would not recover substantially all of its recorded investment would be in response to a default by the borrower (debtor), then a held-to-maturity classification is acceptable if the conditions specified for a held-to-maturity classification in paragraphs 320-10-25-1(c) and 320-10-25-5(a) have been met.

Interpretive response: A transferor evaluates the contractual provisions of the financial asset that provide for prepayment or settlement to determine whether the asset can be contractually prepaid or otherwise settled such that the holder would not recover substantially all of its recorded investment. A contractual provision may not be disregarded, even if it is remote that those prepayments or settlements will occur. Events that are not the result of contractual provisions (e.g. default by a borrower) are disregarded in this analysis. [860-20-35-4]

The following table indicates whether a transferor considers certain events in this analysis. These events are illustrated in Example 7.3.10 [860-20-55-32 – 55-37, 55-39]

Event	Is feature considered?
Changes in the exchange rate between the instrument's denomination of the investment and the entity's functional currency	No
Issuer (borrower) defaults	No
Repayment amount is indexed to the creditworthiness of a party other than the issuer (borrower)	Yes

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Example 7.3.10

Evaluating whether a financial asset can be contractually prepaid or otherwise settled such that the holder would not recover substantially all of its recorded investment

Scenario 1: Foreign currency investment

ABC Corp., a US dollar functional currency entity, receives cash and a loan receivable denominated in euros as proceeds for a transfer of financial assets for which sale accounting applies.

The obligor is contractually required to pay ABC the principal amount of the loan receivable in euros. However, ABC may not recover all of its initial recorded investment due to changes in exchange rates between the euro-denominated loan receivable and its US dollar functional currency.

ABC does not consider foreign exchange risk when evaluating whether it may receive less than substantially all of its recorded investment because the risk of nonpayment is not based on a contractual settlement provision. [860-20-35-4, 55-34 – 55-36]

Scenario 2: Issuer (borrower) default

ABC Corp. receives cash and debt securities as proceeds for a transfer of financial assets for which sale accounting applies. The only way that ABC would not recover substantially all of its recorded investment is in response to a default by the issuer of the debt security. ABC does not consider such an event when evaluating whether it may receive less than substantially all of its recorded investment because it is based on default by the issuer. [860-20-55-39]

Scenario 3: Credit linked note receivable

ABC Corp. receives cash and a note receivable as proceeds for a transfer of financial assets for which sale accounting applies. The repayment of the note is indexed to the creditworthiness of a party that is not the issuer (borrower) of the note. ABC considers the contractual repayment provision when evaluating whether it may receive less than substantially all of its recorded investment because it is based on a contractual provision and not on a default by the issuer. [860-20-35-4, 860-20-55-37]

Question 7.3.50

What does ‘substantially all’ mean when determining whether the holder would not recover substantially all of its recorded investment?

Interpretive response: The Board did not define what ‘substantially all’ means in the context of transfers of financial assets. However, ‘substantially all’ is used elsewhere in US GAAP and is usually interpreted to mean at least 90%. The Board decided not to include a specified percentage test that would be inherently arbitrary even though applying the term requires judgment. [FAS 125.BC207]

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We believe an entity should generally use 90% as its benchmark in assessing whether the holder of a financial asset would recover substantially all of its recorded investment.

Question 7.3.60

Can a transferor reclassify a loan, which can be contractually prepaid or otherwise settled such that the holder would not recover substantially all of its recorded investment, as held-for-investment?

Excerpt from ASC 860-20

• • > Loan That Can Be Prepaid or Otherwise Settled in Such a Way That the Holder Would Not Recover Substantially All of the Recorded Investment at Initial Acquisition

55-38 A loan (that is not a debt security) that when initially obtained could be contractually prepaid or otherwise settled in such a way that the holder would not recover substantially all of its recorded investment may be reclassified as held for investment later in its life (that is, at a date that is so close to the financial asset's maturity that the holder would recover substantially all of its recorded investment even if it was prepaid). That is, the loan would no longer be required to be measured in accordance with the guidance in paragraph 860-20-35-2 if both of the following conditions are met:

a. It would no longer be possible for the holder not to recover substantially all of its recorded investment upon contractual prepayment or settlement.
b. The conditions for amortized cost accounting are met (for example, paragraphs 310-10-35-47 and 948-310-25-1).

However, any unrealized holding gain or loss arising under the available-for-sale classification that exists at the date of the reclassification would continue to be reported in other comprehensive income but should be amortized over the remaining life of the loan as an adjustment of yield. (The loan would not be classified as held to maturity because under Topic 320 only debt securities may be classified as held to maturity.)

Background: In some circumstances, a transferor may receive a beneficial interest in the form of a loan that, when initially obtained, can contractually be prepaid or otherwise settled in such a way that the holder would not recover substantially all of its recorded investment.

As discussed in Question 7.3.20, because the loan is not a debt security but can contractually be prepaid or otherwise settled in such a way that the holder would not recover substantially all of its recorded investment, it is classified as either AFS or trading. However, subsequent to initial recognition, there may be a change in facts and circumstances such that the instrument can no longer contractually be prepaid or otherwise settled in such a way that the holder

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would not recover substantially all of its recorded investment. For example, a provision in the contractual terms may be terminated or expire. [860-20-35-2]

Interpretive response: It depends. The loan may be reclassified as held-for-investment if: [860-20-55-38]

— it would no longer be possible for the holder not to recover substantially all of its recorded investment upon contractual prepayment or settlement; and

— the conditions for amortized cost accounting are met – e.g. management has the intent and ability to hold the beneficial interest for the foreseeable future or until maturity or payoff.

We believe the determination of whether it is no longer possible for the holder not to recover substantially all of its recorded investment is made on the basis of the holder's contractual rights and is not based on an assessment of the probability of recovering substantially all of the recorded investment.

If the loan is accounted for like an AFS debt security before reclassification, any unrealized holding gain or loss arising in OCI before reclassification is amortized over the remaining life of the beneficial interest as a yield adjustment. [860-20-55-38]

7.4 Transferor – Regaining control of financial assets sold

7.4.10 Overview

Question 7.4.10

Are the sale criteria required to be met on an ongoing basis?

Excerpt from ASC 860-10

> Circumstances That Result in a Transferor Regaining Control of Financial Assets Previously Sold

40-41 A change in law or other circumstance may result in a transferred portion of an entire financial asset no longer meeting the conditions of a participating interest (see paragraph 860-10-40-6A) or the transferor's regaining control of transferred financial assets after a transfer that was previously accounted for as a sale, because one or more of the conditions in paragraph 860-10-40-5 are no longer met. See the related guidance beginning in paragraph 860-20-25-8.

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Excerpt from ASC 860-20

> Regaining Control of Financial Assets Sold

25-8 Paragraph 860-10-40-41 explains that a change in law or other circumstance may result in a transferred portion of an entire financial asset no longer meeting the conditions of a participating interest (see paragraph 860-10-40-6A) or the transferor's regaining control of transferred financial assets after a transfer that was previously accounted for as a sale, because one or more of the conditions in paragraph 860-10-40-5 are no longer met.

Interpretive response: Yes. The sale criteria and the definition of a participating interest are required to be met at the time of the transfer and also subsequent to the transfer. Therefore, a change in law or other circumstances may result in a transferred portion of an entire financial asset no longer meeting the definition of a participating interest or a transfer no longer meeting the criteria to qualify as a sale. In such cases, the assets are accounted for as if they were repurchased. Similarly, a transfer that did not meet the sale criteria at the time of transfer may subsequently meet the criteria if facts or circumstances change.[860-10-40-41, 860-20-25-8]

An example of a common event that causes the sale criteria to no longer be met is a removal-of-accounts provision (ROAP). A ROAP is a contingent call option that is conditional on an event (such as a borrower's default) whose occurrence results in the transferor regaining control (see section 7.4.20).

Question 7.4.20

What is the transferor's accounting when it regains control of, but does not repurchase, previously transferred assets?

Excerpt from ASC 860-20

> Regaining Control of Financial Assets Sold

25-9 Such changes shall be accounted for in the same manner as a purchase of the transferred financial assets from the former transferee(s) in exchange for liabilities assumed unless they arise solely from either:

a. Consolidation of an entity involved in the transfer at a subsequent date (see paragraph 860-20-25-10)
b. A change in market prices (for example, an increase in price that moves into the money a **freestanding call option** on a non-readily-obtainable, transferred financial asset that was originally sufficiently out of the money that it was judged not to constrain the transferee).

See the related guidance beginning in paragraph 860-20-25-10.

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25-10 After that change, the transferor shall do all of the following:

a. Recognize in its financial statements those transferred financial assets together with liabilities to the former transferee(s) or beneficial interest holders of the former transferee(s).
b. Not change the accounting for the servicing asset related to the previously sold financial assets. That is, even though the transferor has regained control over the previously sold assets, the cash flows from those assets will contractually be paid to the special-purpose entity, which will then distribute the proceeds to satisfy its contractual obligations (including obligations to the beneficial interest holders). Because the transferor, as servicer, is still contractually required to collect the asset's cash flows for the benefit of the special-purpose entity and otherwise service the assets, it shall continue to recognize the servicing asset and assess the asset for impairment if subsequently measured using the amortization method, as required by paragraph 860-50-35-9. Once a servicing asset is recognized it shall not be added back to the underlying asset. Even when the transferor has regained control over the underlying assets through an event that triggers a transferor to rerecognize previously transferred assets that were accounted for as having been sold, the related servicing asset shall continue to be separately recognized.
c. Continue to account for the transferor's interests in those underlying financial assets apart from any rerecognized financial assets. That is, the transferor's interests shall not be combined with and accounted for with the rerecognized financial assets. Example 10 (see paragraph 860-20-55-83) illustrates this guidance. However, a subsequent event that results in the transferor reclaiming those financial assets from the transferee, for example, the exercise of a removal-of-accounts provision or the consolidation by the transferor of the securitization entity in accordance with applicable GAAP, including the Variable Interest Entities Subsections of Subtopic 810-10, would result in a recombination of the transferor's interests with the underlying financial assets.

For guidance on consolidation, which is relevant to determining whether a transferor must consolidate an entity involved in a transfer that was accounted for as a sale, see Topic 810.

> Regaining Control of Financial Assets Sold

30-3 The transferor shall initially measure **transferred financial assets** and liabilities that are rerecognized under paragraph 860-20-25-10(a) as a result of regaining control of the **financial assets** sold at fair value on the date of the change as if the transferor purchased the transferred financial assets and assumed the liabilities on that date.

Excerpt from ASC 860-50

> Regaining Control of Financial Assets Sold

25-10 Paragraph 860-20-25-10(b) explains that, after a paragraph 860-10-40-41 change, the transferor shall not change, the accounting for the servicing asset related to the previously sold financial assets and provides related guidance.

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Background: A transferor may regain control of previously sold financial assets in the following circumstances.

- A contingent event has occurred, thereby allowing a transferor to reacquire a transferred asset in accordance with a removal-of-accounts provision in the underlying transfer agreement.
- An interest in a previously sold financial asset no longer meets the definition of a participating interest.
- Changes in laws or regulations, amendments to the underlying transfer agreement or other circumstances that cause the transferor to no longer meet all of the conditions in paragraph 860-10-40-5 for sale accounting. See chapters 4, 5 and 6 for additional discussion of the conditions.

Interpretive response: When a transferor regains control of a previously transferred asset, but has not legally repurchased the transferred asset, it does the following.

Step 1	Rerecognizes the asset at fair value along with a corresponding liability to the former transferee(s) or the beneficial interest holders of the former transferee(s) for the same amount. The fair value of the financial assets for which control has been regained would not consider any cash flows related to other interests held by the transferor or the rights to service those financial assets. [860-20-25-10(a)]
Step 2	Continues to separately account for any servicing asset or liability related to the previously sold financial asset Although the transferor has rerecognized the loans from an accounting perspective, it does not legally own them. Because the transferor is still contractually required to service the loans, it continues to separately recognize the servicing asset or liability. Therefore, the servicing asset or liability is not recombined with the loans, but remains a separate unit of account. [860-20-25-10(b), 860-50-25-10]
Step 3	Continues to account for its other interests in those underlying financial assets, as well as any related obligations (such as recourse obligations), apart from – not recombined with – any rerecognized financial assets. There is no change in the transferor's separate accounting for its beneficial interests. [860-20-25-10(c)]

If the transferor has regained control via a call option, this guidance applies regardless of whether the transferor intends to exercise the call option.

Subtopic 860-20's Example 10 (reproduced below) illustrates the accounting when an transferor regains control of previously transferred assets but does not legally repurchase the loans.

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Excerpt from ASC 860-20

• > Example 10: Rerecognition of Transferred Assets and Subsequent Accounting for Transferor's Interest and a Servicing Asset

55-83 This Example illustrates the accounting for a sale of loans in their entirety by a transferor to an unconsolidated entity and the subsequent accounting for the transferor's interest and a servicing asset. In this Example, the transferor's interest is an **interest-only strip** that is accounted for at fair value in the same manner as an available-for-sale security under paragraph 860-20-35-2.

55-84 This Example has the following assumptions.

55-85 On January 2, 20X1, Entity I (the transferor) originates $1,000 of loans, yielding 10.5 percent interest income for their estimated life of 9 years. Entity I later transfers the loans in their entirety to an unconsolidated entity and accounts for the transfer as a sale. Entity I receives as proceeds $1,000 cash plus a beneficial interest that entitles it to receive 1 percent of the contractual interest (an interest-only strip receivable). Entity I will continue to service the loans for a fee of 100 basis points. The guarantor, a third party, receives 50 basis points as a guarantee fee.

55-86 At the date of transfer, the following facts are assumed.

a. The fair value of the servicing asset is $40.
b. The total fair value of the loans including servicing is $1,040.
c. The fair value of the interest-income strip receivable is $60.

55-87 On December 1, 20X1, an event occurs that results in the transfer not meeting the conditions for sale accounting. The fair value of the originally transferred financial assets that remain outstanding in the entity on that date is $929. The fair value of Entity I's interest (in the form of an interest-only strip) on that date is $58. The fair value of the servicing asset on that date is $38. The guarantee that was entered into by the entity does not trade with the underlying financial assets. The fees on this guarantee will be paid as part of the cash waterfall.

55-88 All cash flows from the financial assets transferred to the trust are initially sent directly to the trust and then distributed in order of priority. The priority of payments in the cash waterfall is as follows: servicing fees, guarantees, amounts due to outside beneficial interest holders, and amounts due to Transferor's beneficial interest.

55-90 The following journal entries would be made.

January 2, 20X1

Cash	$ 1000	
Transferor's interest (available for sale)	60	
Servicing asset	40	
Loans		$ 1000
Gain on sale		100

To record the sale of the assets and to recognize Entity I's interest and a servicing asset at fair value.

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December 1, 20X1

Other comprehensive income	$ 2	
Entity I's interest (available for sale)		$ 2

To subsequently measure Entity I's interest in the same manner as an available-for-sale security.

55-91 The following illustrates the accounting entry to be made after the event occurs that results in the transfer not meeting the conditions for sale accounting.

December 1, 20X1

Loans	$ 929	
Due to Securitization Entity		$ 929

To recognize the previously sold loans on Entity I's books along with the obligation to pass the cash flows associated with those loans to Securitization Entity

55-92 Entity I would account for the rerecognized financial assets and transferor's interests as follows:

a. Entity I would continue to account for transferor's interests (in accordance with paragraph 320-10-35-1) at fair value with changes in fair value recognized in other comprehensive income.
b. Entity I would account for the loans at cost plus accrued interest in accordance with Subtopic 310-20.

Question 7.4.30

What is the transferor's accounting when it legally purchases transferred assets it previously regained control over?

Interpretive response: When a transferor legally repurchases transferred assets it had previously regained control over, it: [860-20-25-10(c)]

Step 1	Derecognizes the liability to the former transferee(s) or the beneficial interest holders of the former transferee that was established when control was regained;
Step 2	Derecognizes any beneficial interests that are entirely related to the repurchased asset(s) and recognizes a receivable for the amount due (if any) from the transferee as a result of its ownership of the beneficial interests in those transferred assets;
Step 3	Derecognizes the related servicing asset or liability (that is, recombines the related servicing asset or liability with the assets by adding the carrying amount of the servicing asset or liability to the carrying amount of the assets). This is because upon exercise of the call option, the servicing activities are no

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	longer provided to a third party; the underlying assets have been repurchased and are now legally owned by the servicer.
Step 4	Derecognizes any liabilities related to the repurchased financial asset(s);
Step 5	Derecognizes the amount paid to repurchase the financial asset(s); and
Step 6	Recognizes a gain or loss for the difference between the carrying amounts of assets and liabilities recognized and derecognized and the amount paid to repurchase the financial assets.

Question 7.4.40

Is a gain or loss recognized upon a transferor regaining control of transferred financial assets?

Excerpt from ASC 860-20

> Regaining Control of Financial Assets Sold

25-12 Upon application of paragraph 860-20-25-10, no gain or loss shall be recognized in earnings with respect to any of the transferor's **beneficial interests**. A gain or loss may be recognized upon the exercise of a removal-of-accounts provision or similar contingent right with respect to the repurchased transferred financial assets that were sold if the removal-of-accounts provision or similar contingent right held by the transferor is not accounted for as a derivative instrument under Subtopic 815-10 and is not at the money, resulting in the fair value of those repurchased financial assets being greater or less than the related obligation to the transferee.

Interpretive response: A gain or loss is not recognized when the transferor regains control of previously sold financial assets. However, in some circumstances a gain or loss may be recognized subsequent to regaining control. For example, a gain or loss may be recognized when a transferor repurchases the financial assets if the exercise price/repurchase price is not equal to the fair value of the financial assets when control was regained. [860-20-25-12]

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Example 7.4.10
Repurchase of loans

On January 1, Year 1, ABC Corp. transfers a $100,000 par loan to a third party for cash of $95,000 and the transfer qualifies as a sale. If a specific contingent event occurs, ABC has the right to repurchase the loan for the original par amount.

ABC records the following journal entry to account for the transfer of the loan.

	Debit	*Credit*
Cash	95,000	
Loss on sale	5,000	
Loan		100,000
To record transfer of loan.		

On September 31, Year 1, the specific contingent event occurs and ABC's contingent call option is exercisable. The fair value of the loan is $93,000. ABC determines that the loan has not experienced a more than insignificant deterioration in credit quality since origination and the allowance for credit losses on the loan is $1,500. ABC does not exercise the call option on September 31, Year 1.

ABC records the following journal entry to account for regaining control of the transferred loan.

	Debit	*Credit*
Loan	93,000	
Due to transferee		93,000
To record regaining control of transferred loan.		
Credit loss expense	1,500	
Allowance for credit losses		1,500
To record allowance for credit losses for loan.		

On December 15, Year 1, ABC exercises its call option and repurchases the loan. The purchase price for the loan is the original par amount of $100,000. ABC records the following journal entry to account for the repurchase of the loan.

	Debit	*Credit*
Due to transferee	93,000	
Loss	7,000	
Cash		100,000
To record repurchase of loan.		

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Example 7.4.20
Repurchase of loans with retained servicing asset

On January 1, Year 1, ABC Corp. transfers a $100,000 par loan to a third party for cash of $95,000 and the transfer qualifies as a sale. If a specific contingent event occurs, ABC has the right to repurchase the loan for the original par amount.

ABC determines that it will recognize a servicing asset because the benefits of servicing are greater than adequate compensation. The fair value of the servicing asset is $4,000. ABC subsequently measures the servicing asset at fair value and, for simplicity, it is assumed that there is no change in the fair value. See chapter 10 for additional information on the accounting for servicing rights.

ABC records the following journal entry to account for the transfer of the loan.

	Debit	*Credit*
Cash	95,000	
Servicing asset	4,000	
Loss on sale	1,000	
Loan		100,000
To record transfer of loan.		

On September 31, Year 1, the specific contingent event occurs and ABC's contingent call option is exercisable. The fair value of the loan is $93,000. ABC determines that the loan has not experienced a more than insignificant deterioration in credit quality since origination and the allowance for credit losses on the loan is $1,500. ABC does not exercise the call option on September 31, Year 1.

ABC records the following journal entry to account for regaining control of the transferred loan.

	Debit	*Credit*
Loan	93,000	
Due to transferee		93,000
To record regaining control of transferred loan.		
Credit loss expense	1,500	
Allowance for credit losses		1,500
To record allowance for credit losses for loan.		

On December 15, Year 1, ABC exercises its call option and repurchases the loan. The purchase price for the loan is the original par amount of $100,000. ABC records the following journal entry to account for the repurchase of the loan. For simplicity, an additional allowance for credit losses is not recognized.

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	Debit	*Credit*
Due to transferee	93,000	
Loan	4,000	
Loss	7,000	
Servicing asset		4,000
Cash		100,000
To record repurchase of loan and recombining servicing asset with loan.		

Question 7.4.50

Is an allowance for credit losses recognized for financial assets at the time they are rerecognized?

Excerpt from ASC 860-20

> Regaining Control of Financial Assets Sold

25-13 For financial assets rerecognized in accordance with paragraph 860-20-25-10, an entity shall initially recognize a financial asset at fair value. An entity shall then apply relevant guidance, including this Topic, Topic 310 on receivables, Topic 320 on investments—debt securities, Topic 321 on investments—equity securities, Topic 323 on investments—equity method and joint ventures, and Topic 325 on investments—other. In addition, an entity shall measure an allowance for credit losses in accordance with Topic 326, if applicable.

a. For those financial assets that are not **purchased financial assets with credit deterioration** within the scope of Topic 326, an entity shall recognize an allowance for credit losses with a corresponding charge to credit loss expense as of the reporting date.
b. For those financial assets that are purchased financial assets with credit deterioration (which includes beneficial interest that meets the criteria in paragraph 325-40-30-1A) within the scope of Topic 326, an entity shall recognize an allowance for credit losses in accordance with Topic 326 with a corresponding increase to the amortized cost basis of the financial asset(s) as of the recognition date.

Interpretive response: It depends. The rerecognition of previously transferred financial assets is treated the same way as a purchase (i.e. new acquisition). Therefore, an allowance for credit losses is recognized if the previously transferred financial assets are in the scope of Topic 326.

For a purchased financial asset with credit deterioration (a PCD financial asset), a transferor grosses up the amortized cost basis of the asset for the initial

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estimate of credit losses. This allowance for credit losses is established without affecting earnings. For a rerecognized financial asset that is not a PCD financial asset, an allowance is established with a corresponding adjustment to credit loss expense. See section 12.2 of KPMG Handbook, Credit impairment, for discussion on determining whether a rerecognized asset meets the purchased financial asset with credit deterioration definition and how to measure the allowance for credit losses. [860-20-25-13]

Question 7.4.60

How does a transferor account for previously sold financial assets if it subsequently consolidates the transferee?

Interpretive response: A transferor applies Topic 810 (consolidation) to determine whether it is required to consolidate the transferee and how to apply consolidation procedure. If the transferor previously sold financial assets to a transferee that is later consolidated, the accounting is similar to when the transferor repurchases previously transferred financial assets. We believe the servicing assets or liabilities or other interests previously recognized by the transferor should be eliminated through the elimination of intercompany transactions in consolidation.

For example, ABC Corp. transferred a financial asset to DEF Corp. in exchange for cash and a servicing asset in a transfer for which sale accounting applies. In a subsequent year, ABC is required to consolidate DEF. When ABC consolidates DEF, it recognizes DEF's assets and liabilities by applying Topic 810. Additionally, following the elimination of intercompany transactions in consolidation, the servicing asset is no longer separately recognized in ABC's consolidated financial statements.

7.4.20 ROAPs and other contingent rights

A ROAP is one of the methods through which an entity can regain control over transferred financial assets. A ROAP provides the transferor with the power to reclaim transferred assets, subject to certain restrictions. One of the most common ROAPs is a transferor's right (but not obligation) to purchase defaulted transferred receivables.

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Question 7.4.70

When does a contingent repurchase right result in a transferor rerecognizing the transferred financial assets?

Excerpt from ASC 860-20

25-11 Whether the removal-of-accounts provision is exercised or not, the transferor shall recognize any financial assets subject to the removal-of-accounts provision if all of the following conditions are met:

a. A third party's action (such as default or cancellation) or decision not to act (expiration) occurs.
b. The occurrence allows removal of assets to be initiated solely by the transferor.
c. The provision provides a more-than-trivial benefit to the transferor.

For example, once a contingency is met (such as when a given loan goes into default), the call option on that asset (loan) is no longer contingent.

• > Regaining Control through a Removal-of-Accounts Provision

55-40 This guidance addresses implementation of paragraph 860-20-25-11. Under that paragraph's guidance, if the removal-of-accounts provision is not exercised, the financial assets are recognized because the transferor now can unilaterally cause the transferee to return those specific financial assets and, therefore, the transferor once again has effective control over those transferred financial assets (see paragraphs 860-20-25-8 through 25-10).

55-41 Similarly, when a contingency related to a transferor's contingent right has been met, the transferor generally must account for the repurchase of a specific subset of the financial assets transferred to and held by the entity. When the contingency has been met, the transferor has a unilateral right to purchase a specific transferred financial asset. At that point, the transferor must determine whether the unilateral right to purchase a specific transferred financial asset provides the transferor with a more-than-trivial benefit. If the unilateral right to purchase a specific transferred financial asset provides the transferor with a more-than-trivial benefit, the transfer fails the criterion in paragraph 860-10-40-5(c)(2). The transferor must perform this analysis regardless of whether it intends to exercise its call option.

55-42 Although this guidance uses removal-of-accounts provisions as an example, the guidance is not limited to removal-of-accounts provisions. Contingent rights can arise in many other situations. See paragraphs 860-10-55-39 through 55-42 for more information.

Interpretive response: A transferor rerecognizes the transferred financial assets subject to a ROAP or other contingent right if the following conditions are met: [860-20-25-11, 55-40 – 55-41]

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— a third party's action (such as default or cancellation) or decision not to act (expiration) occurs;
— the occurrence allows removal of assets to be initiated solely by the transferor – it is a transferor call not a transferee put; and
— the provision provides a more-than-trivial benefit to the transferor (see section 6.4.30).

The transferor rerecognizes the transferred financial assets regardless of whether it intends to exercise the option.

7.5 Transferee accounting

7.5.10 Overview

Excerpt from ASC 860-20

25-3 The **transferee** shall recognize all assets obtained (including any **participating interest(s)** obtained) and any liabilities incurred.

30-2 The **transferee** shall initially measure, at fair value, any asset or liability recognized under paragraph 860-20-25-3, unless it is a **purchased financial asset with credit deterioration** or is a beneficial interest that meets the criteria in paragraph 325-40-30-1A, in which case the transferee shall apply the guidance in Topic 326 on measurement of credit losses to determine the initial amortized cost basis.

> Transferor and Transferee Accounting Circumstances upon Regaining Control

40-3 The guidance beginning in paragraph 860-20-25-8 discusses the transferor's accounting upon regaining control of financial assets sold. In such circumstances, the former transferee would derecognize the transferred financial assets on that date, as if it had sold the transferred financial assets in exchange for a receivable from the transferor.

The accounting requirements of Topic 860 are symmetrical for the transferor and the transferee. As a result, the transferee generally recognizes all assets obtained and liabilities incurred initially at fair value. [860-20-25-3]

Unless the fair value option in Topic 825 is elected, fair value accounting is not applied if the transferee acquires PCD financial assets or beneficial interests in the scope of Topic 325 that are required to be treated as a PCD. Chapters 12 and 20 of KPMG Handbook, Credit impairment, provide guidance. [860-20-30-2]

If a transferor regains control of financial assets previously sold, the transferee derecognizes the financial assets on that date, as if it had sold the transferred assets in exchange for a receivable from the transferor. [860-20-40-3]

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Question 7.5.10

How does the transferee account for a put option embedded in a transferred marketable security?

Excerpt from ASC 860-20

• > Options Embedded in Transferred Securities

55-20 This guidance addresses transactions that involve the sale of a marketable security to a third-party buyer, with the buyer's having an option to put the security back to the seller at a specified future date or dates for a fixed price. Because of the put option, the seller generally receives a premium price for the security.

55-21 If the transfer is accounted for as a sale, a put option that enables the holder to require the writer of the option to reacquire for cash or other assets a marketable security or an equity instrument issued by a third party should be accounted for as a derivative by both the holder and the writer, provided the put option meets the definition of a derivative in paragraph 815-10-15-83 (including meeting the net settlement requirement, which may be met if the option can be net settled in cash or other assets or if the asset required to be delivered is readily convertible to cash). If multiple put options exist, recognition of the multiple put options as liabilities, and initial measurement at fair value, are required.

55-22 A put option that is issued as part of a transfer being accounted for as a sale that is not accounted for as a derivative under Subtopic 815-10 would be considered a guarantee under paragraph 460-10-55-2(b) and would be subject to its initial recognition, initial measurement, and disclosure requirements. If the written put option is accounted for as a derivative under Subtopic 815-10 by the seller-transferor, then the put option would be subject to only the disclosure requirements of Topic 460.

Background: Assume a transferor transfers a marketable security to a third party together with an option for the transferee to require the transferor to repurchase the security in the future at a fixed price (i.e. a fixed-price put option). The transferor receives a premium for the security because of the put option and accounts for the transfer as a sale. See Question 8.2.70 if the transfer is accounted for as a secured borrowing. [860-20-55-20]

Interpretive response: It depends. The put option is analyzed to determine whether it is a derivative or a guarantee. If multiple put options exist, the analysis is completed for each option. [860-20-55-21]

The put option is accounted for as a derivative by the holder (transferee) if it meets the definition of a derivative in Topic 815 (derivatives and hedging) and does not qualify for a scope exception. For further guidance on the scope exceptions and definition of a derivative, see chapters 2 and 3, respectively, of KPMG Handbook, Derivatives and hedging. If the put option is accounted for as

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a derivative, it is subject to only the disclosure requirements of Topic 460 (guarantees). [860-20-55-21, 860-20-55-22]

See Question 7.2.110 for the transferor accounting for the put option.

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8. Accounting for secured borrowings

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Questions

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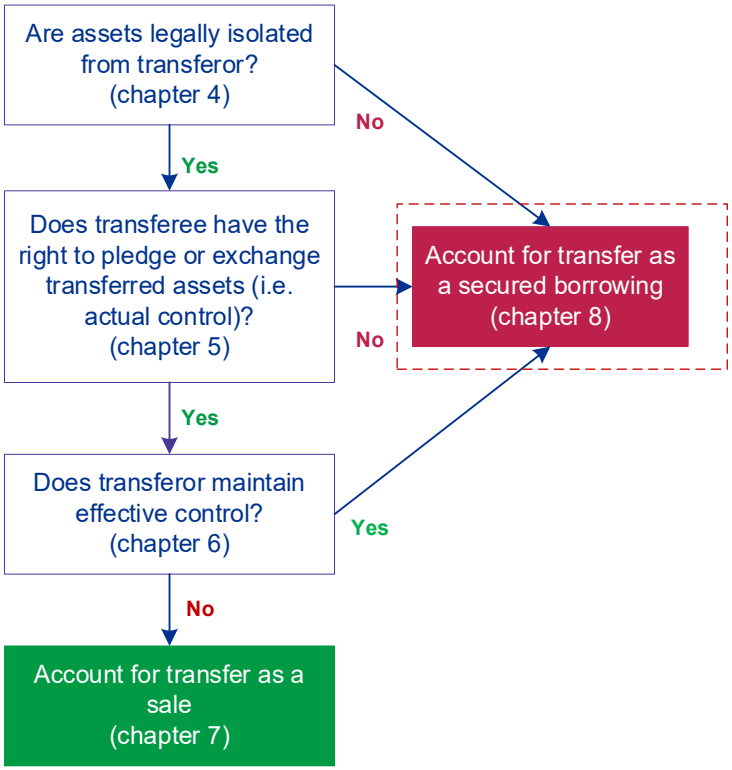
8.1 How the standard works

The broad outline of how an entity evaluates whether a transfer qualifies as a sale is summarized in the following decision tree; there is no requirement to evaluate the criteria in the decision tree in any particular sequence. This chapter addresses accounting for a transfer that does not qualify as a sale.



Transfers that do not qualify to be accounted for as sales by the transferor are accounted for as secured borrowings with a pledge of collateral by both the transferor and transferee.

This chapter addresses the accounting by both the transferor and transferee for a transfer accounted for as a secured borrowing. This accounting is generally as follows.

Transferor	— Continues to recognize the transferred assets – i.e. does not derecognize them or recognize a gain or loss. — Identifies the transferred assets as pledged/encumbered on the balance sheet if the transferee has the right to pledge or exchange them. — Recognizes any cash received along with an obligation (liability) to return it to the transferee. — Subsequently recognizes interest expense on the obligation.
Transferee	— Derecognizes the cash paid. — Recognizes a receivable from the transferor. — Subsequently recognizes interest income on the receivable.

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However, the subsequent accounting for noncash collateral (i.e. the transferred financial asset) for both the transferor and transferee is impacted by whether the transferor (as the obligor) has defaulted and is no longer entitled to redeem the pledged asset. As a result, the transferor may subsequently be required to derecognize the transferred asset and the transferee may be required to recognize it.

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8.2 Recognition and measurement

8.2.10 Overview

Excerpt from ASC 860-30

05-1 This Subtopic provides guidance on transactions that are accounted for as secured borrowings with a **transfer** of **collateral**.

05-2 A debtor (obligor) 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 obligor. 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.

05-3 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 (see paragraph 860-30-25 2).

15-1 This Subtopic follows the same Scope and Scope Exceptions as outlined in the Overall Subtopic, see Section 860-10-15, with specific transaction qualifications noted below.

> **Pending Content**
>
> Transition Date: (P) June 30, 2027; (N) June 30, 2027 | Transition Guidance: 105-10-65-7
>
> **15-1** This Subtopic follows the same Scope and Scope Exceptions as outlined in the Overall Subtopic, see Section 860-10-15, with specific transaction qualifications noted below. Paragraph 860-30-50-7(d) applies to **public business entities** only.

> Transactions

15-2 The **collateral** accounting provisions of paragraphs 860-30-25-5, 860-30-30-1, and 860-30-45-1 apply to all **transfers** of financial assets pledged as collateral in a transaction accounted for as a secured borrowing.

15-3 The guidance in this Subtopic applies to many types of transactions in which cash is obtained in exchange for financial assets with an obligation for an opposite exchange later. For example, that guidance may apply to any of the following types of transactions with those characteristics:

a. **Repurchase agreements**
b. Dollar rolls
c. Securities lending transactions.

25-2 The **transferor** and **transferee** shall account for a transfer as a secured borrowing with pledge of collateral in either of the following circumstances:

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a. If a transfer of an entire financial asset, a group of entire financial assets, or a **participating interest** in an entire financial asset does not meet the conditions for a sale in paragraph 860-10-40-5
b. If a transfer of a portion of an entire financial asset does not meet the definition of a participating interest.

The transferor shall continue to report the transferred financial asset in its statement of financial position with no change in the asset's measurement (that is, basis of accounting).

Transfers do not qualify to be accounted for as sales if they:

— fail to meet any of the criteria for sale accounting;
— are transfers of portions of financial assets that do not meet the participating interest characteristics.

Instead, both the transferor and transferee account for the transfer as a secured borrowing with a pledge of collateral. See chapters 3, 4, 5 and 6 for guidance about whether to account for a transfer as a sale. [860-30-05-1, 25-2]

Examples of secured borrowings	The guidance in this chapter applies to all transfers accounted for as secured borrowings. Although an analysis must be performed for any specific transfer, some common examples of secured borrowings include: [860-30-15-1 – 15-3] — securities lending transactions; — repurchase agreements; and — dollar rolls. See further discussion of these transactions in chapter 9. In addition, repurchase-to-maturity transactions are always accounted for as secured borrowings, as if the transferor maintains effective control (see Question 6.3.20).

The following table provides a roadmap to the recognition and measurement accounting guidance for the transferor and transferee in a secured borrowing transaction.

Transferor	Transferee
Section 8.2.10, Overview	
Question 8.2.10	Question 8.2.20
Section 8.2.20, Accounting for cash collateral (i.e. accounting for cash consideration (proceeds) for transferred financial assets)	
Questions 8.2.30, 8.2.40, 8.2.50, 8.2.60 and 8.2.70 Examples 8.2.10 and 8.2.20	Question 8.2.80 Example 8.2.10
Section 8.2.30, Accounting for noncash collateral (i.e. accounting for the transferred financial asset)	
Questions 8.2.90 and 8.2.100 Examples 8.2.30 and 8.2.40	Questions 8.2.110, 8.2.120 and 8.2.130 Examples 8.2.30 and 8.2.40

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Transferor	Transferee
Section 8.2.40, Transferor accounting for noncash proceeds received in securities lending (and similar) transactions	
Questions 8.2.140 and 8.2.150 Example 8.2.50	Example 8.2.50

Question 8.2.10

In a secured borrowing, does the transferor derecognize the transferred financial asset at the time of transfer?

Interpretive response: No, and neither does the transferor recognize a gain or loss. Instead, the transfer is accounted for similar to other borrowing relationships in which a debtor (obligor) grants a security interest in certain assets – with or without recourse – as collateral to a lender (the secured party). [860-30-05-2 – 05-3, 25-2]

Therefore, the transferor (as the debtor/obligor) does both of the following:

- recognizes proceeds received (i.e. cash or other assets) with an offsetting liability to the transferee. See guidance about accounting for proceeds received in securities lending (and similar) transactions in section 8.2.40.
- continues to recognize the transferred financial asset, which represents noncash collateral and is commonly referred to as 'pledged' or 'encumbered.' The transferor may be required to reclassify the transferred financial asset in the balance sheet (e.g. as encumbered or pledged assets – see section 8.3.10).

However, the transferor derecognizes the transferred financial asset if it subsequently defaults under the terms of the secured contract and is no longer entitled to redeem the transferred financial asset (see Question 8.2.100).

Question 8.2.15**

In a transfer accounted for as a secured borrowing, does the transferor recognize a beneficial interest received?

Background: Assume that Transferor transfers receivables to Transferee (a third party) for proceeds of cash and a 10% beneficial interest in the receivables, and accounts for the transfer as a secured borrowing.

Interpretive response: No. In a transfer accounted for as a secured borrowing, the transferor continues to recognize the transferred financial assets. Recognizing a beneficial interest in the transferred assets would result in accounting for essentially the same value twice (i.e. double counting those assets), as follows:

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— first by recognizing the transferred financial assets on the balance sheet; and
— second by accounting for the beneficial interest, whose cash flows are sourced from collections on the transferred financial assets.

Therefore, in the background example, we believe that the secured borrowing should reflect only the cash proceeds received (with a corresponding obligation to return the cash collateral).

Question 8.2.20

In a secured borrowing, does the transferee recognize the transferred financial asset at the time of transfer?

Interpretive response: No. Instead, the transferee derecognizes the cash paid (which is also referred to as cash collateral) with an offsetting receivable from the transferor. The transfer is accounted for similar to other lending relationships in which the lender (secured party) receives a security interest in certain assets – with or without recourse – from the debtor (obligor). See also section 8.2.20. [860-30-05-2 – 05-3, 25-2]

However, in certain situations, the transferee is required to subsequently recognize the transferred financial asset even though the initial transfer is accounted for as a secured borrowing (see Question 8.2.110).

8.2.20 Accounting for cash collateral

Excerpt from ASC 860-30

> Cash Collateral

25-3 Transfers of financial assets in exchange for cash collateral cannot be distinguished from borrowing cash. Further, because cash is fungible, it is impossible to determine whether it has been used by the secured party. Accordingly, all cash collateral shall be recorded as an asset by the party receiving it (the secured party), together with a liability for the obligation to return it to the payer (obligor), whose asset is a receivable.

Cash provided to the transferor as consideration for the transferred financial asset in a secured borrowing transaction is referred to as 'cash collateral' because it represents collateral from the transferee securing the return of the transferred financial asset.

The accounting for cash collateral in a transfer accounted for as a secured borrowing is summarized as follows.

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Transferor [860-30-25-3]	— Recognizes the cash received as an asset (i.e. cash). — Recognizes a liability for the obligation to return the cash to the transferee. Questions 8.2.30, 8.2.40, 8.2.50, 8.2.60 and 8.2.70 discuss the accounting for this obligation.
Transferee [860-30-25-3]	— Derecognizes the cash. — Recognizes a receivable for its right to receive cash from the transferor. Question 8.2.80 discusses the accounting for this receivable.

Question 8.2.30

How does the transferor subsequently account for the liability in a secured borrowing transaction?

Interpretive response: Topic 860 does not provide subsequent accounting guidance and, as such, it does not provide guidance about how to define the liability's terms. The liability in a secured borrowing transaction is the result of applying Topic 860 and is typically not evidenced by a legal debt agreement having stated terms.

We believe the liability's terms should be defined based on the contractual arrangement's terms and resulting economics, and the transferor should apply applicable US GAAP in subsequently accounting for the liability and related interest expense.

A wide array of facts and circumstances can exist within a given contract, so other applicable US GAAP may include:

— Topic 470 (debt);
— Topic 815 (derivatives and hedging), including Subtopic 815-15 (embedded derivatives);
— Topic 825 (financial Instruments), including its fair value option subsections (which provide a fair value option for certain recognized liabilities); and
— Topic 835 (interest).

Question 8.2.50 discusses liability derecognition considerations.

Also see the following KPMG Handbooks for additional accounting guidance:

— Debt and equity financing, for guidance about accounting for debt obligations;
— Derivatives and hedging, for guidance about accounting for derivatives and embedded derivatives; and
— Investments, for guidance about the fair value option for certain recognized assets.

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Question 8.2.40

How does a transferor account for direct transaction costs incurred in a secured borrowing?

Background: Transfers of financial assets (including securitizations) typically involve incurring direct transaction costs with third parties. Examples of such costs include lawyers' fees, accountants' fees, rating agencies' fees, costs to print and circulate the legal offering documents, and fees paid to the SEC to register the transaction.

Interpretive response: It depends on whether the transferor elects to subsequently measure the liability under the fair value option subsections of Topic 825.

- **Transferor elects fair value option.** The transferor expenses the transaction costs because fair value is not adjusted for transaction costs. See also Questions E40 to E80 in KPMG Handbook, Fair value measurement.
- **Transferor does not elect fair value option.** The transferor defers any direct transaction costs and recognizes them as an adjustment to interest expense over the life of the borrowing using the interest method under Topic 835 (interest).

Question 7.2.50 discusses how a transferor accounts for transaction costs incurred in a transfer accounted for as a sale.

Question 8.2.50

When does a transferor derecognize the liability recognized in a secured borrowing?

Interpretive response: A transferor generally derecognizes a liability only when it meets the relevant conditions in Subtopic 405-20 (extinguishments of liabilities). In practice, applying that guidance generally results in the transferor (debtor) derecognizing the liability when it pays the transferee (creditor) through transferring assets and is relieved of its obligation for the liability.

See chapter 4 of KPMG Handbook, Debt and equity financing, for guidance about derecognizing liabilities.

Question 8.2.60

Does the transferor's subsequent accounting for the transferred financial asset match the subsequent accounting for the related liability in a secured borrowing?

Interpretive response: Generally, no. A transferor accounts for the liability by applying US GAAP applicable to the liability (see Questions 8.2.30, 8.2.40 and

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8.2.50). Similarly, a transferor does not change its basis of accounting for a transferred financial asset, and instead continues to apply otherwise applicable US GAAP (see Question 8.2.90). Because US GAAP's guidance for accounting for financial assets usually does not align with the accounting for liabilities, the accounting for a transferred financial asset generally will not match the accounting for the liability.

For example, Subtopic 326 (credit losses) generally requires an entity to recognize lifetime expected credit losses for financial assets in its scope, and to write off financial assets that are deemed uncollectible. US GAAP does not have corresponding guidance permitting an entity to reduce a liability secured by assets for which credit losses are recognized, even if that liability is nonrecourse. Example 8.2.20 illustrates the accounting when a transferred financial asset becomes impaired.

However, the extent of the accounting mismatch can be reduced when both the transferred financial asset and liability are subsequently measured at fair value with changes reported in earnings. For example, if an entity elects the fair value option under Topic 825 when it initially recognizes 1) a financial asset upon origination or purchase and 2) a nonrecourse liability resulting from a transfer of that asset accounted for as a secured borrowing.

Question 8.2.70

How does the transferor account for the difference between proceeds received and a fixed put price when a security and put option are transferred in a secured borrowing transaction?

Excerpt from ASC 860-20

• > Options Embedded in Transferred Securities

55-20 This guidance addresses transactions that involve the sale of a marketable security to a third-party buyer, with the buyer's having an option to put the security back to the seller at a specified future date or dates for a fixed price. Because of the put option, the seller generally receives a premium price for the security.

55-23 If the transaction is accounted for as a secured borrowing under Subtopic 860-30, any difference between the sale proceeds and the put price shall be accrued as interest expense, and any impairment of the underlying security would generally not be recognized. The difference between the original sale price and the put price should be amortized over the period to the first date the securities are eligible to be put back. If the transfer is accounted for as a secured borrowing, the put option falls under paragraph 815-10-15-63, which provides a scope exception for a derivative instrument (such as the put option) that serves as an impediment to sale accounting under Subtopic 860-10. The guidance in paragraph 815-10-55-41 may also be relevant.

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Background: Assume that Transferor transfers a security to Transferee (a third party) together with an option for Transferee to require Transferor to repurchase the security in the future at a fixed price (i.e. a fixed-price put option). Transferor receives a premium for the security because of the put option. The transfer is accounted for as a secured borrowing. [860-20-55-20]

Interpretive response: The transferor recognizes the difference between the proceeds received and the fixed put price as interest expense over the period between the initial transfer and the first date the put option can be exercised. [860-20-55-23]

The put option is not accounted for as a derivative instrument because derivative accounting provides a scope exception for an instrument that serves as an impediment to sale accounting or would result in the same asset being double counted; see section 2.8 of KPMG Handbook, Derivatives and hedging. [860-20-55-23]

Question 8.2.80

How does the transferee subsequently account for a receivable in a secured borrowing transaction?

Interpretive response: Topic 860 does not provide subsequent accounting guidance, or guidance about how to define the receivable's terms. The receivable in a secured borrowing transaction is the result of applying Topic 860 and is typically not evidenced by a legal loan agreement having stated terms.

Similar to a transferor's subsequent accounting for its liability in a secured borrowing transaction (see Question 8.2.30), we believe the receivable's terms should be defined based on the contractual arrangement's terms and resulting economics, and the transferee should apply other applicable US GAAP in subsequently accounting for the receivable and related interest income.

A wide array of facts and circumstances can exist within a given contract, so other applicable US GAAP may include, but is not limited to:

- Topic 310 (receivables);
- Topic 326 (credit losses);
- Topic 815 (derivatives and hedging), including Subtopic 815-15 (embedded derivatives); and
- Topic 825 (financial Instruments), including its fair value option subsections (which provide a fair value option for certain recognized assets).

See also the following KPMG Handbooks for additional accounting guidance:

- Credit impairment, for guidance about accounting for credit losses;
- Derivatives and hedging, for guidance about accounting for derivatives and embedded derivatives; and
- Investments, for guidance about the fair value option for certain recognized assets.

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Example 8.2.10
Accounting for initial transfer of financial asset in exchange for cash

On January 1, Transferor transfers a financial asset to Transferee in exchange for cash collateral of $1,000.

Transferor

Transferor records the following journal entry.

	Debit	*Credit*
Cash	1,000	
Obligation to return cash		1,000
To record cash collateral received from Transferee and related obligation.[1]		

Note:

1 This example assumes Transferee does not have the right by contract or custom to sell or repledge the transferred financial asset. If it did, Transferor would also be required to separately classify the transferred financial asset (see Question 8.3.20).

Transferee

Transferee records the following journal entry.

	Debit	*Credit*
Receivable from Transferor	1,000	
Cash		1,000
To record cash collateral transferred to Transferor and related receivable from Transferor.		

Example 8.2.20
Transferor accounting for secured borrowing transaction involving a loan subject to Topic 326

On January 1, Year 1, Transferor originates at par a five-year, $1,000,000 loan receivable. The loan receivable bears interest at a fixed rate of 6% and requires payments of interest only until its maturity. On that same day, it transfers – on a servicing-retained basis – to Transferee (a third party) an interest in all principal cash flows of the loan plus interest at a fixed rate of 4% in exchange for consideration of $1,000,000 cash.

The transferred interest does not represent a transfer of an entire financial asset and does not meet the characteristics of a participating interest. As a result, the transfer is accounted for as a secured borrowing.

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Transferor measures estimated credit losses under Topic 326 as follows:

— January 1, Year 1: $20,000.
— December 31, Year 1: $120,500.

For simplicity, this example does not reflect deferred fees and costs associated with originating the loan receivable or transaction costs associated with the secured borrowing transaction.

Journal entries on January 1, Year 1

Transferor records the following journal entries on January 1, Year 1 related to the loan receivable and secured borrowing transaction.

	Debit	*Credit*
Loan receivable	1,000,000	
Cash		1,000,000
To recognize origination of loan receivable.		
Credit loss expense	20,000	
Allowance for credit losses		20,000
To recognize expected credit losses on originated loan receivable.		
Cash	1,000,000	
Obligation under secured borrowing transaction		1,000,000
To recognize proceeds and related liability from transfer of loan receivable in secured borrowing transaction.[1]		

Note:
1. This example assumes Transferee does not have the right by contract or custom to sell or repledge the transferred financial asset. If it did, Transferor would also be required to separately classify the transferred financial asset (see Question 8.3.20).

Journal entries for Year ended December 31, Year 1

Transferor records the following journal entries during the year ended December 31, Year 1 related to the loan receivable and secured borrowing transaction.

	Debit	*Credit*
Accrued interest receivable[1]	60,000	
Interest income		60,000
To recognize accrual of interest income on loan receivable.		
Cash	60,000	
Accrued interest receivable		60,000
To recognize cash received for interest income on loan receivable.		

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	Debit	*Credit*
Interest expense	40,000	
Accrued interest payable[2]		40,000
To recognize interest expense on obligation under secured borrowing transaction.		
Accrued interest payable	40,000	
Cash		40,000
To recognize cash paid for interest expense on obligation under secured borrowing transaction.		
Credit loss expense	100,500	
Allowance for credit losses		100,500
To recognize change in expected credit losses on loan receivable.[3]		

Notes:

1. $1,000,000 par of loan receivable × 6% fixed rate.
2. $1,000,000 principal cash flows under obligation × 4% fixed rate.
3. $120,500 expected credit losses at December 31, Year 1 – $20,000 expected credit losses recognized at origination (January 1, Year 1).

Financial statement excerpts

Transferor's financial statements as of and for the year ended December 31, Year 1 reflect the following amounts related to the loan receivable and secured borrowing transaction (disregarding cash).

Account	Amount
Balance sheet – assets	
Loans receivable	$1,000,000
Allowance for credit losses	(120,500)
Loans receivable, net of allowance for credit losses	$ 879,500
Balance sheet – liabilities	
Obligation under secured borrowing transaction	$1,000,000
Income statement	
Interest income	$ 60,000
Interest expense	40,000
Net interest income	20,000
Credit loss expense	120,500
Net interest income after credit loss expense	$ (100,500)

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8.2.30 Accounting for noncash collateral

Excerpt from ASC 860-30

> Noncash Collateral

25-5 The accounting for noncash collateral by the obligor (or debtor) and the secured party depends on whether the secured party has the right to sell or repledge the collateral and on whether the obligor has defaulted. Noncash collateral shall be accounted for as follows:

a. If the secured party (transferee) has the right by contract or custom to sell or repledge the collateral, then paragraph 860-30-45-1 requires that the obligor (transferor) 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 Topic.
c. If the obligor (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 as required by paragraph 860-30-40-1 and the secured party (transferee) shall recognize the collateral as its asset. (See paragraph 860-30-30-1 for guidance on the secured party's initial measurement of collateral recognized. See paragraph 860-30-40-1 for further guidance if the debtor has sold the collateral.)
d. Except as provided in paragraph 860-30-40-1 the obligor (transferor) shall continue to carry the collateral as its asset, and the secured party (transferee) shall not recognize the pledged asset.

40-1 In circumstances where an obligor (**transferor**) **transfers** noncash **collateral** in a secured borrowing and the obligor (transferor) defaults under the terms of the secured contract and is no longer entitled to redeem the pledged asset, the obligor shall derecognize the pledged asset. If the secured party has already sold the collateral, the secured party shall derecognize its obligation to return the collateral.

40-2 Otherwise paragraph 860-30-25-5(c) addresses the secured party's accounting for the collateral.

The transferred financial asset is noncash collateral provided by the transferor to secure return of the cash (or other assets) it received for the transfer. The accounting for noncash collateral by each party generally depends on whether the transferee (as the secured party) has the ability to sell or repledge the noncash collateral and on whether the transferor (as the obligor) has defaulted.

The accounting for noncash collateral in a secured borrowing transaction is summarized as follows.

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Transferor	— Continues to recognize the transferred financial asset (noncash collateral) and to use the same basis of accounting unless it has defaulted under the contract and is no longer entitled to redeem the asset — See Questions 8.2.90 and 8.2.100.
Transferee	— Does not recognize the transferred financial asset (noncash collateral) unless the transferor has defaulted under the contract and is no longer entitled to redeem the asset. — Recognizes an obligation to return the collateral if it sells or repledges the asset. — See Questions 8.2.110, 8.2.120 and 8.2.130, and Examples 8.2.30 and 8.2.40.

Question 8.2.90

After a transfer accounted for as a secured borrowing, does the transferor change the basis of accounting for a transferred financial asset?

Excerpt from ASC 860-30

> Pledged Assets Required to Be Reclassified

35-2 A **transferor** that has transferred collateral that must be reclassified in accordance with paragraph 860-30-25-5(a) (for example, as securities pledged to creditors) shall not change its measurement of that collateral. The transferor shall follow the same measurement principles as before the transfer. For example, securities reclassified from the available-for-sale category to securities pledged to creditors should continue to be measured at fair value, with changes in fair value reported in comprehensive income, while debt securities reclassified from the held-to-maturity category to securities pledged to creditors should continue to be measured at amortized cost. See Topic 320 for guidance related to measurement of investments in securities classified as available for sale and held to maturity.

Interpretive response: No, the transferred financial asset's basis of accounting (measurement) is not changed. [860-20-25-2, 860-30-35-2]

As discussed in Question 8.2.10, the transferor does not derecognize the transferred financial asset at the time of transfer. Instead, it continues to recognize and apply appropriate accounting guidance to the transferred financial asset with no change in the asset's measurement (accounting basis). This is the case regardless of whether the transferor is required to change the presentation of the transferred asset on its balance sheet (e.g. from unpledged/unencumbered to pledged/encumbered). [860-30- 35-2]

For example, Bank purchases a debt security at a premium and categorizes it as held-to-maturity. Later, before the premium is fully amortized, Bank transfers

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the debt security in a transaction accounted for as a secured borrowing. Bank continues to amortize the premium and apply other applicable US GAAP for held-to-maturity securities even if the security is required to be presented on the balance sheet as securities pledged to creditors. [860-20-55-25, 860-30-35-2]

Paragraph 860-20-55-25 (reproduced below) demonstrates the guidance in this Question.

Excerpt from ASC 860-20

• > Transfer of a Bond Purchased at a Premium

55-25 Assume an entity transfers a bond to an unconsolidated entity for cash and beneficial interests. When the transferor purchased the bond, it paid a premium for it (or bought it at a discount), and that premium (or discount) was not fully amortized (or accreted) at the date of the transfer. In other words, the carrying amount of the bond included a premium (or discount) at the date of the transfer. If the transfer of the bond is accounted for as a secured borrowing under Subtopic 860-30, the transferor would continue to amortize (or accrete) the premium (or discount) because paragraph 860-30-25-2 requires that the transferor continue to report the transferred financial assets in its statement of financial position with no change in their measurement (that is, basis of accounting). If the transfer of the bond satisfies the conditions to be accounted for as a sale, any beneficial interests received as proceeds would be initially recognized at fair value. As a result, the previously existing premium (or discount) would not continue to be amortized (or accreted); rather, the unamortized (or nonaccreted) amount would be included in the calculation of the gain (or loss) as of the transfer date.

Question 8.2.100

Does the transferor subsequently derecognize a transferred financial asset after an initial transfer that is accounted for as a secured borrowing?

Interpretive response: It depends. The transferor subsequently derecognizes the pledged asset if: [860-30-25-5(c), 40-1, 40-2]

— it has defaulted under the contract and is no longer entitled to redeem the pledged asset; or
— a change in law or other circumstance results in the sale accounting requirements being met.

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Question 8.2.110

How does the transferee subsequently account for noncash collateral received in a transfer accounted for as a secured borrowing?

Excerpt from ASC 860-30

> Noncash Collateral

30-1 Noncash **collateral** recognized by the secured party as its asset under paragraph 860-30-25-5(c) that the secured party has not already sold shall be initially measured at fair value.

Interpretive response: As discussed in Question 8.2.20, the transferee does not recognize the transferred financial asset at the time of the initial transfer. Considerations for the transferee's subsequent accounting are summarized in the following decision tree. These considerations are evaluated in subsequent reporting periods until the noncash collateral is returned (or the obligation is otherwise settled).

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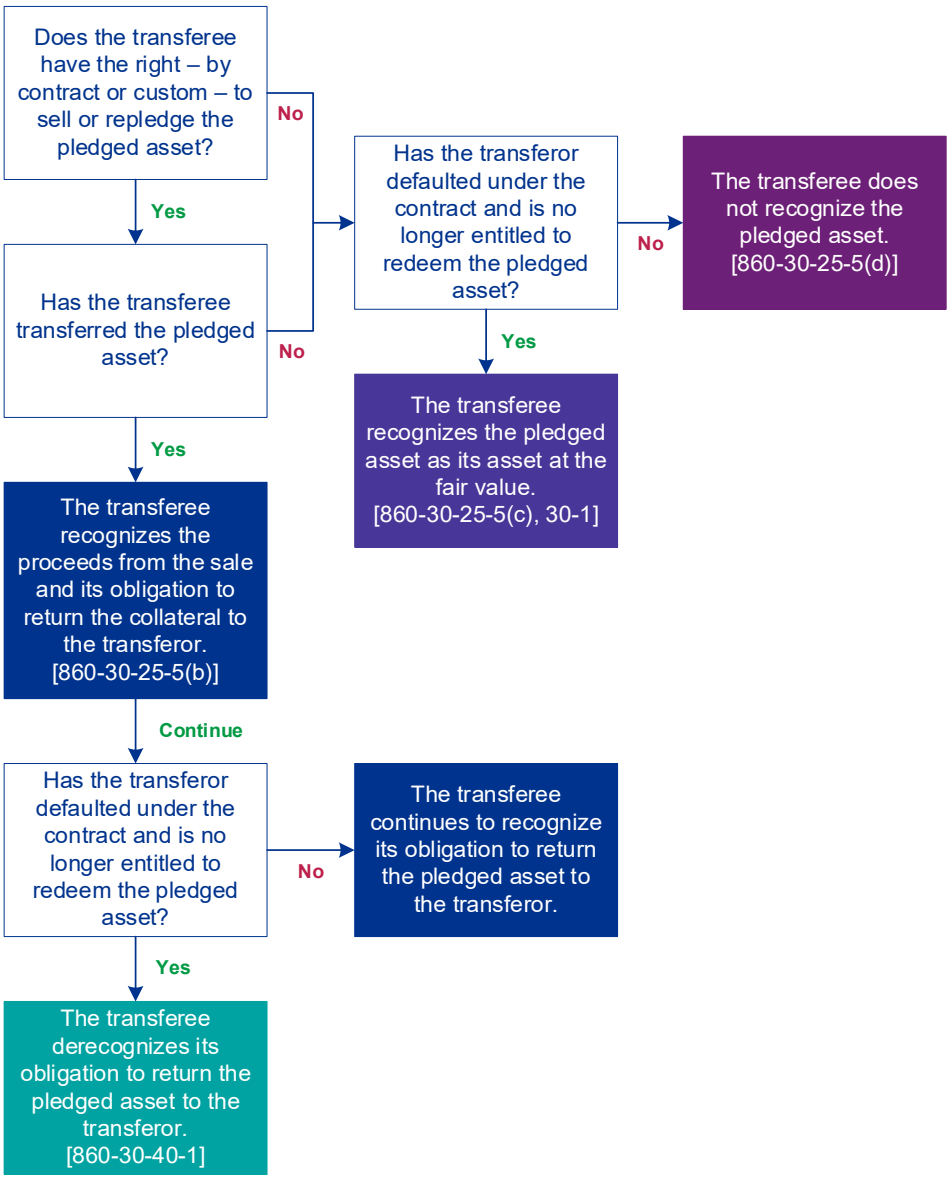

Question 8.2.120

How does the transferee subsequently measure collateral it recognizes?

Interpretive response: As discussed in Question 8.2.110, Subtopic 860-30 requires the transferee to initially recognize noncash collateral at its fair value (when recognition is required). However, Subtopic 860-30 does not provide subsequent measurement guidance. We believe a transferee should apply other applicable US GAAP based on the nature of the noncash collateral.

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For example, if the noncash collateral is a debt security, the transferee should apply the guidance in Topic 320, Topic 825 (if the transferee elects the fair value option for the debt security) or specialized industry guidance if applicable (e.g. Topic 946 for investment companies).

Question 8.2.125#

Does the transferee recognize an obligation to return noncash collateral if it subsequently pledges that collateral to another party for no proceeds?

Background: Entity A receives noncash collateral from Entity B in connection with a secured borrowing transaction. Entity A (transferee) does not recognize the noncash collateral received.

Subsequently, Entity A pledges that noncash collateral to Entity C to serve as collateral for a separate secured borrowing transaction. Entity A does not receive any collateral (proceeds) from Entity C.

Topic 860 states that if the secured party (transferee) sells noncash collateral pledged to it, it recognizes the proceeds from the sale and its obligation to return the collateral. However, Topic 860 does not directly address how the transferee (Entity A) accounts for its subsequent repledge of noncash collateral if it does not receive proceeds in the repledge transaction. [860-30-25-5(b)]

Interpretive response: In this situation, we believe one acceptable approach is for the secured party (transferee/Entity A) to recognize an obligation to return noncash collateral when it subsequently repledges that collateral to another party in a separate transaction. That is, an obligation to return the noncash collateral would be recognized by the transferee regardless of whether the sale accounting criteria are met for the subsequent repledge.

However, given the lack of explicit guidance in Topic 860, we understand there is diversity in practice and not recognizing an obligation also may be acceptable in some circumstances.

Question 8.2.130

How does the transferee subsequently measure the obligation to return noncash collateral?

Excerpt from ASC 860-30

> Sales of Collateral Held

25-10 Obligations to return to the transferor assets borrowed and then sold have sometimes been effectively recognized as part of a liability for securities sold but not yet purchased, and this Section does not require any change in that practice.

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> Obligation to Return Transferred Collateral

35-3 This Section does not provide specific guidance on the subsequent measurement of the obligation to return transferred collateral. The liability to return the collateral shall be measured in accordance with other relevant accounting guidance. Paragraph 942-405-35-1 requires that a bank or savings institution that, as **transferee**, sells transferred collateral subsequently measure that liability like a short sale at fair value.

Excerpt from ASC 942-405

35-1 The obligations incurred in short sales shall be subsequently measured at fair value through the income statement at each reporting date. Interest on the short positions shall be accrued periodically and reported as interest expense.

Interpretive response: Subtopic 860-30 does not provide subsequent measurement guidance for the obligation to return the noncash collateral. It acknowledges that some transferees account for that liability as a short sale (also referred to as 'securities sold, not yet purchased'), and does not prohibit that approach. Further, paragraph 942-405-35-1 requires banks and savings institutions to measure it like a short sale at fair value. [860-30-35-3]

Example 8.2.30

Repurchase agreement accounted for as a secured borrowing – transferee is not permitted to sell or repledge the transferred financial asset

Bank (transferor) and Dealer (transferee) enter into a repurchase agreement that is accounted for as a secured borrowing. Under the agreement:

- Bank transfers a security with a fair value of $1,000,000 to Dealer and receives $980,000 cash in exchange.
- Bank will repurchase the security from Dealer in 30 days for $982,450 (annual interest rate of 3%).
- Dealer is not permitted to sell or repledge the security.

For simplicity, this example:

- assumes the transferred security's fair value does not change during the term of the repurchase agreement;
- does not reflect the return on the transferred security;
- reflects interest income and expense when cash is received or paid, instead of on an accrual basis.

Bank (transferor) – journal entries and financial statements

Upon receipt of the $980,000 cash, Bank invests it in a short-term instrument and earns $2,860 (annual interest rate of 3.5%).

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Bank records the following journal entries during the term of the repurchase agreement. Bank is not required to reclassify the security because Dealer does not have the right to sell or repledge it.

	Debit	*Credit*
Cash	980,000	
Obligation for securities sold under repurchase agreements		980,000
To recognize transfer of security under repurchase agreement in exchange for cash.		
Short-term investment	980,000	
Cash		980,000
To recognize investment of cash received under repurchase agreement.		
Cash	982,860	
Short-term investment		980,000
Interest income[1]		2,860
To recognize results of short-term investment.		
Obligation for securities sold under repurchase agreements	980,000	
Interest expense[2]	2,450	
Cash		982,450
To record repurchase of security sold under repurchase agreement.		

Notes:

1. $980,000 (cash invested) × 3.5% (interest rate) × 30 (days invested) / 360 (days in a year – convention)
2. $980,000 (cash borrowed) × 3% (interest rate) × 30 (days invested) / 360 (days in a year – convention)

During the term of the repurchase agreement, Bank's balance sheet reflects the following amounts related to these arrangements.

Account	Amount
Balance sheet – assets	
Short-term investment	$ 980,000
Securities available-for-sale	1,000,000
Balance sheet – liabilities	
Obligation for securities sold under repurchase agreements	$ 980,000

At the conclusion of the repurchase agreement, Bank's financial statements reflect the following amounts related to these arrangements (disregarding cash).

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Account	Amount
Balance sheet – assets	
Securities available-for-sale	$1,000,000
Income statement	
Interest income – short-term investments	$ 2,860
Interest expense – securities sold under repurchase agreements	2,450

Dealer (transferee) – journal entries and financial statements

Dealer records the following journal entries during the term of the repurchase agreement.

	Debit	*Credit*
Receivable from Transferor for securities purchased under resale agreements	980,000	
Cash		980,000
To recognize receivable for security purchased under resale agreement in exchange for cash.		
Cash	982,450	
Receivable from Transferor for securities purchased under resale agreement		980,000
Interest income[1]		2,450
To recognize repayment of borrowing with related return of pledged security.		

Note:

1. $980,000 (cash invested) × 3% (interest rate) × 30 (days invested) / 360 (days in a year – convention)

During the term of the repurchase agreement, Dealer's balance sheet reflects the following amounts related to these arrangements.

Account	Amount
Balance sheet – assets	
Receivable from Transferor for securities purchased under resale agreement	$980,000

At the conclusion of the repurchase agreement, Dealer's financial statements reflect the following amounts related to these arrangements (disregarding cash).

Account	Amount
Income statement	
Interest income – securities purchased under resale agreement	$2,450

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Example 8.2.40

Repurchase agreement accounted for as a secured borrowing – transferee sells the transferred financial asset

Assume the same facts as in Example 8.2.30, except that Dealer is permitted to (and does) sell or repledge the security.

Bank (transferor) – journal entries and financial statements

Upon receipt of the $980,000 cash, Bank invests it in a short-term instrument and earns $2,860 (annual interest rate of 3.5%).

Bank records the following journal entries during the term of the repurchase agreement.

	Debit	*Credit*
Cash	980,000	
Obligation for securities sold under repurchase agreements		980,000
To recognize transfer of security under repurchase agreement in exchange for cash.		
Securities available-for-sale (pledged)	1,000,000	
Securities available-for-sale		1,000,000
To reclassify security pledged under repurchase agreement for which transferee has right to sell or repledge.		
Short-term investment	980,000	
Cash		980,000
To recognize investment of cash received under repurchase agreement.		
Cash	982,860	
Short-term investment		980,000
Interest income		2,860
To recognize results of short-term investment.		
Obligation for securities sold under repurchase agreements	980,000	
Interest expense	2,450	
Cash		982,450
To record repurchase of security sold under repurchase agreement.		
Securities available-for-sale	1,000,000	
Securities available-for-sale (pledged)		1,000,000
To reclassify security that is no longer pledged under repurchase agreement.		

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Immediately after the initial transfer and Bank's investment of the proceeds from transfer, Bank's balance sheet reflects the following amounts related to these arrangements (disregarding cash).

Account	Amount
Balance sheet – assets	
Short-term investment	$ 980,000
Securities available-for-sale (pledged)	1,000,000
Balance sheet – liabilities	
Obligation for securities sold under repurchase agreements	$ 980,000

After the conclusion of the repurchase agreement, Bank's financial statements reflect the following amounts related to these arrangements (disregarding cash).

Account	Amount
Balance sheet – assets	
Securities available-for-sale	$1,000,000
Income statement	
Interest income – short-term investments	$ 2,860
Interest expense – securities sold under repurchase agreements	2,450

Dealer (transferee) – journal entries and financial statements

Upon receipt of the security, Dealer repledges it in exchange for borrowing $980,000 cash. Dealer is obligated to repay $981,630 cash (annual interest rate of 2%) in 30 days. Dealer invests the cash received from the borrowing in a short-term instrument and earns $2,040 (annual interest rate of 2.5%).

Dealer records the following journal entries during the term of the repurchase agreement.

	Debit	*Credit*
Receivable from Transferor for securities purchased under resale agreements	980,000	
Cash		980,000
To recognize receivable for security purchased under resale agreement in exchange for cash.		
Cash	980,000	
Obligation to return collateral purchased under resale agreement		980,000
To record borrowing entered through pledging security purchased under resale agreement.		

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	Debit	*Credit*
Short-term investment	980,000	
Cash		980,000
To recognize investment of cash received under borrowing.		
Cash	982,040	
Short-term investment		980,000
Interest income		2,040
To recognize results of short-term investment.		
Obligation to return collateral purchased under resale agreement	980,000	
Interest expense	1,630	
Cash		981,630
To recognize repayment of borrowing with related return of pledged security.		
Cash	982,450	
Receivable from Transferor for securities purchased under resale agreement		980,000
Interest income		2,450
To recognize repayment of borrowing with related return of pledged security.		

Immediately after the initial transfer, Dealer's pledge of the transferred asset, and Dealer's investment of the proceeds from that pledge, Dealer's balance sheet reflects the following amounts related to these arrangements (disregarding cash).

Account	Amount
Balance sheet – assets	
Receivable from Transferor for securities purchased under resale agreement	$980,000
Short-term investment	980,000
Balance sheet – liabilities	
Obligation to return collateral purchased under resale agreement	$980,000

After the conclusion of the repurchase agreement and transactions related to pledging the transferred security, Dealer's financial statements reflect the following amounts related to these arrangements (disregarding cash).

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Account	Amount
Income statement	
Interest income – securities purchased under resale agreement	$2,450
Interest income – short-term investments	2,040
Interest expense – securities sold under repurchase agreements	1,630

8.2.40 Transferor accounting for proceeds received in securities lending (and similar) transactions

Excerpt from ASC 860-30

> Cash Collateral

25-4 Cash collateral used, for example, in securities lending transactions (see paragraphs 860-10-05-16 through 05-18) shall be derecognized by the obligor and recognized by the secured party, not as collateral but rather as proceeds of either a sale or a borrowing. See paragraphs 860-30-25-6 through 25-9 for further discussion of recognition of cash and noncash collateral as proceeds of a transfer.

> Cash or Securities Received as Proceeds

25-6 Paragraph 860-10-55-55A discusses securities lending transactions in which the criteria in paragraph 860-10-40-5 for a sale are met. The following guidance relates to securities lending or similar transactions in which a transferor (lender) transfers securities and receives either cash or securities as collateral and the transfer does not meet the sale criteria in that paragraph.

25-7 Many securities lending transactions are accompanied by an agreement that both entitles and obligates the transferor to repurchase or redeem the transferred financial assets before their maturity. Paragraph 860-10-40-24 states that an agreement that both entitles and obligates the transferor to repurchase or redeem transferred financial assets from the transferee maintains the transferor's effective control over those assets as described in paragraph 860-10-40-5(c)(1), if all of the conditions in paragraph 860-10-40-24 are met. Those transactions shall be accounted for as secured borrowings, in which either cash or securities that the holder is permitted by contract or custom to sell or repledge received as collateral are considered the amount borrowed, the securities loaned are considered pledged as collateral against the cash borrowed and reclassified as set forth in paragraph 860-30-25-5(a), and any rebate paid to the transferee of securities is interest on the cash the transferor is considered to have borrowed.

25-8 In a securities lending transaction, 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. Cash collateral or securities

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received as collateral that a securities lender is permitted to sell or repledge are the proceeds of a borrowing secured by them. 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. See Example 1 (paragraph 860-30-55-1) for an illustration of a securities lending transaction that is accounted for as a secured borrowing in which cash collateral is transferred.

25-9 As noted in paragraphs 860-30-25-4 and 860-30-25-8, the collateral accounting provisions do not apply to cash, or securities that can be sold or pledged for cash, received as so-called collateral for noncash financial assets, for example, in certain securities lending transactions. Such cash or securities that can be sold or pledged for cash are accounted for as proceeds of either a sale or a borrowing.

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. Borrowers of securities generally must provide /collateral to the lender of securities, which may be cash or other noncash assets (e.g. other securities or standby letters of credit). See further discussion in chapter 9.

Securities lending transactions are accounted for as sales if they meet the criteria for sale accounting. However, in our experience, they are frequently designed to fail to meet at least one such criterion and as a result are frequently accounted for as secured borrowings. [860-30-25-6]

Question 8.2.140#

In a repurchase transaction involving an exchange of securities, which entity is the transferor and which is the transferee?

Interpretive response: We believe the determination of which entity is the transferor (debtor) and which is the transferee (creditor) is based on the underlying collateral agreement or individual transaction ticket.

Generally, this documentation states which party is the debtor and which is the creditor. In the absence of an explicit statement in this documentation, we believe the party that receives a fee (or – if both parties receive a fee – receives the larger fee) will generally be the transferor. If the documentation does not identify the transferor and it is not clear based on the fee (e.g. if the fee is negligible), we believe the receiver of the more liquid securities generally will be the transferor. If none of these situations exist, judgment is necessary to determine which entity is the transferor (and which is the transferee). In this instance, we believe it is acceptable to conclude that either is the transferor.

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Question 8.2.150

How does the transferor of securities account for proceeds received in a securities lending (or similar) transaction?

Interpretive response: Unlike the collateral accounting provisions of paragraphs 860-30-25-3 and 25-5(a) to (c) for other types of transactions, which distinguish between cash and noncash collateral, the transferor in a securities lending transaction accounts for the proceeds received (i.e. cash or securities) in the same way, regardless of whether the transfer is accounted for as a sale or a secured borrowing. This includes that the transferor: [860-30-25-4, 25-7 – 25-9]

- recognizes the proceeds received (i.e. cash or securities that it is permitted to sell or repledge), because that 'collateral' represents proceeds of either a sale or a borrowing; and
- recognizes any investments made with cash collateral (including when those investments are made by agents or in pools with other securities lenders).
- recognizes securities that it is permitted to sell or repledge as proceeds of either a sale or a borrowing regardless of whether it has actually sold or repledged them.

Subtopic 860-30's Example 1 (reproduced below) illustrates the accounting for securities lending transactions, as does Example 8.2.50.

Excerpt from ASC 860-30

• > Example 1: Securities Lending Transaction Accounted for as a Secured Borrowing

55-1 This Example illustrates the guidance in paragraph 860-30-25-8 related to 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. This Example has the following assumptions:

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

55-2 For simplicity, the fair value of the security is assumed not to change during the 35-day term of the transaction.

55-3 The journal entries for the **transferor** and the **transferee** are as follows.

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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		

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Example 8.2.50
Securities lending – exchange of securities accounted for as a secured borrowing

Bank (Transferor) and Dealer (Transferee) enter into a securities lending arrangement that is accounted for as a secured borrowing because the transfer does not meet the sale criteria. Under the agreement:

- Bank transfers common stock of ABC Corp. (an unrelated third party) with a fair value of $1,000,000 to Dealer.
- Dealer transfers a Treasury security with a fair value of $1,020,000 to Bank.
- Bank and Dealer will exchange these securities in 30 days. At that time, Dealer will pay a fee of $4,000 to Bank.
- Bank and Dealer both are permitted to sell or repledge the respective securities received.

Based on the underlying transaction documents and considering that Dealer pays a fee for the borrowed security, Bank is the transferor and Dealer is the transferee in this arrangement.

For simplicity, this example:

- assumes the exchanged securities' fair values do not change during the term of the securities lending arrangement;
- does not reflect the return on the exchanged securities;
- reflects interest income and expense when cash is received or paid, instead of on an accrual basis.

Bank (transferor) – journal entries and financial statements

Bank does not sell or repledge the Treasury security received during the term of the arrangement.

Bank records the following journal entries during the term of the arrangement.

	Debit	*Credit*
Investment in US Treasury security[1]	1,020,000	
Obligation under securities lending arrangement		1,020,000
To recognize receipt of US Treasury security in exchange for common stock under securities lending arrangement.[1]		
Investment in common stock (pledged)	1,000,000	
Investment in common stock		1,000,000
To reclassify common stock transferred under securities lending arrangement for which transferee has right to sell or repledge.		

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	Debit	*Credit*
Obligation under securities lending arrangement	1,020,000	
Investment in common stock	1,000,000	
Cash	4,000	
Investment in US Treasury security		1,020,000
Investment in common stock (pledged)		1,000,000
Securities lending fee income		4,000
To record exchange of securities at conclusion of securities lending arrangement and payment of the related securities lending fee.		

Note:

1 The US Treasury security received in exchange for common stock is accounted for as proceeds of a borrowing (see Question 8.2.150).

During the term of the repurchase agreement, Bank's balance sheet reflects the following amounts related to these arrangements.

Account	Amount
Balance sheet – assets	
Investment in common stock (pledged)	$1,000,000
Investment in US Treasury security	1,020,000
Balance sheet – liabilities	
Obligation under securities lending arrangement	$1,020,000

At the conclusion of the repurchase agreement, Bank's financial statements reflect the following amounts related to these arrangements (disregarding cash).

Account	Amount
Balance sheet – assets	
Investment in common stock	$1,000,000
Income statement	
Securities lending fee income	$ 4,000

Dealer (transferee) – journal entries and financial statements

Dealer entered into the securities lending transaction to cover its short position in ABC common stock. Upon receipt of the common stock, Dealer sells it to cover that short position. At the conclusion of the arrangement, Dealer purchases ABC common stock in the open market to meet its obligation to return it to Bank.

For simplicity, this example does not reflect amounts and transactions related to the short position entered into before this securities lending transaction.

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Dealer records the following journal entries during the term of the securities lending arrangement.

	Debit	*Credit*
Securities sold short	1,000,000	
Obligation to return collateral borrowed under securities lending arrangement[1]		1,000,000
To record transfer of borrowed common stock to fill existing short position and related obligation to return common stock to Bank.		
Investment in common stock	1,000,000	
Cash		1,000,000
To recognize purchase of common stock to fulfill obligation to return collateral borrowed under securities lending arrangement.		
Obligation to return collateral borrowed under securities lending arrangement[1]	1,000,000	
Securities borrowing fee expense	4,000	
Investment in common stock		1,000,000
Cash		4,000
To recognize repayment of borrowing with related return of pledged security.		

Note:

1. Dealer accounts for this obligation as part of its short sale obligation (see Question 8.2.130). For ease of reference, the obligation is separately captioned in this example.

Dealer does not record any journal entries related to the initial exchange (with Bank) of ABC common stock for US Treasury security. This is because:

— the ABC common stock is the transferred financial asset, which a transferee does not recognize when it is initially received (Question 8.2.20);

— the US Treasury security exchanged for the borrowed common stock is treated as proceeds of a securities lending arrangement instead of as noncash collateral. As a result, Dealer is not required to reclassify the US Treasury security in its balance sheet (see Question 8.3.40).

During the term of the repurchase agreement, Dealer's balance sheet reflects the following amounts related to these arrangements.

Account	**Amount**
Balance sheet – assets	
Obligation to return collateral borrowed under securities lending arrangement	$1,000,000

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At the conclusion of the repurchase agreement, Dealer's financial statements reflect the following amounts related to the securities lending arrangement (disregarding cash).

Account	Amount
Income statement	
Securities borrowing fee expense	$4,000

Example 8.2.60

Repurchase agreement – exchange of securities accounted for as a secured borrowing

Bank (transferor) and Dealer (transferee) enter into a repurchase agreement that is accounted for as a secured borrowing.

- Bank transfers common stock of ABC Corp. (an unrelated third party) with a fair value of $1,000,000 to Dealer.
- Dealer transfers a Treasury security with a fair value of $1,020,000 to Bank.
- Bank and Dealer will repurchase the securities in 30 days. At that time, Dealer will pay a fee of $2,500 to Bank.
- Bank and Dealer both are permitted to sell or repledge the respective securities received.
- Neither Bank nor Dealer sells or repledges the securities received during the term of the arrangement.

Based on the underlying transaction documents and considering that Dealer pays a fee for the borrowed security and the Treasury security is a more liquid security, Bank is the transferor and Dealer is the transferee in this arrangement.

For simplicity, this example:

- assumes the fair value of both the common stock and Treasury security does not change during the term of the repurchase agreement;
- does not reflect the return on the transferred security; and
- reflects income and expense when cash is received or paid, instead of on an accrual basis.

Bank (transferor) – journal entries and financial statements

Bank records the following journal entries during the term of the repurchase agreement.

	Debit	*Credit*
Investment in US Treasury security[1]	1,020,000	
Obligation to return US Treasury security		1,020,000
To recognize the receipt of the US Treasury security as the proceeds of a secured borrowing transaction, along with a related obligation to return it to the counterparty. [1]		

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	Debit	*Credit*
Investment in common stock (pledged)	1,000,000	
Investment in common stock		1,000,000
To reclassify common stock transferred under securities lending arrangement for which transferee has right to sell or repledge.		
Obligation to return US Treasury security	1,020,000	
Investment in common stock	1,000,000	
Cash	2,500	
Investment in US Treasury security		1,020,000
Investment in common stock (pledged)		1,000,000
Repurchase fee income		2,500
To record exchange of securities at conclusion of the repurchase agreement and payment of the related repurchase fee.		
Note: 1. The US Treasury security received in exchange for common stock is accounted for as proceeds of a borrowing (see Question 8.2.150).		

During the term of the repurchase agreement, Bank's balance sheet reflects the following amounts related to these arrangements.

Account	Amount
Balance sheet – assets	
Investment in common stock (pledged)	1,000,000
Investment in US Treasury security	1,020,000
Balance sheet – liabilities	
Obligation for securities sold under repurchase agreement	1,020,000

At the conclusion of the repurchase agreement, Bank's financial statements reflect the following amounts related to these arrangements (disregarding cash).

Account	Amount
Balance sheet – assets	
Investment in common stock	1,000,000
Income statement	
Repurchase fee income	2,500

Dealer (transferee) – journal entries and financial statements

Dealer does not record any journal entries related to the initial exchange (with Bank) of ABC common stock for the US Treasury security. This is because:

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— the ABC common stock is the transferred financial asset, which a transferee does not recognize when it is initially received (Question 8.2.20);

— the US Treasury security exchanged for the borrowed common stock is treated as proceeds of a securities lending arrangement instead of as noncash collateral. As a result, Dealer is not required to reclassify the US Treasury security in its balance sheet (see Question 8.3.40).

Dealer records the following journal entry during the term of the repurchase agreement.

	Debit	*Credit*
Repurchase fee expense	2,500	
Cash		2,500
To recognize repayment of borrowing with related return of pledged security.		

At the conclusion of the repurchase agreement, Dealer's financial statements reflect the following amounts related to these arrangements (disregarding cash).

Account	Amount
Income statement	
Repurchase fee expense	2,500

8.3 Presentation

8.3.10 Presentation

Excerpt from ASC 860-30

45-1 If the secured party (**transferee**) has the right by contract or custom to sell or repledge the **collateral**, then the obligor (**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.

45-2 Liabilities incurred by either the secured party or obligor in securities borrowing or resale transactions shall be separately classified.

Pending Content

Transition Date: (P) June 30, 2027; (N) June 30, 2027 | Transition Guidance: 105-10-65-7

45-2 Liabilities, including accrued interest, incurred by either the secured party or obligor in securities borrowing or resale transactions shall be separately classified.

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45-2A If as of the date of the most recent statement of financial position the aggregate carrying amount of reverse repurchase agreements (securities or other assets purchased under agreements to resell) exceeds 10 percent of total assets, the assets shall be separately classified.

45-3 This Section does not specify the classification or the terminology to be used to describe the following:

a. Pledged assets reclassified by the transferor of securities loaned or transferred under a **repurchase agreement accounted for as a collateralized borrowing** if the transferee is permitted to sell or repledge those securities
b. Liabilities incurred by either the secured party or obligor in securities borrowing or resale transactions.

Example 1 (see paragraph 860-30-55-1) illustrates possible classifications and terminology.

Pending Content

Transition Date: (P) June 30, 2027; (N) June 30, 2027 | Transition Guidance: 105-10-65-7

45-3 This Section does not specify the classification or the terminology to be used to describe the following:

a. Pledged assets reclassified by the transferor of securities loaned or transferred under a **repurchase agreement accounted for as a collateralized borrowing** if the transferee is permitted to sell or repledge those securities
b. Liabilities, including accrued interest, incurred by either the secured party or obligor in securities borrowing or resale transactions.

Example 1 (see paragraph 860-30-55-1) illustrates possible classifications and terminology.

Subtopic 860-30's guidance for presentation of financial statement amounts related to secured borrowings is summarized in the following table.

Description	Transferor	Transferee
Balance sheet presentation[1]		
Assets [860-30-25-5, 45-1]	A transferor (obligor) is required to separately classify a transferred financial asset if the transferee has the right by contract or custom to sell or repledge it (see Question 8.3.20).	N/A
	See also section 8.3.20, which discusses when transferors and transferees are permitted to offset payables (receivables) related to repurchase (reverse repurchase) agreements.	

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Description	Transferor	Transferee
Liabilities [860-30-45-2]	Liabilities incurred by either the transferee (secured party) or the transferor (obligor) in securities borrowing transactions are required to be separately classified. Further, transferors that are in the scope of Topic 942 (depository and lending) must separately classify mortgage-backed bond liabilities as debt (see Question 8.3.30). See also Question 8.2.110, which discusses when a transferee is required to recognize a liability.	
Note: 1 Subtopic 860-30 does not prescribe the classification or terminology used. See Subtopic 860-30's Example 1 (reproduced in section 8.2.40). See also Question 8.3.30 for guidance for entities in the scope of Topic 942. [860-30-45-3]		
Income statement presentation		
Gains or losses resulting from transfers in secured /borrowings	Classified as interest income or expense by the transferor (see Question 8.3.10).	N/A

In addition, in some situations SEC registrants are required to separately present repurchase agreements and/or reverse repurchase agreements on the balance sheet. See Question 11.4.50 for guidance.

Chapter 10 of KPMG Handbook, Statement of cash flows, discusses the statement of cash flows treatment for securitizations and other transfers of financial assets.

Question 8.3.10

How does a transferor classify expense recognized on its liability to return proceeds to the transferee?

Interpretive response: We believe it generally should be classified as interest income or expense.

A transferor does not derecognize a transferred financial asset or recognize a gain or loss in a secured borrowing. Instead, the transferor recognizes a liability for the proceeds received and continues to measure and report the assets as if the transaction had not occurred (see Question 8.2.10).

Subsequent expense on the liability, if any, is recognized by applying other applicable US GAAP (see Questions 8.2.30 and 8.2.40). We believe the resulting expense should be classified as interest expense. However, a different classification may be acceptable when the transferor elects the fair value option under Topic 825 for the liability. [860-10-40-1B]

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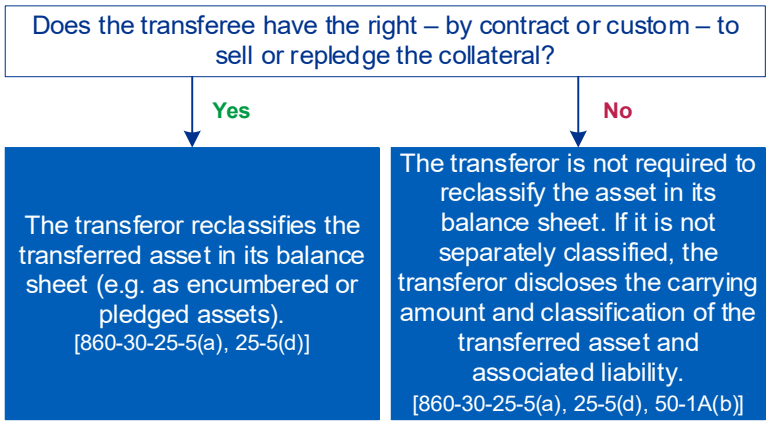
Question 8.3.20

How does the transferor present financial assets related to secured borrowings in its balance sheet?

Interpretive response: The transferor's presentation of the transferred asset is based on the considerations summarized in the following decision tree.



Question 8.3.30

How does the transferor classify mortgage-backed bonds payable resulting from transfers of mortgages accounted for as secured borrowings?

Excerpt from ASC 942-10

> Entities

15-2 The guidance in the Financial Services—Depository and Lending Topic applies to all of the following entities:

a. Finance companies, including finance company subsidiaries
b. Depository institutions insured by either:
    1. The Federal Deposit Insurance Corporation's (FDIC's) Deposit Insurance Fund
    2. The National Credit Union Administration's National Credit Union Share Insurance Fund.
c. Bank holding companies
d. Savings and loan association holding companies
e. Branches and agencies of foreign banks regulated by U.S. federal banking regulatory agencies
f. State-chartered banks, credit unions, and savings institutions that are not federally insured

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g. Foreign financial institutions whose financial statements are purported to be prepared in conformity with accounting principles generally accepted in the United States
h. Mortgage companies
i. Corporate credit unions.

Excerpt from ASC 942-470

> Secured Borrowings

45-2 Transfers of mortgages accounted for under Topic 860 as secured borrowings of the issuing institution shall be classified as debt on the institution's balance sheet. Such mortgage-backed bonds shall be classified separately from advances, other notes payable, and subordinated debt.

Interpretive response: Subtopic 860-30 does not prescribe the classification or terminology to be used to describe mortgage-backed bonds payable resulting from transfers of mortgages accounted for as secured borrowings. However, Topic 942 (depository and lending) requires transferors in its scope to classify such mortgage-backed bonds payable as debt in the balance sheet. Further, it requires them to be presented separately from advances, other notes payable, and subordinated debt. [942-10-15-2, 942-470-45-2]

Question 8.3.40

Is a transferee in a securities lending transaction required to reclassify the financial asset paid in its balance sheet?

Interpretive response: No. When a securities lending transaction is accounted for as a secured borrowing, the transferor recognizes the assets it receives from the transferee as proceeds in the transaction and the collateral accounting provisions of Subtopic 860-30 do not apply (see Question 8.2.150). Similarly, the noncash collateral provisions of Subtopic 860-30 do not apply to the transferee in a securities lending transaction.

8.3.20 Offsetting of repurchase and reverse repurchase agreements

Excerpt from ASC 210-20

> Repurchase and Reverse Repurchase Agreements

45-11 Notwithstanding the condition in paragraph 210-20-45-1(c), an entity may, but is not required to, offset amounts recognized as payables under

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repurchase agreements accounted for as collateralized borrowings and amounts recognized as receivables under **reverse repurchase agreements accounted for as collateralized borrowings** if all of the following conditions are met:

a. The repurchase and reverse repurchase agreements are executed with the same counterparty.
b. The repurchase and reverse repurchase agreements have the same explicit settlement date specified at the inception of the agreement.
c. The repurchase and reverse repurchase agreements are executed in accordance with a master netting arrangement.
d. The securities underlying the repurchase and reverse repurchase agreements exist in book entry form and can be transferred only by means of entries in the records of the transfer system operator or **securities custodian**. Book entry securities meeting the criterion in this paragraph exist only as items in accounting records maintained by a transfer system operator. This requirement does not preclude offsetting of securities held in book entry form solely because other securities of the same issue exist in other forms.
e. The repurchase and reverse repurchase agreements will be settled on a securities transfer system that operates in the manner described in paragraphs 210-20-45-14 through 45-17, and the entity must have associated banking arrangements in place as described in those paragraphs. Cash settlements for securities transferred shall be made under established banking arrangements that provide that the entity will need available cash on deposit only for any net amounts that are due at the end of the business day. It must be probable that the associated banking arrangements will provide sufficient **daylight overdraft** or other intraday credit at the settlement date for each of the parties. The term *probable* is used in this Subtopic consistent with its use in paragraph 450-20-25-1 to mean that a transaction or event is likely to occur.
f. The entity intends to use the same account at the clearing bank or other financial institution at the settlement date in transacting both the cash inflows resulting from the settlement of the reverse repurchase agreement and the cash outflows in settlement of the offsetting repurchase agreement

45-12 The entity's choice to offset or not shall be applied consistently. Net receivables resulting from the application of this Subtopic shall not be offset against net payables resulting from the application of this Subtopic in the statement of financial position.

> Securities Transfer System

45-14 This guidance describes a securities transfer system for repurchase agreements and reverse repurchase agreements (and associated banking arrangements) that meets the requirements of paragraph 210-20-45-11. In a securities transfer system for repurchase agreements and reverse repurchase agreements that meets the requirements of that paragraph, cash transfers are initiated by notification from the owner of record of the securities to its securities custodian to transfer those securities to the counterparty to the agreement. The securities custodian for a securities transfer system may be the bank or financial institution that executes securities transfers over the securities transfer system, and book entry securities exist only in electronic

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form on the records of the transfer system operator for each entity that has a security account with the transfer system operator. Book entry securities exist only as items of account on the controlling records of the transfer system operator. Banks or other financial institutions may maintain subsidiary records of book entry securities. Book entry securities may be transferred on the subsidiary records of a bank or financial institution but, for entities that have a security account with the transfer system operator, may be transferred from the account of such an entity only through the transfer system operator.

45-15 Under associated banking arrangements, each party to a same-day settlement of both a repurchase agreement and a reverse repurchase agreement would be obligated to pay a gross amount of cash for the securities transferred from its counterparty but would be able to reduce that gross obligation by notifying its securities custodian to transfer other securities to that counterparty the same day.

45-16 Thus, each party is responsible for maintaining available cash on deposit only for the amount of any net payable unless it fails to instruct its securities custodian to transfer securities to its counterparty. Failure by either party to instruct its securities custodian to transfer securities owned of record would result in that party's failing to receive cash from the counterparty and, thereby, would require that party to have available cash on deposit for the gross payable due for securities transferred to it. The failure also shall be an event of default under the master netting arrangement required by paragraph 210-20-45-11. The event of default, in turn, shall entitle the other party to terminate the arrangement and demand the immediate net settlement of all contracts.

45-17 If both parties transfer the appropriate securities in settlement of the repurchase and reverse repurchase agreements, the party with a net receivable will not need any cash to facilitate the settlement, while the party with a net payable will need only to have available the required net amount due at the end of the business day.

As a general principle, offsetting of assets and liabilities in the balance sheet is only permitted if a right of setoff exists. Subtopic 210-20 provides conditions that are required for a right of setoff to exist. [210-20-05-1]

However, Subtopic 210-20 provides a different set of conditions (see Question 8.3.50) that are required to be met to offset for: [860-30-60-1, 210-20-45-11]

- payables under repurchase agreements accounted for as collateralized borrowings; and
- receivables under reverse repurchase agreements accounted for as secured borrowings.

When all conditions are met for those payables and those receivables, an entity may elect to offset those amounts. The choice to offset should be applied consistently. Net receivables resulting from applying the offsetting guidance in Subtopic 210-20 cannot be offset in the balance sheet against net payables resulting from applying it. [210-20-45-11 – 45-12]

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Question 8.3.50

What conditions must be met to offset payables under repurchase agreements and receivables under reverse repurchase agreements?

Interpretive response: If the repurchase and reverse repurchase agreements are accounted for as secured borrowings, they must meet all of the following conditions. [210-20-45-11,45-17]

- They are executed with the same counterparty.
- They have the same explicit settlement date specified at the inception of the agreement.
- They are executed in accordance with a master netting arrangement.
- The securities underlying the agreements exist in book entry form and can be transferred only by means of entries in the transfer system operator's or securities custodian's records.
- They will be settled on an appropriate securities transfer system and have appropriate banking arrangements in place. To be appropriate:
  - securities transfer systems must operate in the manner described in paragraphs 210-20-45-14 to 45-17.
  - banking arrangements must be as described in paragraphs 210-20-45-11(e) and 45-14 to 45-17.
- The entity intends to use the same account at the clearing bank or other financial institution at the settlement date in transacting both the cash inflows and outflows resulting from the settlement of the offsetting agreements.

Example 8.3.10

Clearance and settlement of repurchase agreements

Clearing Org clears and settles repurchase and reverse repurchase agreements in certain European government bonds for its Members (collectively referred to in this example as Repurchase Agreements). Initially, Members negotiate with each other and agree to the terms of the Repurchase Agreements. Then, each Member accesses Clearing Org's trading and trade confirmation system and submits the Repurchase Agreements to Clearing Org. The system operates in the manner described in paragraphs 210-20-45-14 to 45-17.

The securities underlying the agreements exist in book entry form and can be transferred only by means of entries in the transfer system operator's or securities custodian's records.

Clearing Org registers the terms of the agreements for each Member. Upon registration, Clearing Org guarantees to each Member the final settlement of netted open positions registered in Clearing Org's name, subject to the Member's timely performance of its obligations.

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At the end of each trading day, Clearing Org aggregates individual registered gross obligations or receivables – with respect to payment of cash and receipt of securities (or receipt of cash and delivery of securities) – into net payment/receipt or receipt/delivery obligations for each Member.

The settlement process reduces Clearing Org's gross repurchase payables and gross reverse repurchase receivables to a net obligation or receivable with each Member for agreements with the same fixed settlement date. The Repurchase Agreements are executed in accordance with master netting agreements.

Further, Clearing Org and Members have established banking arrangements in place as described in paragraphs 210-20-45-11(e) and 45-14 to 45-17, and the same account is used at the settlement date in transacting both the cash inflows and outflows resulting from the settlement of the offsetting agreements.

All parties account for the transactions that result from the Repurchase Agreements as secured lendings/borrowings because the transferor in the initially negotiated transaction maintains effective control over the transferred financial asset.

Each Member is permitted to offset payables or receivables related to Repurchase Agreements with the same settlement date with Clearing Org and report those amounts net in its balance sheet because they meet the conditions for netting (see Question 8.3.50).

Question 8.3.60

Can balances arising from securities lending and borrowing transactions be offset?

Interpretive response: No. Balances that arise from securities lending and borrowed transactions accounted for as secured borrowings are presented gross on the balance sheet. Subtopic 210-20's guidance permitting offsetting for repurchase and reverse repurchase agreements does not extend to other lending/borrowing arrangements. [210-20-45-11]

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9.1 How the standard works

This chapter discusses several types of transactions involving transfers of financial assets that are common in practice. For each transaction type, this chapter identifies some common features and identifies some relevant accounting considerations.

Transaction	Description
Securitizations section 9.2	The process of pooling financial assets into a group, and selling interests in that group of assets to investors.
Securities lending section 9.3.20	The practice of loaning financial assets to others in exchange for a fee.
Repurchase agreements section 9.3.30	A transaction involving the sale of securities with a corresponding agreement to repurchase the securities at a future date.
Dollar rolls section 9.3.40	A variation of a repurchase agreement in which the repurchased securities are similar, but not identical, to the originally transferred securities.
Banker's acceptances and risk participations section 9.4.10	A banker's acceptance is a short-term financing arrangement in which an accepting bank agrees to pay a customer's liability to its vendor. The customer repays the bank at a later date. A risk participation is a form of credit protection in which a second bank agrees to reimburse the accepting bank if the customer defaults on the acceptance.
Wash sales section 9.4.20	A transaction in which a transferor sells securities with the intent to repurchase the same (or substantially the same) securities to obtain income tax or other benefits.

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9.2 Securitizations

9.2.10 Overview

Excerpt from ASC 860-10

20 Glossary

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

• > Securitizations

05-7 An originator of a typical securitization (the transferor) transfers a portfolio of financial assets to a securitization entity, commonly a trust. Financial assets such as mortgage loans, automobile loans, trade receivables, credit card receivables, and other revolving charge accounts are financial 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.

05-8 Beneficial interests in the securitization entity are sold to investors and the proceeds are used to pay the transferor for the transferred financial assets. 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 entity.

Securitization is the process by which financial assets are transformed into securities. Entities may securitize financial assets to obtain increased financial flexibility because securities can be traded more freely and cost-effectively than the underlying financial assets. [860-10 Glossary]

Securitizations qualify for sale accounting if all the criteria for sale accounting are met and if the securitization entity is not consolidated by the transferor or its affiliates in the financial statements being presented.

Question 9.2.10

What is the basic structure of a securitization?

Interpretive response: In a basic securitization structure: [860-10-05-7 – 05-8]

— the originator of a securitization (the transferor) transfers a portfolio of financial assets to an SPE (see Question 9.2.20);

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— beneficial interests in the SPE – which may include multiple classes – are sold to investors (see Question 9.2.40); and
— the proceeds from the sale of the beneficial interests are used to pay the transferor for the transferred financial assets.

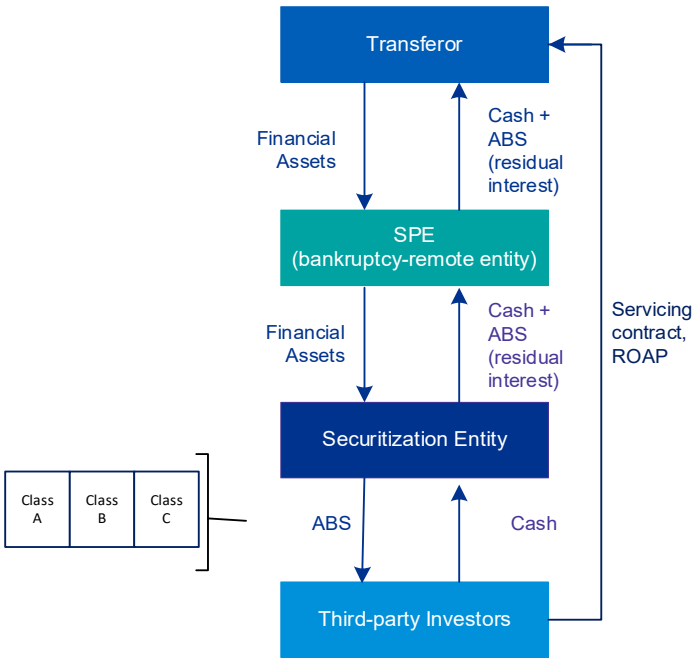
In our experience, the assets transferred into a securitization entity are frequently entire financial assets, instead of portions of financial assets. When an entire financial asset (or group of financial assets) is transferred, the transfer is eligible for sale accounting. When a portion is transferred, the transferred portion must first meet the participating interest characteristics to be a unit of account that is eligible for sale accounting. See sections 3.3 and 3.4.

A securitization can be accomplished in a transaction with a single step (as described above) or multiple steps. That structure may affect whether the transferred financial assets have been legally isolated from the transferor, particularly when the transferor has continuing involvement with the transferred financial assets. In our experience, it is more common for securitizations to be structured in multiple steps (e.g. two-step securitization structures). See further discussion of legal isolation and securitization transactions in section 4.3.

A securitization entity is typically a trust or other legal vehicle whose sole purpose is to engage in securitization or asset-backed financing activities and that is constrained from pledging or exchanging the transferred financial assets to protect the rights of beneficial interest holders. In these cases, the transferor looks through the constrained entity and applies the guidance about actual control to each third-party beneficial interest holder of that entity; see Question 5.3.10.

Further, a transferor frequently has continuing involvement with transferred financial assets in a securitization (see Question 9.2.50).

The following diagram depicts an example of a securitization that includes continuing involvements of the transferor.



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Question 9.2.20

What types of asset transfers into a securitization entity are in the scope of Topic 860?

Interpretive response: Transfers of financial assets into securitization entities are in the scope of Topic 860. In contrast, transfers of nonfinancial assets into securitization entities generally are not in its scope. The scope of Topic 860 is discussed in chapter 2, including Questions 2.3.20 and 2.3.30.

Financial assets that are commonly securitized include:

- mortgage loans – e.g. single-family residential mortgages, multifamily residential mortgages, commercial property mortgages;
- automobile loans and loans for other equipment, including direct financing or sales-type leases;
- trade receivables;
- credit card receivables;
- receivables from other revolving charge accounts; and
- beneficial interests in securitizations – even if the securitized assets underlying the beneficial interests are nonfinancial (see Question 2.3.20).

An entity may securitize both financial and nonfinancial assets. However, as indicated above, securitizations of nonfinancial assets generally are outside the scope of Topic 860 – e.g. securitizations of stranded costs (see section 2.3.40).

Question 9.2.30

Are financial assets transferred to a securitization entity only at a securitization's inception?

Excerpt from ASC 860-10

• • > Pass-Through, Pay-Through, and Revolving-Period Securitizations

55-44 Paragraphs 860-10-05-7 through 05-13 provide background on securitization transactions. In pass-through and pay-through securitizations, receivables are transferred to the entity 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 entity. Pass-through, pay-through, and revolving-period securitizations that meet the conditions in paragraph 860-10-40-5 qualify for sale accounting under this Subtopic, provided the securitization entity is not consolidated by the transferor or its consolidated affiliates in the financial statements being presented.

Interpretive response: No. In a revolving-period securitization, receivables are transferred at inception of the securitization and at various intervals throughout a specified reinvestment period. In contrast, in pass-through and pay-through

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securitizations, receivables are transferred to the SPE only at inception of the securitization. [860-10-55-44]

For further discussion about revolving-period securitizations, see Question 9.2.60.

Question 9.2.40

What are beneficial interests?

Excerpt from ASC 860-10

20 Glossary

Beneficial Interests

Rights to receive all or portions of specified cash inflows received by a trust or other entity, including, but not limited to, all of the following:

a. Senior and subordinated shares of interest, principal, or other cash inflows to be passed-through or paid-through
b. Premiums due to guarantors
c. Commercial paper obligations
d. Residual interests, whether in the form of debt or equity.

Interpretive response: Beneficial interests are rights to receive all or portions of specified cash inflows of an SPE. The legal documents of a securitization typically specify the manner in which the cash collected from the underlying portfolio is to be distributed to the SPE's investors as well as other parties. The specified distribution method is commonly referred to as a 'waterfall'. [860-10-05-8]

Beneficial interests may be either a single class of interests with characteristics of equity or multiple classes of interests with characteristics of both debt and equity. For example, an SPE may issue 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). In addition, beneficial interests can be either fixed rate (determined at issuance) or floating rate with periodic reset periods (e.g. indexed to SOFR).

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Question 9.2.50

Does a transferor typically have continuing involvement with transferred financial assets in a securitization?

Interpretive response: Yes. In practice, a transferor typically has continuing involvement in a securitization transaction. That continuing involvement impacts whether a transferor should consolidate the securitization entity (see section 3.2). If the transferor does not consolidate the securitization entity, continuing involvement is considered when evaluating whether the transferor has surrendered control of the transferred financial assets under the control criteria (see section 3.5 and chapters 4, 5 and 6).

Common forms of a transferor's continuing involvement in a securitization include the following.

— **Servicing.** An SPE typically has few (if any) employees. As a result, it often relies on others for servicing – i.e. collecting cash due from assets it holds and making distributions to beneficial interest holders. The transferor (or an affiliate) frequently enters into an agreement with the SPE to provide servicing.

— **Credit guarantees or enhancements.** To increase the credit rating of the securities issued, the transferor frequently guarantees a certain level of the securities issued from the securitization structure or otherwise provides some form of recourse to mitigate the risk of default associated with the transferred assets.

— **Call options.** It is common for a transferor to maintain contingent call options on the transferred assets. For example, many securitizations include ROAPs, which provide the transferor with the right to repurchase assets subject to certain restrictions (see Question 6.4.50 and Example 6.4.50). [860-10-05-12]

— **Beneficial interests.** The transferor frequently receives an interest in the transferred assets as proceeds in the transfer. For example, the most subordinated interest (residual interest) is commonly retained by the transferor, as are I/O and P/O strips.

Question 9.2.60

What are some unique characteristics of a revolving-period securitization?

Excerpt from ASC 860-10

• > Securitizations

05-11 Securitizations of credit card and other receivable portfolios usually involve a specified reinvestment period (usually 18 to 36 months), during which

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the trust will purchase additional credit card receivables generated by the selected accounts. After the reinvestment period, a period of liquidation occurs during which the investors receive an allocated portion of principal payments relating to receivables in the trust. The **liquidation method** may vary depending on the terms of the agreement and may be a participation method (payout allocation rate may be fixed, preset, or variable) or a **controlled amortization method** (payout based on a predetermined schedule). Specific methods are as follows:

a. **Fixed participation method**
b. **Floating participation method**
c. **Preset participation method.**

05-12 Credit card securitizations (and other types of securitizations) may include a removal-of-accounts provision that permits the **seller**, under certain conditions and with trustee approval, to withdraw receivables from the pool of securitized receivables.

Interpretive response: A revolving-period securitization is in one in which receivables are transferred at inception of the securitization and also at various intervals throughout a specified reinvestment period (e.g. daily, monthly and collectively the 'reinvestment period').

Those transfers are typically purchases by the SPE of additional receivables (e.g. credit card receivables) from the transferor and are typically made using the collections from the receivables transferred previously. Once the reinvestment period is closed, the liquidation period begins, and the beneficial interest holders receive their respective allocated portions of principal payments from the SPE's receivables.

Question 9.2.70

How is cash collected by a securitization entity distributed to the different classes of beneficial interests?

Excerpt from ASC 860-10

• > Securitizations

05-13 Many securitization structures provide for a disproportionate distribution of cash flows to various classes of investors during the amortization period, which is referred to as a turbo provision. For example, a turbo provision might require the first $100 million of cash received during the amortization period of the securitization structure to be paid to one class of investors before any cash is available for repayment to other investors. Similarly, certain revolving-period securitizations use what is referred to as a bullet provision as a method of distributing cash to their investors. Under a bullet provision, during a specified period preceding liquidating distributions to investors, cash proceeds from the underlying assets are reinvested in short-term investments other than the

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underlying revolving-period receivables. Those investments mature or are otherwise liquidated to make a single bullet payment to certain classes of investors.

Interpretive response: The method used to distribute cash (i.e. liquidate) collected by the securitization entity is typically specified within the terms of the entity's legal documents. Common liquidation methods and provisions include the following. [860-10-05-11, 05-13]

Method or provision	Description
Liquidation methods [860-10 Glossary]	
Controlled amortization method	Principal payments on the entity's receivables are allocated to investors under a predetermined monthly payment schedule intended to pay out investors over a specified liquidation period. Principal payments are allocated based on investors' participation interests in the entity using the fixed, preset or floating method. Amounts received that differ from the predetermined schedule are allocated as follows. — **If principal payments are in *excess* of the predetermined monthly payment**, they are allocated to the transferor and increase the investors' ownership interests. — **If principal payments allocated to the investors are *insufficient* to cover the predetermined monthly payment**, the monthly payment is reduced by the amount of the deficiency and the amount is paid in subsequent months having excess principal payments (if any).
Fixed participation method	All principal payments on the entity's receivables are allocated to investors based on their respective participation interests in the receivables at the end of the reinvestment period.
Floating participation method	Principal payments are allocated to investors based on their actual participation interests in the entity's receivables each month. Each month, investors' participation interests in the receivables in the entity are redetermined for that month's allocation of principal payments.
Preset participation method	The percentage used to determine the principal payments allocated to investors is preset higher than their expected participation interests in the entity's receivables at the end of the reinvestment period. This method results in a faster payout to the investors than the fixed participation method (which it is similar to) because a higher percentage of the principal payments is allocated to investors.
Liquidation provisions [860-10-05-13]	
Bullet provision	Before the liquidation period, cash proceeds from the underlying assets are reinvested in short-term investments other than the underlying revolving-period receivables. Those investments mature or are otherwise liquidated to make a single bullet payment to certain classes of investors.
Turbo provision	Cash flows are disproportionately distributed to various classes of investors during the amortization period. For example, the first $100 million of cash received during the amortization period is paid to one class of investors before any cash is distributed to other investors.

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Question 9.2.80

Do liquidation methods that disproportionately allocate receipts of principal or interest preclude a securitization transaction from being accounted for as a sale?

Excerpt from ASC 860-20

• > Estimating the Fair Value of Certain Beneficial Interests

55-16 Trust liquidation methods that allocate receipts of principal or interest between beneficial interest holders and transferors in proportions different from their stated percentage of ownership interests do not affect whether the transferor should obtain sale accounting and **derecognize** those transferred assets, assuming the trust is not required to be consolidated by the transferor. However, both turbo and bullet provisions in securitization structures (as discussed in paragraph 860-10-05-3) should be taken into consideration in determining the fair values of assets obtained by the transferor and transferee.

Interpretive response: Some liquidation methods allocate receipts of principal or interest between beneficial interest holders and transferors in proportions that are different from their respective stated percentage of ownership interests.

Those methods do not preclude sale accounting, provided the transferee entity is not consolidated by the transferor. As explained in section 3.2, a transfer of financial assets to a consolidated affiliate does not qualify for sale accounting. [860-20-55-16]

However, both turbo and bullet provisions are considered in determining the fair values of assets obtained by the transferor. See KPMG Handbook, Fair value measurement. [860-20-55-16]

9.3 Securities lending, repurchase agreements and dollar rolls

9.3.10 Overview

Excerpt from ASC 860-10

• • > Repurchase Agreements and Securities Lending Transactions

55-51 Paragraphs 860-10-05-19 through 05-21 provide background on repurchase agreements. Paragraphs 860-10-05-16 through 05-18 provide background on securities lending transactions. Repurchase agreements and

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securities lending transactions are required to be evaluated under each of the following conditions for derecognition in accordance with paragraph 860-10-40-5:

a. Isolation. Paragraph 860-10-40-5(a) requires an assessment of whether the transferred **financial assets** are isolated from the transferor. Paragraphs 860-10-40-5(a) and 860-10-40-8 require that the transferred financial assets be placed beyond the reach of all consolidated affiliates, except for certain bankruptcy-remote entities, included in the financial statements being presented.
b. Transferee's rights to pledge or exchange. Paragraph 860-10-40-5(b) requires an assessment of the transferee's rights to pledge or exchange the transferred financial assets. If a transferor has transferred financial assets 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, the transferor has not surrendered control over those assets. In a securities lending transaction, 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, the transaction does not satisfy the sale conditions and is accounted for as a loan of securities by the transferor to the transferee.
c. Effective control. Paragraph 860-10-40-5(c) requires an assessment of whether the transferor maintains effective control over transferred financial assets. An agreement that both entitles and obligates the transferor to repurchase transferred financial assets from the transferee in accordance with paragraph 860-10-40-5(c)(1) that meets the criteria in paragraph 860-10-40-24 maintains the transferor's effective control over transferred financial assets. Therefore, transfers with agreements to repurchase transferred financial assets that either meet the effective control criteria or qualify for the **repurchase-to-maturity transaction** exception need not be assessed under the remaining conditions for derecognition and should be accounted for as a secured borrowing. Paragraph 860-10-55-51A illustrates the application of the effective control condition in paragraph 860-10-40-5(c)(1).

Repurchase agreements and securities lending transactions that do not meet all the conditions in paragraph 860-10-40-5 should be treated as secured borrowings.

This section addresses typical securities lending, repurchase agreements and dollar roll arrangements. These types of transactions qualify for sale accounting if all the criteria for sale accounting are met. However, it is common for these transactions to be accounted for as secured borrowings because they frequently do not meet the actual or effective control criteria, even when they meet the legal control criterion.

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9.3.20 Securities lending

Excerpt from ASC 860-10

• > Securities Lending Transactions

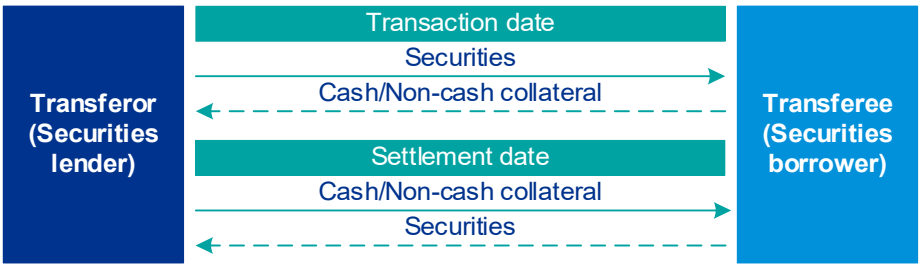
05-16 Securities lending transactions are initiated by broker-dealers and other financial institutions that need specific securities to cover a short sale or a customer's failure to deliver securities sold. Securities custodians or other **agents** commonly carry out securities lending activities on behalf of clients.

05-17 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.

05-18 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.

Securities lending is the practice of loaning financial assets to other parties; they are most commonly transacted by broker-dealers and other financial institutions. Securities lending transactions are generally initiated to cover a short sale or a customer's failure to deliver securities sold. Often, they are open-ended agreements; that is, rather than having an explicit termination date, either party may terminate the agreement on short notice.[860-10-05-16 – 05-17]

The following diagram depicts a typical securities lending arrangement.



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Question 9.3.10

What collateral is generally provided in a securities lending arrangement?

Interpretive response: The transferee (borrower of securities) generally provides collateral to the transferor (lender of securities), which may consist of:

- **Cash collateral**. The transferor's return is typically earned by investing the cash collateral at a rate higher than the rate paid or rebated to the transferee.
- **Securities or standby letters of credit**. Typically the securities or standby letters of credit posted as collateral have a value higher than that of the borrowed securities and the transferor receives a fee.

Collateral is typically valued daily and adjusted frequently for changes in the transferred securities' market value. Most securities lending transactions do not result in significant levels of credit risk to either party because of these collateral adjustment provisions and the short-term nature of the transactions. However, securities lending transactions may present other risks depending on what each party does with the assets it receives. [860-10-05-18]

See also Question 8.2.140, which discusses which party is the transferor/lender and which is the transferee/borrower in an exchange of securities (i.e. noncash collateral is received by the lender).

Question 9.3.20

How does an entity record a securities lending transaction that meets the conditions to be accounted for as a sale?

Excerpt from ASC 860-10

• • > Repurchase Agreements and Securities Lending Transactions

55-55A If the conditions in paragraph 860-10-40-5 are met, a securities lending transaction should be accounted for as follows:

a. By the transferor as a sale of the loaned securities for proceeds consisting of the cash collateral and a forward repurchase commitment. If the collateral in a transaction that meets the conditions in paragraph 860-10-40-5 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.
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

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securities with the ability to sell or transfer them at will. In that circumstance, creditors of the transferor have a claim only to the collateral and the forward repurchase commitment.

Interpretive response: If the transfer meets the conditions to be accounted for as a sale, the transaction is accounted for as a sale; if not, it is accounted for as a secured borrowing. [860-30-25-7]

In our experience, most securities lending transactions are designed to be accounted for as secured borrowings. Frequently, this is through the transferor maintaining effective control through an agreement that both entitles and obligates the transferor to repurchase or redeem the transferred assets before their maturity (see section 6.3).

The following table summarizes how a securities lending transaction is accounted for by the transferor and transferee at the time of the initial transfer when the criteria for sale accounting are met. [860-10-55-55A]

Transferor	Transferee
— Derecognizes the loaned securities — Recognizes the proceeds received (e.g. cash collateral[1] or other securities obtained) and a forward purchase commitment.[2] — Recognizes the gain or loss on the transaction, if any. See also section 7.2.	— Recognizes the borrowed securities (i.e. purchased) and a forward resale commitment.[2] — Derecognizes the cash or other securities used as collateral.

Notes:

1. The transferor accounts for cash received for securities being loaned in the same way, regardless of whether the transfer is accounted for as a sale or a secured borrowing. See further discussion in section 8.2.40.
2. The forward commitment may be subject to accounting as a derivative under Topic 815. See chapter 2 of KPMG Handbook, Derivatives and hedging, for guidance about the Topic 815 definition of a derivative and scope exceptions.

Chapter 8 discusses the accounting for transferors and transferees when the transfer is accounted for as a secured borrowing.

9.3.30 Repurchase agreements

Excerpt from ASC 860-10

20 Glossary

Repurchase agreement

An agreement under which the transferor (repo party) transfers a financial asset to a transferee (repo counterparty or reverse party) in exchange for cash and concurrently agrees to reacquire that financial asset at a future date for an

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amount equal to the cash exchanged plus or minus a stipulated interest factor. Instead of cash, other securities or letters of credit sometimes are exchanged. Some repurchase agreements call for repurchase of financial assets that need not be identical to the financial assets transferred.

• > Repurchase Agreements

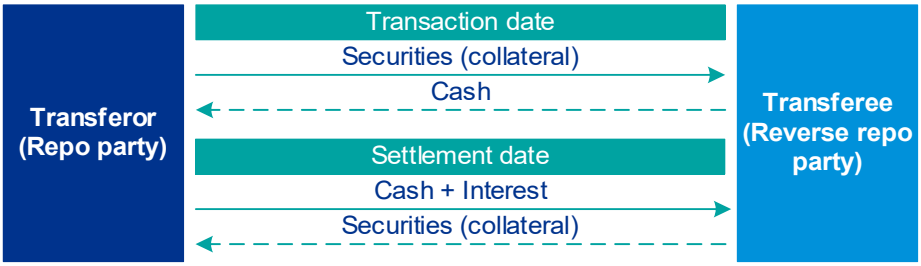
05-19 Government securities dealers, banks, other financial institutions, and corporate investors commonly use **repurchase agreements** to obtain or use short-term funds.

05-20 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 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.

05-21 Many repurchase agreements are for short terms, often overnight, or have indefinite terms that allow either party to terminate the arrangement on short notice. Other repurchase agreements are for longer terms, sometimes until the maturity of the transferred financial asset (repo to maturity).

A repurchase agreement (repo) is a form of short-term borrowing that is commonly used by government securities dealers, banks, other financial institutions and corporate investors. In a repurchase agreement, the transferor (repo party) transfers a security to a transferee (repo counterparty or reverse repo party) in exchange for cash. The transferor simultaneously agrees to reacquire that security at a future date for an amount equal to the cash exchanged plus (or minus) an agreed-upon interest factor. [860-10 Glossary, 860-10-05-19]

The following diagram depicts a typical repurchase agreement.



Question 9.3.30

Who are the typical parties to a repurchase agreement?

Interpretive response: Repurchase agreements may be structured directly between two parties (i.e. a bilateral repurchase agreement) or can involve a

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third-party custodian (usually a clearing bank) that acts as an intermediary between the parties to the repurchase agreement (i.e. a tri-party repurchase agreement).

The following table summarizes three common types of repurchase agreements.

Type	Description
Specified delivery (bilateral)	The transferor (repo party) delivers the securities to the transferee (repo counterparty) or the transferee's custodial agent.
Hold in custody (bilateral)	The transferor (repo party) retains possession of the securities, acting as the custodian for the transferee (repo counterparty). In this situation, the transferor is both a principal to the repurchase agreement and a custodial agent of the transferee.
Tri-party	The tri-party custodian is a party to the repurchase agreement and has certain responsibilities to both the transferor (repo party) and transferee (repo counterparty). The custodian is typically responsible for determining the amount and form of collateral that is required throughout the agreement, in addition to serving as the custodian of the collateral.

Question 9.3.40

What are typical terms of repurchase agreements?

Interpretive response: Repurchase agreements can have a wide variety of terms, including the following. [860-10-05-19 – 05-21]

- **Transferee (reverse repo party) rights to sell or repledge.** Many repurchase agreements are similar to securities lending transactions in that the transferee has the right to sell or repledge the securities during the term of the agreement. However, the transferee does not always have such rights, such as with a tri-party repurchase agreement (see Question 9.3.60).
- **Form of collateral.** While cash is typically provided as collateral in exchange for transferred securities, sometimes securities or letters of credit are exchanged instead.
- **Length of agreement term.** Many repurchase agreements are for short terms (often overnight) or have indefinite terms that allow either party to terminate the arrangement on short notice. Other repurchase agreements are for longer terms, sometimes until the maturity of the transferred asset (for guidance about repurchase-to-maturity transactions, see Question 6.3.20).
- **Asset to be repurchased.** Many (but not all) repurchase agreements require the securities returned to be identical or substantially the same as those initially transferred.

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Question 9.3.50

How does an entity record a repurchase agreement that meets the conditions to be accounted for as a sale?

Excerpt from ASC 860-10

• • > Repurchase Agreements and Securities Lending Transactions

55-55 If the conditions in paragraph 860-10-40-5 are met, the transferor should account for the repurchase agreement as a sale of financial assets and a forward repurchase commitment, and the transferee should account for the agreement as a purchase of financial assets and a forward resale commitment.

55-56 Repurchase agreements that involve an exchange of securities or letters of credit are accounted for in the same manner as securities lending transactions (see paragraphs 860-30-25-7 through 25-8).

55-56B In repurchase agreements and securities lending transactions in which the transferor does not derecognize the transferred financial asset, if the transferee obtains the right to sell or pledge the asset, the transferor reclassifies the asset in its statement of financial position separately from other assets not so encumbered in accordance with paragraph 860-30-45-1.

Interpretive response: If the transfer meets the conditions to be accounted for as a sale, the transaction is accounted for as a sale; if not, it is accounted for as a secured borrowing. [860-30-25-7]

In our experience, most repurchase agreements are designed to require the transferor to account for them as secured borrowings. Frequently, this is through the transferor maintaining effective control through an agreement that both entitles and obligates the transferor to repurchase or redeem the transferred assets before their maturity (see section 6.3).

The following table summarizes how a repurchase agreement is accounted for by the transferor and transferee at the time of the initial transfer when the criteria for sale accounting are met. [860-10-55-55]

Transferor	Transferee
— Derecognizes the transferred assets — Recognizes the proceeds received (e.g. cash collateral or other securities obtained[1]) and a forward purchase commitment.[2] — Recognizes the gain or loss on the transaction, if any. See also section 7.2.	— Recognizes the transferred assets (i.e. purchased) and a forward resale commitment.[2] — Derecognizes the cash or other securities[1] used as collateral.

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Notes:

1. A repurchase agreement is treated in the same manner as a securities lending transaction if the entities exchange other securities or letters of credit rather than cash (see Question 9.3.20). [860-10-55-56]
2. The forward commitment may be subject to accounting as a derivative under Topic 815. See chapter 2 of KPMG Handbook, Derivatives and hedging, for guidance about the Topic 815 definition of a derivative and scope exceptions.

Chapter 8 discusses the accounting for transferors and transferees when the transfer is accounted for as a secured borrowing.

Example 9.3.05
Repurchase agreement accounted for as a sale

Bank (transferor) and ABC Corp. (transferee) enter into a repurchase agreement that is accounted for as a sale.

- Bank transfers AFS debt securities with a fair value of $1,000,000 to ABC and receives $980,000 cash in exchange.
- In 30 days, Bank will repurchase the AFS debt securities from ABC for $982,450.
- The debt securities to be repurchased are not substantially the same as the securities transferred at execution of the agreement.
- Both the Bank and ABC classify the debt securities as AFS.
- ABC is permitted to sell or repledge the debt securities.

The forward commitment meets the definition of a derivative.

For simplicity, this example assumes:

- the fair value of the forward commitment at the outset of the arrangement is $20,000 and the fair value of the AFS debt securities at the end of 30 days is $1,002,450;
- there is no gain or loss recognized upon the transfer of the available-for-sale debt securities; and
- the fair value of the forward purchase commitment does not change over the 30 days.

Bank (seller/transferor) – journal entries and financial statements

Bank records the following journal entries during the term of the repurchase agreement.

	Debit	*Credit*
Cash	980,000	
Forward purchase commitment	20,000	
Securities available-for-sale		1,000,000
To derecognize carrying value of securities sold, recognize cash and a forward purchase commitment.		

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	Debit	*Credit*
Securities available-for-sale	1,002,450	
Forward purchase commitment		20,000
Cash		982,450
To record purchase of different securities under forward commitment.		

During the term of the repurchase agreement, Bank's balance sheet reflects the following amounts related to these arrangements.

Account	Amount
Balance sheet – assets	
Cash	980,000
Forward purchase commitment	20,000

At the conclusion of the repurchase agreement, Bank's financial statements reflect the following amounts related to these arrangements (disregarding cash).

Account	Amount
Balance sheet – assets	
Securities available-for-sale	1,002,450

ABC (buyer/transferee) – journal entries and financial statements

ABC records the following journal entries during the term of the repurchase agreement.

	Debit	*Credit*
Securities available-for-sale	1,000,000	
Forward sale commitment		20,000
Cash		980,000
To recognize the purchase of the securities and forward sale commitment in exchange for cash.		
Securities available-for-sale (unrealized gain)	2,450	
Other comprehensive income[1]		2,450
To recognize the change in fair value of the securities available-for-sale over the 30-day term.		

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	Debit	*Credit*
Cash	982,450	
Forward sale commitment	20,000	
Securities available for sale		1,002,450
Other comprehensive income[1]	2,450	
Realized gain on sale		2,450
To recognize the transfer of different securities under the forward sale commitment and repurchase agreement.		

Note:
1. The effect of taxes has been disregarded for this example.

During the term of the repurchase agreement, ABC's balance sheet reflects the following amounts related to these arrangements.

Account	Amount
Balance sheet – assets	
Securities available-for-sale	1,000,000
Balance sheet – liabilities	
Forward sale commitment	20,000

At the conclusion of the repurchase agreement, ABC's financial statements reflect the following amounts related to these arrangements.

Account	Amount
Balance sheet – assets	
Cash	982,450
Income statement	
Realized gain on sale	2,450

Question 9.3.60

Is a tri-party repurchase agreement typically accounted for as a sale or a secured borrowing?

Interpretive response: A secured borrowing. In a tri-party repurchase agreement, a third-party custodian holds the transferred financial asset and the transferee does not have the right to sell or pledge it. As a result, the transferor (repo party) has not surrendered actual control. Further, the transferor is not required to reclassify the transferred financial asset in its balance sheet (see Question 8.3.20).

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9.3.40 Dollar rolls

Excerpt from ASC 860-10

20 Glossary

Dollar-Roll Repurchase Agreement

An agreement to sell and repurchase similar but not identical securities. The securities sold and repurchased are usually of the same issuer. Dollar rolls differ from regular repurchase agreements in that the securities sold and repurchased have all of the following characteristics:

a. They are represented by different certificates.
b. They are collateralized by different but similar mortgage pools (for example, conforming single-family residential mortgages).
c. They generally have different principal amounts.

Fixed coupon and yield maintenance dollar agreements comprise the most common agreement variations. In a fixed coupon agreement, the seller and buyer agree that delivery will be made with securities having the same stated interest rate as the interest rate stated on the securities sold. In a yield maintenance agreement, the parties agree that delivery will be made with securities that will provide the seller a yield that is specified in the agreement.

Dollar-roll repurchase agreements (also called dollar rolls) are agreements to sell and repurchase similar (but not identical) securities. The most common agreement variations are: [860-10 Glossary]

— **Fixed coupon agreements** in which the seller and buyer agree that the repurchased securities will have the same stated interest rate as the interest rate stated on the securities sold.

— **Yield maintenance agreements** in which the seller and buyer agree that the securities will provide the seller a yield that is specified in the agreement.

Question 9.3.70

How do dollar-roll repurchase agreements differ from traditional repurchase agreements?

Interpretive response: Dollar-roll repurchase agreements differ from traditional repurchase agreements because the securities sold and repurchased in dollar rolls: [860-10 Glossary]

— are represented by different certificates;
— are collateralized by different but similar mortgage pools – e.g. conforming single-family residential mortgages; and
— generally have different principal amounts.

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Question 9.3.80

How does an entity account for a dollar-roll repurchase agreement?

Excerpt from ASC 860-10

• • > Dollar Rolls

55-58 Whether paragraph 860-10-40-5(c) precludes sale accounting for a dollar-roll transaction depends on the facts and circumstances. Paragraph 860-10-40-24 states the conditions under which an agreement that both entitles and obligates the transferor to repurchase or redeem transferred financial assets from the transferee maintains the transferor's effective control over those assets as described in paragraph 860-10-40-5(c)(1). The condition in paragraph 860-10-40-24(a) requires that the financial assets to be repurchased or redeemed are the same or substantially the same as those transferred. Paragraph 860-10-40-24(a) describes six characteristics that must all exist for a transfer to meet the substantially-the-same requirement. Paragraph 860-10-40-24(a)(6) requires (as one of those six characteristics) that the financial asset that was transferred and the financial asset that is to be repurchased or redeemed have the same aggregate unpaid principal amount or principal amounts within accepted good delivery standards for the type of security involved.

Interpretive response: A dollar-roll repurchase agreement that is in the scope of Topic 860 is accounted for as sale if all the criteria for sale accounting are met. Otherwise, it is accounted for as a secured borrowing.

Determining whether the sale criteria are met for a dollar-roll transaction is often driven by whether effective control is maintained via a requirement to return a security that is substantially the same as the transferred security. Section 6.3.20 discusses whether securities are substantially the same. [860-10-55-58]

Question 9.3.90

Must a transferor confirm that the transferee holds securities that are 'substantially the same' at the time of the transfer for the transferor to maintain effective control?

Excerpt from ASC 860-10

• • > Dollar Rolls

55-59 For transfers of existing securities under a dollar-roll repurchase agreement, the transferee must be committed to return substantially-the-same

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securities to the transferor, which would indicate that the transferor has maintained effective control. In a transfer of existing securities under a dollar-roll repurchase agreement, if the transferee is committed to return substantially-the-same securities to the transferor but that transferee's securities at the time of the transfer were to-be-announced securities, the transferor would not be precluded from accounting for the transfer as a secured borrowing. The transferor is only required to obtain a commitment from the transferee to return substantially-the-same securities and is not required to determine that the transferee holds the securities that it has committed to return. Therefore, the financial asset to be returned may be a to-be-announced asset at the time of the transfer because the transferor would have no way of knowing whether the transferee held the security to be returned.

Interpretive response: No. The transferor maintains effective control if the transferee is committed to return substantially the same securities. The transferor is not required to confirm that the transferee holds the securities. [860-10-55-59]

For example, a transferor may maintain effective control of transferred financial assets through a repurchase agreement even if the transferee's securities are to-be-announced (TBA) – i.e. do not yet exist – at the time of the transfer. [860-10-55-59]

Question 9.3.100

What are GNMA rolls and what are the accounting considerations for each?

Excerpt from ASC 860-10

20 Glossary

Government National Mortgage Association Rolls

The term Government National Mortgage Association (GNMA) rolls has been used broadly to refer to a variety of transactions involving mortgage-backed securities, frequently those issued by the GNMA. There are four basic types of transactions:

a. Type 1. Reverse repurchase agreements for which the exact same security is received at the end of the repurchase period (vanilla repo)
b. Type 2. Fixed coupon dollar reverse repurchase agreements (dollar repo)
c. Type 3. Fixed coupon dollar reverse repurchase agreements that are rolled at their maturities, that is, renewed in lieu of taking delivery of an underlying security (GNMA roll)
d. Type 4. Forward commitment dollar rolls (also referred to as to-be-announced GNMA forward contracts or to-be-announced GNMA rolls), for which the underlying security does not yet exist.

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• • > Dollar Rolls

55-60 As illustrated by the following, whether a GNMA roll is accounted for as a secured borrowing or a sale affects the evaluation of the forward contract embedded in the securities subject to the agreement:

a. Types 1-3 of dollar rolls would qualify for secured borrowing treatment if the redemption of securities on substantially the same terms is assured (see paragraph 860-10-40-24). In that circumstance, the forward contracts embedded in the Types 1-3 securities are outside the scope of Topic 815 because of the scope exception provided in paragraph 815-10-15-63 for derivative instruments that serve as impediments to sale accounting.
b. Types 2 and 3 securities that involve repurchase of other than substantially-the-same securities are considered sales of securities and forward contracts. The forward contract would need to be evaluated under Subtopic 815-10 because it has terms that would generally meet the definition of a derivative instrument. If the dollar-roll repurchase agreement is accounted for as a sale under this Subtopic, Subtopic 815-10 provides guidance on the subsequent accounting for the forward contract.

Interpretive response: The term 'GNMA rolls' refers to securities frequently issued by GNMA, but may include similar instruments issued by other entities. There are four basic types of GNMA rolls involving MBS, which are summarized in the following table. [860-10 Glossary, 860-10-55-60]

Type	Description	Accounting considerations
Type 1	Reverse repo involving the repurchase of the exact security that was initially transferred (i.e. vanilla repo)	Transfer is of an existing financial asset and is in scope of Topic 860. The accounting depends on whether the security to be repurchased is substantially the same (see section 6.3.20). — Substantially the same[1]: Typically accounted for as a secured borrowing with the forward contract excluded from Topic 815 under the scope exception for derivatives that impede sale accounting.[2] — Not substantially the same: Accounted for as a sale with the forward contract evaluated to determine whether it must be accounted for as a derivative under Topic 815.[3]
Type 2	Fixed coupon dollar reverse repo (dollar repo)	
Type 3	Fixed coupon dollar reverse repo that is renewed at maturity, instead of delivering the underlying security (GNMA roll)	
Type 4	Forward commitment dollar roll for which the security does not exist at the time of initial transfer (TBA GNMA forward or TBA GNMA roll)	Not in the scope of Topic 860 because it does not involve the transfer of a recognized financial asset. Topic 815 requires an entity to account for forward commitment dollar rolls as assets or liabilities that are measured both initially and subsequently at fair value, even if they do not meet the definition of a derivative.[4]

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Notes:

1. 'Substantially the same' includes securities that are identical to the security initially transferred.
2. See section 2.8 of KPMG Handbook, Derivatives and hedging, for guidance about the Topic 815 scope exception for derivatives that impede sale accounting.
3. See chapter 2 of KPMG Handbook, Derivatives and hedging, for guidance about the Topic 815 definition of a derivative and scope exceptions.
4. See Question 2.3.60 of KPMG Handbook, Derivatives and hedging, for guidance about the Topic 815 scope inclusion for forward commitment dollar rolls.

9.3.50 Examples

Example 9.3.10
Accounting for repurchase agreements and securities lending transactions

The following tables provide examples in which the control criteria are met versus not met for transfers of financial assets under repurchase agreements or securities lending arrangements. All examples assume that the legal control criterion is met (see chapter 4). The examples are based on guidance in paragraphs 860-10-55-51 to 55-51B and 55-54.

Control criteria are not met: Accounted for as secured borrowings	
Description	**Examples**
Transfers that maintain the transferor's actual control (see chapter 5)	— Transferor transfers financial assets to an independent third-party custodian, or to Transferee, under conditions that preclude Transferee from selling or repledging the assets during the term of the repurchase agreement. [860-10-55-51(b)] — A securities lending transaction to the extent that the collateral consists of letters of credit or other financial instruments that Transferee is not permitted to sell or repledge. [860-10-55-51(b)]
Transfers that maintain the transferor's effective control (see chapter 6)	Repurchase agreements and securities lending transactions involving return of assets that are identical or substantially the same (see section 6.3.20), such as the following. [860-10-55-51B] — A repurchase agreement that requires Transferor to repurchase or redeem the identical asset (or an asset that is substantially the same) before its maturity at a fixed price or at the sale price plus or minus a lender's return. — A securities lending transaction that requires Transferee to return to Transferor the identical asset (or an asset that is substantially the same) before its maturity at a fixed price.

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Control criteria are not met: Accounted for as secured borrowings	
Description	**Examples**
	— Other agreements under which the securities to be repurchased are substantially the same as the securities initially transferred, such as fixed-coupon and dollar-roll repurchase agreements.
Repurchase-to-maturity transactions (see Question 6.3.20)	As an exception to the effective control criterion, Topic 860 requires all repurchase-to-maturity transactions to be accounted for as secured borrowings. Under the exception, all repurchase-to-maturity transactions are required to be accounted for as secured borrowings as if the transferor maintains effective control. A transfer of a financial asset made simultaneously with a total return swap to maturity does not meet the definition of a repurchase-to-maturity transaction. [860-10-55-51B(c)]

Control criteria are met: Accounted for as sales	
Description	**Explanation**
Cash-settled repurchase agreements	A transfer of a financial asset with a simultaneous agreement with the same counterparty to repurchase or redeem the asset before its maturity at a fixed repurchase price or a price equal to the sale price plus or minus a lender's return when the agreement requires cash settlement (i.e. does not involve a return of the financial asset to the transferor). An exception is a repurchase-to-maturity transaction. [860-10-55-51B(d)]
Repurchase agreements and securities lending transactions involving readily obtainable assets that do not maintain a transferor's effective control	A transfer of a readily obtainable security with a simultaneous agreement with the same counterparty to repurchase or redeem a security having a different maturity or different contractual interest rate – i.e. with an asset that is not identical to and not substantially the same as the transferred security. [860-10-55-54]

FASB examples

Excerpt from ASC 860-10

55-51A Under certain agreements to repurchase transferred financial assets before their maturity, the transferor maintains effective control over the transferred financial assets. If effective control is maintained or the transaction qualifies for the repurchase-to-maturity transaction exception, the agreement is accounted for as a secured borrowing. If effective control is not maintained or the repurchase-to-maturity transaction exception is not met, the transaction would be assessed under the other derecognition conditions in paragraph 860-

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10-40-5 to determine if the transferred financial asset should be derecognized and accounted for as a sale.

55-51B The following illustrates the application of the derecognition guidance in paragraphs 860-10-40-24 through 40-24A:

a. Repurchase agreements and securities lending transactions—assets that are identical. The following illustrates agreements for which the transferor maintains effective control over the transferred financial asset:

    1. A financial asset is transferred under a contemporaneous agreement with the same counterparty that requires the transferor to repurchase or redeem it before its maturity at a fixed price or at the sale price plus or minus a lender's return.
    2. A financial asset is transferred under a securities lending transaction that requires the transferee to return to the transferor the identical asset before its maturity at a fixed price.

b. Repurchase agreements and securities lending transactions—assets that are substantially the same. The following illustrates agreements for which the transferor maintains effective control over the transferred financial asset:

    1. A financial asset is transferred under a contemporaneous agreement with the same counterparty to repurchase or redeem an asset that is substantially the same as the initially transferred asset (in accordance with paragraph 860-10-40-24(a)) before its maturity at a fixed price or at the sale price plus or minus a lender's return.
    2. A financial asset is transferred under a securities lending transaction that requires the transferee to return to the transferor an asset that is substantially the same as the initially transferred financial asset (in accordance with paragraph 860-10-40-24(a)) before its maturity at a fixed price.
    3. Fixed-coupon and dollar-roll repurchase agreements, and other contracts under which the securities to be repurchased are substantially the same in accordance with paragraph 860-10-40-24(a) as the securities initially transferred.

c. Repurchase-to-maturity transactions. A repurchase-to-maturity transaction is accounted for as a secured borrowing as if it maintains the transferor's effective control over the transferred financial asset. A transfer of a financial asset with a contemporaneous total return swap to maturity does not meet the definition of repurchase-to-maturity transaction.
d. Cash-settled repurchase agreements. If a financial asset is transferred under a contemporaneous agreement with the same counterparty to repurchase or redeem it before its maturity at a fixed repurchase price or a price equal to the sale price plus or minus a lender's return and the agreement requires the transferee to settle the agreement in cash, the agreement does not maintain the transferor's effective control over the transferred financial assets. An exception is a repurchase-to-maturity transaction as discussed in (c).

55-54 In repurchase agreements and securities lending transactions involving readily obtainable held-to-maturity debt securities, the conditions set forth in paragraph 860-10-40-24 should be carefully evaluated to determine whether

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the transaction should be accounted for as a sale or secured borrowing. For example, if the security that is required to be returned has a different maturity or has a different contractual interest rate from the transferred security, the substantially-the-same criterion would not be met. In that circumstance, effective control would not be maintained under the condition in paragraph 860-10-40-5(c) and the transfer would be accounted for as a sale if the other conditions in paragraph 860-10-40-5 are met.

9.4 Miscellaneous other topics

9.4.10 Banker's acceptances and risk participations

Question 9.4.10

What is a banker's acceptance and how does an accepting bank account for it?

Excerpt from ASC 860-10

• > Banker's Acceptances

05-24 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.

05-25 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.

Interpretive response: A banker's acceptance is a short-term financing arrangement (typically not longer than six months) in which an 'accepting bank' provides financing to a customer for its purchase of goods from a vendor.

Under an agreement between the accepting bank, the customer and the vendor, the bank agrees to pay the customer's liability to the vendor after the bank has been presented with evidence of delivery and acceptance of the purchased goods. A draft (or bill of exchange) is typically drawn by the customer, and is stamped by the accepting bank to signify its acceptance of the

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obligation to make payment on the draft on its due date. Upon that acceptance, the customer is liable to repay the accepting bank when the draft matures. [860-10-05-24]

To record the acceptance, the accepting bank recognizes a receivable from the customer and a liability for the acceptance it issued to the vendor. An accepted draft is a negotiable financial instrument that the vendor typically can transfer at a discount either to the accepting bank or in the marketplace. That transfer is in the scope of Topic 860 (see Question 2.2.10) and is recorded as a sale if the conditions for sale accounting are met. [860-10-05-25]

Question 9.4.20

What is a risk participation and how do the accepting and participating banks account for it?

Excerpt from ASC 860-10

05-26 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.

55-65 Paragraphs 860-10-05-24 through 05-26 provide background on banker's acceptances and risk participations in them. 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. Rather, 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. For an illustration of this guidance, see Example 1 (paragraph 860-10-55-80).

Interpretive response: A risk participation is a contract between two banks in which the participating bank agrees to reimburse the accepting bank if the accepting bank's customer defaults on its liability under a banker's acceptance (see Question 9.4.10). The participating bank receives a fee and is in effect a guarantor of the credit of the accepting bank's customer. [860-10-05-26]

The accepting bank's accounting is summarized as follows. [860-10-55-65]

— **Continue to recognize the liability for the banker's acceptance.** Even though it benefits from the guarantee, the accepting bank is still the primary debtor to the holder of the banker's acceptance and does not qualify to

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extinguish the liability. See chapter 4 of KPMG Handbook, Debt and equity financing, for guidance on debt extinguishments.

— **Continue to recognize the receivable from the customer.** This is because the receivable has not been transferred; rather, the accepting bank controls the benefits of the receivable and it is entitled to receive payment from the customer.

— **Recognize an asset for the guarantee purchased.**

The participating bank recognizes a liability for the guarantee issued. [860-10-55-65]

Topic 860 includes the following example journal entries recorded by the accepting and participating banks in a banker's acceptance with a risk participation.

Excerpt from ASC 860-10

• > Example 1: Banker's Acceptance with a Risk Participation

55-80 This Example illustrates the guidance in paragraph 860-10-55-65. This Example has the following assumption.

55-81 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 as follows:

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

55-82 The accepting bank would make the following journal entries.

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

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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

9.4.20 Wash sales

In a wash sale, a transferor sells securities with the intent, but no contractual obligation, to reacquire the same or substantially the same securities, usually to obtain income tax or other benefits. The time period between the sale and the reacquisition varies. The transfers in a wash sale are in the scope of Topic 860.

Question 9.4.30

Are wash sales accounted for as sales or secured borrowings?

Excerpt from ASC 860-10

• • > Wash Sales

55-57 Wash sales shall be accounted for as sales under this Subtopic. 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 financial assets.

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Interpretive response. Wash sales are generally accounted for as sales unless the financial asset is sold with a concurrent contract to repurchase or redeem it from the transferee. That is, each transfer is accounted for as a separate transaction. [860-10-55-57]

Topic 860 requires an entity to consider its continuing involvement with transferred financial assets when determining whether a transfer should be accounted for as a sale. This includes considering arrangements or agreements that are made contemporaneously with – or in contemplation of – the transfer. See section 3.5.20. [860-10-40-4]

However, wash sales are generally accounted for as sales because an expectation or intention to reacquire the same securities – without any contractual commitment – does not result in the transferor maintaining effective control over the transferred securities.

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10. Servicing assets and liabilities

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10.4.30 [Not used]

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10.4.140 [Not used]

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10.5.30 Sale of servicing rights with loan retained

10.6 Presentation

10.6.10 Overview

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10.1 How the standard works

Servicing financial assets includes a variety of activities, including collecting payments from borrowers, monitoring delinquencies and remitting fees to service providers (e.g. trustees, guarantors). Servicing is inherent in all financial assets but is not accounted for separately as a distinct asset (or liability) until:

— the entity transfers the financial asset in a transaction accounted for as a sale under Topic 860 while retaining the servicing rights to that asset; or
— the entity acquires or assumes a servicing right but does not own the related financial asset.

This chapter covers the life cycle of a servicing asset or liability, including:

— whether and how to recognize a servicing asset or liability (see section 10.3);
— how to initially measure a servicing asset or liability (see section 10.3);
— how to subsequently measure a servicing asset or liability under one of two available methods (see section 10.4); and
— whether the transfer of a servicing asset or liability by the servicer qualifies as a sale (see section 10.5).

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10.2 Introduction and scope

Excerpt from ASC 860-50

05-1 This Subtopic provides accounting guidance for **servicing assets** and **servicing liabilities**.

05-2 Servicing is inherent in all **financial assets**; it becomes a distinct asset or liability for accounting purposes only in the circumstances described in paragraph 860-50-25-1.

05-3 Servicing of mortgage loans, credit card receivables, or other financial assets commonly includes, but is not limited to, the following activities:

a. Collecting principal, interest, and escrow payments from borrowers
b. Paying taxes and insurance from escrowed funds
c. Monitoring delinquencies
d. Executing foreclosure if necessary
e. Temporarily investing funds pending distribution
f. Remitting fees to guarantors, trustees, and others providing services
g. Accounting for and remitting principal and interest payments to the holders of beneficial **interests** or **participating interests** in the financial assets.

> Overall Guidance

15-1 This Subtopic has its own discrete scope, which is separate and distinct from the pervasive scope for this Topic as outlined in Section 860-10-15.

> Entities

15-2 The guidance in this Subtopic applies to all entities.

Servicing is inherent in all financial assets, such as mortgage loans, credit card receivables. It commonly includes the following activities: [860-50-05-2 – 05-3]

- 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 or participating interests in the financial assets.

While servicing is inherent in financial assets, servicing assets and servicing liabilities are not themselves financial instruments. Instead, they represent executory contracts. Servicing only becomes a distinct asset or liability for accounting purposes in certain situations that are described in section 10.3.10. [860-50-05-2]

Subtopic 860-50 applies to the accounting for servicing assets and liabilities by all entities. [860-50-15-1 - 15-2]

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10.3 Initial recognition and measurement

10.3.10 Overview

Excerpt from ASC 860-50

> Transactions

15-3 The guidance in this Subtopic applies to transactions in which **servicing assets** are obtained and **servicing liabilities** are incurred, including transactions in which loans are transferred with servicing retained by the **transferor**. The guidance in this Subtopic also applies to transactions in which servicing assets are transferred with loans retained by the transferor.

25-1 An entity shall 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 servicer's transfer of any of the following, if that transfer meets the requirements for sale accounting:

    1. An entire financial asset
    2. A group of entire financial assets
    3. A participating interest in an entire financial asset, in which circumstance the transferor shall recognize a servicing asset or a servicing liability only related to the participating interest sold. …

c. An acquisition or assumption of a servicing obligation that does not relate to financial assets of the servicer or its **consolidated affiliates** included in the financial statements being presented.

Example 1 (see paragraph 860-50-55-20) illustrates accounting for a sale of receivables with servicing obtained by the transferor.

25-2 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 financial assets remaining on the transferor's balance sheet shall not recognize a servicing asset or a servicing liability.

25-3 A servicer that recognizes a servicing asset or servicing liability shall account for the contract to service financial assets separately from those financial assets.

25-4 An entity that transfers its financial assets to an unconsolidated entity in a transfer that qualifies as a sale in which the transferor obtains the resulting securities and classifies them as debt securities held to maturity in accordance with Topic 320 may either separately recognize its servicing assets or servicing liabilities or report those servicing assets or servicing liabilities together with the asset being serviced.

30-1 An entity shall initially measure at fair value, a **servicing asset** or **servicing liability** that qualifies for separate recognition regardless of whether explicit consideration was exchanged.

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A servicing right must first qualify for recognition separately from the financial assets being serviced (see Question 10.3.10). If it does, the entity must determine if it represents an asset or liability (see section 10.3.20).

Question 10.3.10

When is a servicing asset or liability separately recognized?

Interpretive response: An entity (the servicer) recognizes a servicing asset or liability when it enters into a contract to service financial assets (a servicing contract) in connection with: [860-50-15-3, 25-1]

- a transfer of an entire financial asset, a group of entire financial assets, or a participating interest in an entire financial asset that is accounted for as a sale (i.e. an entity transfers the financial assets but retains the servicing); or
- an acquisition or assumption of an obligation to service financial assets that are not held by the entity or its consolidated affiliates (e.g. a transaction in which the entity obtains the servicing right but not the loans). For example, an entity may enter into a servicing agreement for loans it originated as an agent for a third party that funded and legally owns the loans.

A servicing asset or liability is *not* recognized when an entity retains servicing and transfers financial assets in a transaction accounted for as a secured borrowing. [860-50-25-2]

Election available when held-to-maturity debt securities are involved

If an entity transfers financial assets to an unconsolidated entity in a transaction that is accounted for as a sale, receives debt securities in exchange and classifies the debt securities as held-to-maturity, it may either: [860-50-25-4]

- separately recognize the servicing asset or liability; or
- report it together with the asset being serviced (i.e. the held-to-maturity debt securities).

We believe this election may be applied only if an entity receives all of the beneficial interests (i.e. debt securities) issued by the unconsolidated entity.

Question 10.3.20

When does an entity recognize a servicing asset or liability for a revolving period securitization?

Excerpt from ASC 860-50

> Revolving-Period Securitizations

25-9 Recognition of servicing assets or servicing liabilities for revolving-period receivables shall be limited to the servicing for the receivables that exist and

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have been sold. As new receivables are sold, rights to service them may become assets or liabilities that are recognized. Therefore, additional transfers under revolving-period securitizations (for example, home equity loans or credit card receivables) may result in the recognition of additional servicing assets or servicing liabilities.

Background: An entity transfers financial assets in a revolving-period securitization, which is a transaction in which there are ongoing, multiple transfers to a third party. The entity determines the transfer meets the sale criteria and continues to service the transferred financial assets.

Interpretive response: An entity recognizes a servicing asset or liability only for financial assets that exist and have been sold. As new financial assets are sold under the revolving period securitization, additional servicing assets or liabilities may be recognized. Subsequently, as each of the financial assets are paid off, the related servicing rights are derecognized. [860-50-25-9]

10.3.20 Servicing asset and liability

Excerpt from ASC 860-50

20 Glossary

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. It is the amount demanded by the marketplace to perform the specific type of servicing. Adequate compensation is determined by the marketplace; it does not vary according to the specific servicing costs of the servicer.

Servicing Assets

A contract to service financial assets under which the benefits of servicing 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
b. Purchased or assumed separately.

Servicing Liabilities

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

30-2 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

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not expected to adequately compensate a servicer for performing the servicing, the contract results in a servicing liability. Paragraph 860-50-35-1A states that a servicing asset may become a servicing liability, or vice versa, if circumstances change. 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 servicing contract that entitles the servicer to receive benefits of servicing just equal to adequate compensation, regardless of the servicer's own servicing costs, does not result in recognizing a servicing asset or a servicing liability. A purchaser would neither pay nor receive payment to obtain the right to service for a rate just equal to adequate compensation.

30-3 The determination of whether the servicer is adequately compensated for servicing specified assets is based on the amount demanded by the marketplace, not the contractual amount to be paid to a replacement servicer. However, that contractual provision would be relevant for determining the amount of **contractually specified servicing fees**. Therefore, the amount that would be paid to a replacement servicer under the terms of the servicing contract can be more or less than adequate compensation.

30-4 Whether a servicing asset or servicing liability is recorded is a function of the marketplace, not the servicer's cost of servicing. For example, a loss shall not 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.

Once a servicer determines a servicing right qualifies for separate recognition, it must determine if the servicing right represents an asset, liability or neither. If it represents neither, no amount is recognized regarding the servicing right.

A servicer then initially measures the servicing asset or liability at fair value (see Question 10.3.90). [860-50-30-1]

Question 10.3.30

How does an entity determine whether a servicing right represents an asset or a liability?

Interpretive response: Whether a servicing right represents an asset or liability depends on the benefits of servicing compared to adequate compensation a servicer receives for performing servicing. [860-50 Glossary, 860-50-30-2]

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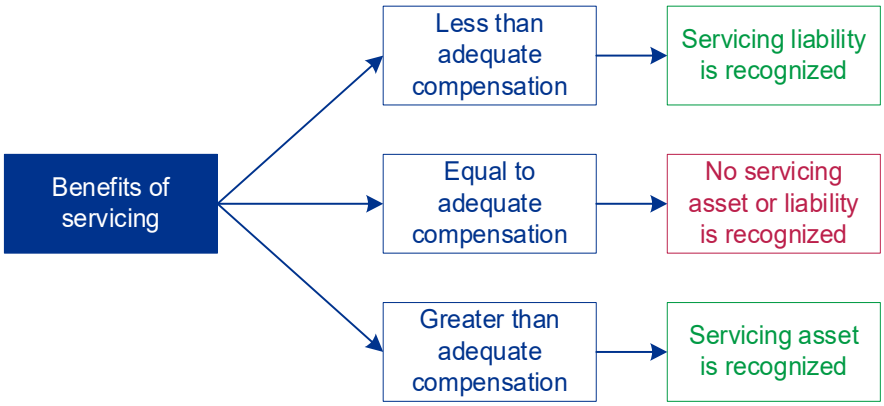

Whether compensation is adequate is not based on an individual servicer's servicing cost but is a market-based concept. [860-50-30-4]

If an entity determines after inception that a contract no longer provides adequate compensation, the servicer recognizes a servicing liability. Similarly, if the contract provides greater (not less) than adequate compensation, a servicing asset is recognized. [860-50-35-1A]

Question 10.3.40

What is considered when determining 'adequate compensation'?

Interpretive response: Adequate compensation is the amount of benefits of servicing that would fairly compensate a substitute servicer should one be required. This includes the normal profit that would be demanded in the marketplace for performing servicing for similar assets.

The determination of adequate compensation is not based on the contractual amount the entity would have to pay a replacement servicer. The amount that an entity would pay to a replacement servicer under the terms of the servicing contract can be more or less than adequate compensation. [860-50 Glossary, 860-50-30-3]

Question 10.3.50

How does an entity determine the 'benefits of servicing'?

Excerpt from ASC 860-50

20 Glossary

Contractually Specified Servicing Fees

All amounts that, per contract, are due to the servicer in exchange for servicing

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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 financial asset being serviced and the rate to be paid to the beneficial owners of those financial assets.

05-4 A servicer of financial assets commonly receives the following **benefits of servicing**:

a. Revenues from **contractually specified servicing fees**
b. A portion of the interest from the financial assets
c. Late charges
d. Other ancillary sources, including float.

A servicer is entitled to receive all of those benefits of servicing only if it performs the servicing and incurs the costs of servicing the financial assets.

Interpretive response: The benefits of servicing are the estimated future revenues that an entity receives for providing servicing. The benefits of servicing include: [860-50-05-4]

- contractually specified servicing fees;
- portion of the interest from the financial assets;
- late charges; and
- other ancillary sources, including rights to short-term investment proceeds earned from investing excess cash payments before their required distribution to investors or third-party beneficial interest holders (commonly referred to as float).

Contractually specified servicing fees are all amounts that are contractually due to the servicer in exchange for servicing the financial asset that would no longer be received if the beneficial owners of the serviced assets (or their trustees or agents) were to shift the servicing to another servicer. [860-50 Glossary]

The contractual amounts that would be paid to a replacement servicer are relevant to determining the amount of contractually specified servicing fees. [860-50-30-3]

Example 10.3.10
Servicing asset vs liability determination

The following table illustrates whether a servicing asset or liability is recognized based on various scenarios.

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	Scenarios *Amounts in basis points (bps)*			
	A	**B**	**C**	**D**
Benefits of servicing (contractual servicing fees) (a)	100	50	55	25
Adequate compensation (based on market- based compensation, which includes profit) (b)	50	50	50	50
Internal servicing costs	25	60	60	25
Excess (deficiency) of benefits of servicing over (below) adequate compensation (c) = (a) - (b)	50	0	5	(25)
Servicing asset or liability?	Asset, based on 50 bps excess.	Neither. Although internal servicing costs exceed contractual servicing fees, the servicer receives contractual servicing fees equal to market-based adequate compensation	Asset, based on 5 bps excess. Although contractual servicing fees are not expected to cover internal servicing costs, a servicing asset is recognized because the fees exceed market-based adequate compensation	Liability, based on 25 bps deficit. Although contractual servicing fees are expected to cover the internal servicing costs, a servicing liability is recognized because the fees are less than market-based adequate compensation

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Question 10.3.60

Is a servicing asset or liability recognized if an entity transfers a portion of a loan and retains servicing?

Excerpt from ASC 860-50

• • > Recognition of Servicing upon Sale of a Participating Interest

55-4 If the entity that transfers a portion of a loan under a participation agreement that meets the definition of a participating interest and qualifies for sale accounting under Subtopic 860-10 obtains the right to receive **benefits of servicing** that more than adequately compensate it for servicing the loan, and the entity would continue to service the loan regardless of the **transfer** because it retains part of the participated loan, the entity shall record a servicing asset for the portion of the loan it sold. The assumption that the entity would service the loan because it retains part of the participated loan does not affect the requirement to recognize a servicing asset. Conversely, an entity could not avoid recording a servicing liability if the benefits of servicing are not expected to adequately compensate the servicer for performing the servicing. However, if the benefits of servicing are significantly above an amount that would fairly compensate a substitute service provider, should one be required, the transferred portion does not meet the definition of a participating interest, and, therefore, the transfer does not qualify for sale accounting (see paragraph 860-10-40-6A(b)).

Interpretive response: It depends. If an entity transfers a portion of a loan to a third party and continues to service the loans, a servicing asset or liability is recognized for the portion of the loan transferred if: [860-50-55-4]

- the portion of the loan transferred meets the definition of a participating interest;
- the transfer meets the sale criteria; and
- the benefits of servicing are more or less than adequate compensation for servicing the loan.

If the benefits of servicing are significantly above an amount that would fairly compensate a substitute servicer, the portion of the loan transferred does not meet the definition of a participating interest and the transfer is not recorded as a sale. As a result, a servicing asset is not recognized. See Questions 3.4.100 and 3.4.120 for additional guidance on evaluating the participating interest definition. [860-50-55-4]

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Question 10.3.70

How does an entity (transferee) account for a servicing asset that is assumed without cash payment?

Excerpt from ASC 860-50

• • > Servicing Assets Assumed without Cash Payment

55-6 The following guidance addresses transactions in which servicing assets are assumed without cash payment, and the appropriate offsetting entry by the **transferee**.

55-7 The offsetting entry depends on whether an exchange or capital transaction has occurred. If an exchange has occurred, then the transaction should be recorded based on the facts and circumstances. For example, the servicing asset may represent consideration for goods or services provided by the transferee to the **transferor** of the servicing. In that case, the offsetting entry by the transferee would be the same as if cash was received in exchange for the goods and services (that is, revenue or a liability as appropriate).

55-8 The servicing assets also might be received in full or partial satisfaction of a receivable from the transferor of the servicing. In those cases, the offsetting entry by the transferee would be to **derecognize** all or part of the receivable satisfied in the exchange. Another possibility is that an investor is in substance making a capital contribution to the investee (the party receiving the servicing asset, that is, the transferee) in exchange for an increased ownership interest. In that case, the investee should recognize an increase in equity from a contribution by owner.

Interpretive response: If an entity assumes a servicing asset without making a cash payment, it recognizes a servicing asset and the offsetting entry depends on the nature of the transaction. [860-50-55-6 – 55-8]

Nature of transaction	Offsetting entry
Exchange – Consideration for goods or services provided by the entity (transferee) to the transferor.	Entity recognizes revenue or a liability, as appropriate. Entry is the same as if cash was received in exchange for the goods and services.
Exchange – Full or partial satisfaction of a receivable owed by the transferor to the entity (transferee).	Entity derecognizes all or part of the receivable satisfied in the exchange.
Capital transaction – Transferor of the servicing is (in substance) making a capital contribution to the entity (transferee).	Entity recognizes an increase in equity from a contribution by the transferor (owner).

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Question 10.3.80

Does an entity record a servicing liability if it does not receive contractually specified servicing fees?

Excerpt from ASC 860-50

• • > Servicer Is Not Entitled to Receive a Contractually Specified Servicing Fee

55-5 The following guidance addresses whether an entity should recognize a servicing liability if it transfers all or some of a **financial asset** that meets the definition of a participating interest that is accounted for as a sale and undertakes an obligation to service the asset but is not entitled to receive a contractually specified servicing fee. In the circumstances described, the transferor-servicer would be required to recognize a servicing liability at fair value if the benefits of servicing are less than **adequate compensation**. The requirements in paragraph 860-50-25-1 apply even if it is not customary to charge a contractually specified servicing fee. Example 1, Case C (paragraph 860-50-55-25) illustrates a transaction in which a transferor agrees to service loans without explicit compensation.

Background: An entity transfers a financial asset (or a participating interest in an entire financial asset) that is accounted for as a sale and undertakes an obligation to service the asset, but is not entitled to receive a contractually specified servicing fee.

Interpretive response: Yes. An entity recognizes a servicing liability at fair value if the benefits of servicing are less than adequate compensation. The requirement to recognize a servicing liability applies even if it is not customary to receive a contractually specified servicing fee. [860-50-55-5]

Subtopic 860-50's Example 1, Case C (reproduced below) illustrates when an entity agrees to service loans without explicit compensation and the impact on the gain on sale calculation. Subtopic 860-20's Example 1 is reproduced next because Case C refers to it.

Excerpt from ASC 860-50

• > Example 1: Sale of Receivables with Servicing Obtained by the Transferor

55-20 The following Cases illustrate the guidance in paragraph 860-50-25-1:

a. Transferor continues to service the loans (Case A). …
c. Future benefits of servicing do not provide adequate compensation (Case C).

55-21 Entity A originates $1,000 of loans that yield 10 percent interest income for their estimated lives of 9 years. Entity A transfers the entire loans to an unconsolidated entity and the transfer is accounted for as a sale.

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• • > Case C: Future Benefits of Servicing Do Not Provide Adequate Compensation

55-25 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.

55-26 For example, if in the transaction illustrated in paragraphs 860-20-55-43 through 55-45, the transferor (Entity A) 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 $980, gain on sale would become a loss on sale of $20, and the transferor would report a servicing liability of $50.

Excerpt from ASC 860-20

• > Example 1: Recording Transfers with Proceeds of Cash, Derivative Instruments, and Other Liabilities

55-43 This Example illustrates the guidance in paragraphs 860-20-25-1 and 860-20-30-1. Entity A transfers entire loans with a carrying amount of $1,000 to an unconsolidated securitization entity and receives proceeds with a fair value of $1,030, and the transfer is accounted for as a sale. Entity A undertakes no obligation to service and assumes a limited recourse obligation to repurchase delinquent loans. Entity A agrees to provide the transferee a return at a variable rate of interest even though the contractual terms of the loan are fixed rate in nature (that provision is effectively an interest rate swap).

55-44 This Example has the following assumptions.

Fair Values	
Cash proceeds	$1,050
Interest rate swap asset	40
Recourse obligation	60

Net Proceeds	
Cash received	$1,050
Plus: Interest rate swap asset	40
Less: Recourse obligation	(60)
Net proceeds	$ 1,030

Gain on Sale	
Net proceeds	$ 1,030
Less: Carrying amount of loans sold	(1,000)
Gain on sale	$ 30

55-45 The following journal entry is made by Entity A.

Journal Entry		
Cash	$ 1,050	
Interest rate swap asset	40	
Loans		$ 1,000
Recourse obligation		60

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Gain on sale	30
To record transfer	

Question 10.3.90

How does an entity measure the fair value of a servicing asset or liability?

Excerpt from ASC 860-50

30-6 When valuing the right to receive future cash flows from ancillary sources such as late fees, an entity shall estimate the value of the right to benefit from the cash flows of potential future transactions, not the value of the expected cash flows to be derived from future transactions.

30-7 Entities shall consider the nature of the assets being serviced as a factor in determining the fair value of a servicing asset or servicing liability. The types of assets being serviced affect the amount required to adequately compensate the servicer. Several variables, including the nature of the underlying assets, shall be considered in determining whether a servicer is adequately compensated. For example, the amount of effort required to service a home equity loan likely would be different from the amount of effort required to service a credit card receivable or a small business administration loan.

Interpretive response: The estimated fair value of a servicing asset and liability compares the benefits of servicing with adequate compensation as determined by the marketplace. The approach in Subtopic 860-50 is consistent with the guidance in Topic 820, which emphasizes that fair value is a market-based measure. Therefore, fair value is measured based on the amount a servicer would pay to acquire the servicing in the market.

Some of the items an entity considers when measuring the fair value of a servicing asset or liability include: [860-50-30-6 – 30-7]

— the value of the right to receive potential future cash flows from ancillary sources (e.g. late fees, float) because such benefits directly affect the fair value;

— the nature of the asset being serviced. The nature of the asset affects the level of effort and therefore the compensation that will be received by the servicer. For example, the amount of effort required to service a home equity loan may be different from the amount of effort required to service a credit card receivable or a Small Business Administration (SBA) loan.

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10.3.30 Distinguishing servicing from an I/O strip

Excerpt from ASC 860-50

20 Glossary

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.

> Distinguishing Servicing from an Interest-Only Strip

25-6 A servicer shall account separately for rights to future interest income from the serviced assets that exceed **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 860-20-35-2.

25-7 Whether a right to future interest income from serviced assets should be accounted for as an interest-only strip, a servicing asset, or a combination thereof, depends on whether a servicer would continue to receive that amount (that is, the value of the right to future interest income) if a substitute servicer began servicing the assets. Therefore, any portion of the right to future interest income from the serviced assets that would continue to be received even if the servicing were shifted to another servicer would be reported separately as a financial asset in accordance with paragraph 860-20-35-2. For guidance on why an interest-only strip precludes a portion of a financial asset from meeting the definition of a participating interest, see paragraph 860-10-55-17K.

25-8 The value of the right to receive future cash flows from ancillary sources such as late fees shall be included in the measurement of the servicing asset, not the interest-only strip, if retention of the right to receive the cash flows from those fees depends on servicing being performed satisfactorily, as is generally the case.

A servicer may have the right to receive future interest income from serviced financial assets that exceeds contractually specified servicing fees. The future interest income could relate to servicing the financial asset (i.e. be part of the servicing asset) or represent another form of beneficial interest retained by the servicer (or a combination of the two). The beneficial interest retained is often an I/O strip, which is 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. [860-50-25-6 – 25-7, 860-50 Glossary]

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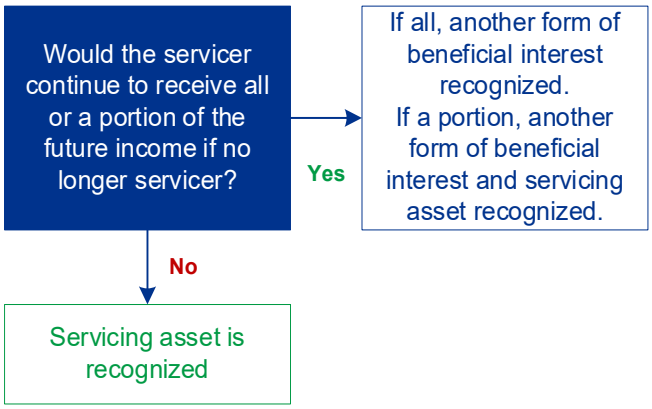
Question 10.3.100

How does an entity distinguish servicing from another form of beneficial interest?

Interpretive response: Whether the right to receive future interest income from a serviced financial asset represents a servicing asset or another form of consideration (e.g. an I/O strip), in whole or part, depends on whether a servicer would continue to receive the interest income if a substitute servicer began servicing the asset. [860-50-25-7]



The beneficial interest retained is often an I/O strip, which is 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. I/O strips are separately recognized as financial assets and measured under Topic 815 (derivatives and hedging) or Topic 320 (investments – debt securities). [860-50 Glossary]

Section 2.12 of KPMG Handbook, Derivatives and hedging, provides guidance on whether an I/O strip is outside the scope of Topic 815, and sections 7.2.50 and 7.3 discuss the accounting for I/O strips that are retained in a sale or securitization transaction that are not derivatives. [860-50-25-6]

In addition, the right to receive future cash flows from ancillary sources (e.g. late fees) generally depends on servicing being performed satisfactorily. In such cases, the value of that right is included in the fair value measurement of the servicing asset, not of the I/O strip. [860-50-25-8]

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10.4 Subsequent measurement

10.4.10 Overview

Excerpt from ASC 860-50

35-1 An entity shall subsequently measure each class of **servicing assets** and **servicing liabilities** using either 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.

35-1A A servicing asset may become a servicing liability, or vice versa, if circumstances change.

35-2 The election described in paragraphs 860-50-35-1 through 35-5 shall be made separately for each class of servicing assets and servicing liabilities.

35-3 The following guidance applies to the election of a method for subsequent measurement of servicing assets and servicing liabilities: …

b. Different elections can be made for different classes of servicing assets and servicing liabilities. …
f. If 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.

35-4 An entity shall apply the same subsequent measurement method to each servicing asset and servicing liability in a class.

An entity may elect to subsequently measure servicing assets and liabilities using either the amortization method or fair value measurement method. Such election is made separately for each class of servicing assets and liabilities, including a new class of servicing assets and liabilities when an entity had not previously recognized a servicing asset or liability that would belong to that class. [860-50-35-1 – 35-2, 35-3(b), 35-3(f), 35-4]

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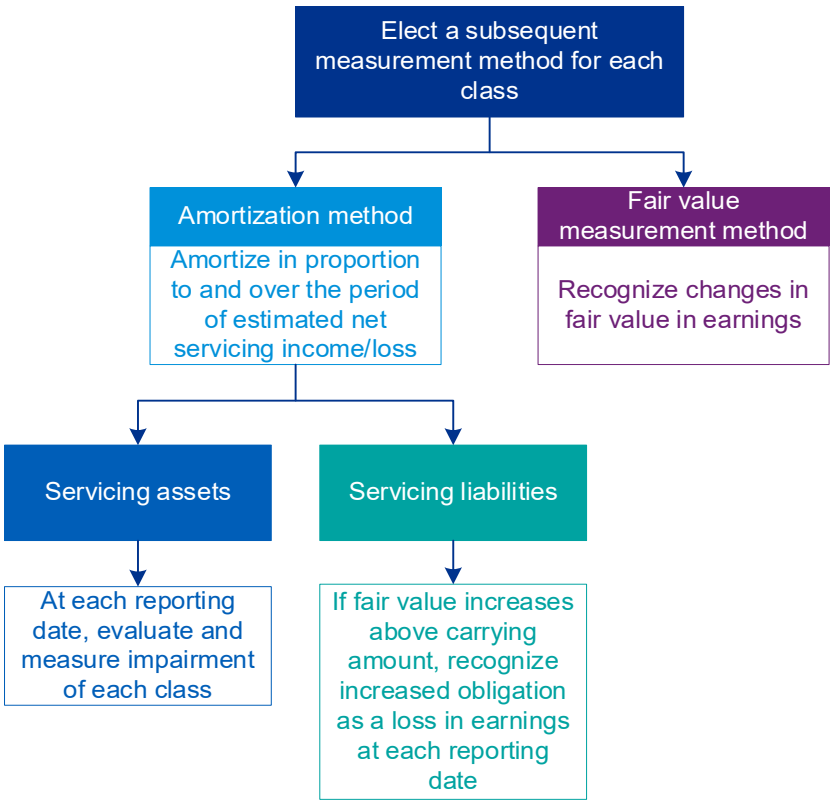
Question 10.4.10

How are servicing assets and liabilities subsequently measured?

Interpretive response: The following diagram summarizes the subsequent measurement under each of the two acceptable subsequent measurement methods. [860-50-35-1]



Question 10.4.20

How does an entity identify classes of servicing assets and liabilities?

Excerpt from ASC 860-50

35-5 Classes of servicing assets and servicing liabilities shall be identified based on any of the following:

a. The availability of market inputs used in determining the fair value of servicing assets or servicing liabilities

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b. An entity's method for managing the risks of its servicing assets or servicing liabilities.

35-6 Under the approach in the preceding paragraph, 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. Further, this approach for defining classes of servicing assets and servicing liabilities is not analogous to the stratification guidance for determining impairment of servicing assets or servicing liabilities that are subsequently measured using the amortization method.

Interpretive response: Classes of servicing assets and liabilities are identified based on: [860-50-35-5]

— the availability of market inputs used in measuring the fair value of servicing assets or liabilities; and
— an entity's method for managing the risks of its servicing assets or liabilities.

In addition, an entity may (but is not required to) consider the major asset type of the underlying financial asset being serviced when identifying classes. For example, an entity may establish separate classes of servicing rights for residential and commercial loans. [860-50-35-6]

Further, the approach for identifying classes of servicing assets and liabilities is not analogous to the stratification guidance for determining impairment of servicing assets or liabilities that are subsequently measured using the amortization method, which is discussed in section 10.4.20. [860-50-35-6]

Question 10.4.30

Is an entity permitted to transfer servicing assets and liabilities between classes?

Excerpt from ASC 860-50

35-3 The following guidance applies to the election of a method for subsequent measurement of servicing assets and servicing liabilities:

a. Once an entity elects the fair value measurement method for a class of servicing assets and servicing liabilities, that election shall not be reversed. …
c. 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 shall not be placed in a class of servicing assets and servicing liabilities that is subsequently measured using the amortization method. …
e. 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

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fiscal year. If an entity makes such a **transfer**, 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.

Interpretive response: Yes, if there has been a change in the relevant facts and circumstances. However, there are limitations on which classes a servicing asset and liability can be transferred into if it has been previously included in a class of servicing assets and liabilities that an entity has elected to subsequently measure using the fair value measurement method.

As discussed in Question 10.4.20, an entity identifies its classes of servicing assets and liabilities based on the availability of market inputs and it's method for managing the risks of its servicing assets or liabilities. If an entity determines that there is a change in these factors, it would transfer servicing assets and liabilities between classes to reflect these changes. For example, an entity may change how it manages the risks associated with its servicing assets, or there may be a change in the availability of market inputs. In these cases, the classes would be realigned to reflect these changes.

However, once a servicing asset or servicing liability is reported in a class of servicing assets and servicing liabilities that an entity elects to subsequently measure using the fair value measurement method, that servicing asset or liability cannot be transferred into a class of servicing assets and liabilities that is subsequently measured using the amortization method. That is, the servicing asset or liability can only be transferred from one class that is subsequently measured at fair value to another class that is subsequently measured at fair value. [860-50-35-3(c)]

In contrast, servicing assets and liabilities in a class that is subsequently measured using the amortization method can be transferred to any class that is appropriate based on the reasons discussed above. If servicing assets and liabilities are transferred from a class subsequently measured using the amortization method to a class subsequently measured using the fair value measurement method, we believe the transfer should take place at the beginning of the fiscal year and be supported by documentation that is completed on or before that date.

In this scenario, the change in measurement is applied prospectively with a cumulative-effect adjustment to retained earnings as of the beginning of the fiscal year. The cumulative-effect adjustment reflects the difference between the fair value and carrying amount – net of any related valuation allowance – of the servicing assets and liabilities transferred at the beginning of the fiscal year. [860-50-35-3(e)]

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Question 10.4.40

Is an entity permitted to change its subsequent measurement for a class of servicing assets and liabilities?

Excerpt from ASC 860-50

35-3 The following guidance applies to the election of a method for subsequent measurement of servicing assets and servicing liabilities:

a. Once an entity elects the fair value measurement method for a class of servicing assets and servicing liabilities, that election shall not be reversed.
…
d. 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.
e. 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. If an entity makes such a **transfer**, 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.

Interpretive response: It depends on which subsequent measurement method the entity is applying.

Amortization method

Yes. An entity may irrevocably change its subsequent measurement for a class of servicing assets and liabilities from the amortization method to the fair value measurement method. The change for a class does not affect the subsequent accounting measurement decisions for other classes of servicing assets and servicing liabilities. [860-50-35-3(d)]

The fair value measurement method must be elected and applied at the beginning of the fiscal year. The election is applied prospectively with a cumulative-effect adjustment to retained earnings recognized as of the beginning of the fiscal year. The cumulative-effect adjustment reflects the difference between the fair value and carrying amount – net of any related valuation allowance – at the beginning of the fiscal year that the election was made. [860-50-35-3(e)]

Fair value measurement method

No. The initial election of the fair value measurement method is irrevocable. [860-50-35-3(a)]

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Question 10.4.50

Does an entity need to document which subsequent measurement method it elects?

Background: Topic 860 does not prescribe how an entity is required to document its subsequent measurement method for servicing assets and liabilities beyond specifying the timing of requirements for making the election.

Interpretive response: Yes. We believe that evidence of the election to apply either the amortization method or the fair value measurement method should be supported by contemporaneous documentation or an existing policy. The policy should include sufficient information to distinguish what subsequent measurement method is applied to each class.

If an entity changes its subsequent measurement methodology for a class of servicing assets and liabilities from the amortization method to the fair value measurement method, we believe that contemporaneous documentation means the entity makes and documents its election at the beginning of the fiscal year in which it applies the fair value measurement method.

Question 10.4.60

How does an entity record servicing fees and costs when it has recognized a related servicing asset or liability?

Interpretive response: An entity's accounting for its servicing assets and liabilities is separate from its accounting for its actual servicing fees and costs. The Transition Resource Group for Revenue Recognition (TRG) discussed whether income from servicing was in the scope of Topic 606 (revenue) or Topic 860. The TRG decided that to the extent servicing or subservicing arrangements are in the scope of Topic 860, their servicing fees are excluded from the scope of Topic 606. [TRG 4-16.52]

This question was raised with the TRG because Topic 860 does not provide explicit guidance on the accounting for contractually specified servicing fees. However, Subtopic 860-50 does provide guidance for the initial recognition and subsequent measurement of assets or liabilities for off-market fees in these arrangements. As such, the TRG generally agreed that Topic 860 provides implicit guidance on the accounting for servicing fees and therefore these fees are excluded from the scope of Topic 606. [TRG 4-16.52]

We believe an entity should recognize its actual servicing fees (and related costs of servicing) through earnings when they are earned (or incurred).

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10.4.20 Amortization method – Impairment (servicing assets) or increased obligation (servicing liabilities)

Excerpt from ASC 860-50

35-7 An entity shall first identify its classes of separately recognized servicing assets and servicing liabilities under the approach in paragraph 860-50-35-5. For any class subsequently measured using the amortization method, an entity shall then stratify that class to determine if impairment has occurred, as discussed in paragraph 860-50-35-9(a).

If an entity elects the amortization method for a servicing asset or liability, it amortizes the initial fair value over the period of the estimated net servicing income/loss in proportionate amounts. However, each period it must also determine if a servicing asset has been impaired or a servicing liability has increased based on the fair value of the asset or liability at the reporting date. [860-50-35-7, 35-11]

Question 10.4.70

How does an entity evaluate and measure impairment for servicing assets?

Excerpt from ASC 860-50

> Amortization Method—Measurement of Impairment or Increased Obligation

35-9 An entity shall evaluate and measure impairment of each class of separately recognized servicing assets that are subsequently measured using the amortization method described in paragraph 860-50-35-1(a) as follows:

a. 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, size, interest rate, date of origination, term, and geographic location. 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.
b. 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.
c. Adjust the valuation allowance to reflect changes in the measurement of impairment after the initial measurement of impairment. Fair value in excess of the carrying amount of servicing assets for that stratum, however, shall not be recognized.

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35-10 This Subtopic does not address when an entity should record a direct write-down of recognized servicing assets.

35-12 The impairment provisions of paragraphs 860-50-35-9 and 860-50-35-11 for classes of servicing assets and servicing liabilities subsequently measured using the amortization method are based on the fair value of the contract rather than the gain or loss from subsequently carrying out the terms of the contract.

Interpretive response: An entity that applies the amortization method to one or more classes of servicing assets evaluates and measures impairment for each class as follows.

Step 1	**Stratifies the class** based on one or more of the predominant risk characteristics of the underlying financial assets. [860-50-35-7, 35-9(a)]
Step 2	**Measures impairment** as the amount by which the carrying amount of the individual stratum exceeds its fair value. [860-50-35-9(b)] The fair value of servicing assets that are not yet recognized is not considered in the evaluation of impairment. [860-50-35-9(b)] Further, impairment is based on the fair value of the servicing contract, not the gain or loss from subsequently carrying out the terms of the contract. [860-50-35-12]
Step 3	**Recognizes impairment** for an individual stratum through a valuation allowance. The amount of impairment recognized is equal to the excess of the carrying amount of servicing assets for a stratum over its fair value. Question 10.4.120 discusses when an entity writes off a servicing asset. [860-50-35-9(b), 35-10]
Step 4	In subsequent periods, **evaluates if any** further adjustment to the valuation allowance are needed. The valuation allowance may be reversed in subsequent periods if the fair value changes. However, fair value in excess of the carrying amount of servicing assets for that stratum is not recognized. Question 10.4.120 discusses when an entity writes off a servicing asset. [860-50-35-9(c)]

Example 10.4.10
Impairment by stratum

ABC Corp. has two strata of recognized servicing assets and determines the following at the reporting date.

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	Strata	
	A	B
Fair value (a)	80	55
Carrying value (b)	100	50
Excess (deficit) (c) = (a) – (b)	(20)	5

The $5 excess from Stratum B cannot be used to offset the $20 decline (impairment) that is present in Stratum A. Instead, ABC recognizes a $20 valuation allowance for Stratum A.

Question 10.4.80

How does an entity stratify its servicing assets for impairment testing?

Excerpt from ASC 860-50

> Amortization Method—Measurement of Impairment or Increased Obligation

35-13 An entity is not required to use either the most predominant risk characteristic or more than one predominant risk characteristic to stratify the servicing assets for purposes of evaluating and measuring impairment. An entity must exercise judgment when determining how to stratify servicing assets (that is, when selecting the most appropriate characteristic[s] for stratification). An entity may use different stratification criteria for the purposes of impairment testing under this Subtopic and for the purposes of grouping similar assets to be designated as a hedged portfolio in a fair value hedge under Subtopic 815-20. If an entity chooses not to restratify servicing assets for impairment testing under this Subtopic consistent with any restratification done for compliance with hedging criteria under Subtopic 815-20, the entity shall record any adjustments resulting from a fair value hedge to the risk strata used for impairment testing under paragraph 860-50-35-9.

Interpretive response: Step 1 of the impairment test (see Question 10.4.70) requires an entity to 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 (e.g. various conventional or government guaranteed or insured mortgage loans and adjustable-rate or fixed-rate mortgage loans), size, interest rate, date of origination, term and geographic location. [860-50-35-9(a)]

An entity is not required to use the most predominant risk characteristics or multiple risk characteristics to stratify the portfolio of servicing assets. Instead, an entity exercises judgment when selecting the most appropriate risk

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characteristics. Question 10.4.100 discusses changing the predominant risk characteristics. [860-50-35-13]

Question 10.4.90

If servicing assets are hedged, must they be stratified for impairment testing in the same manner as they are aggregated for hedging?

Excerpt from ASC 815-20

• • • > Servicing Rights as a Hedged Item

55-16 Paragraph 815-20-25-12(b)(1) provides criteria under which similar assets or similar liabilities may be aggregated and hedged as a portfolio under a fair value hedge, requiring, in part, that the individual assets or individual liabilities share the risk exposure for which they are designated as being hedged. Servicers of financial assets that designate a hedged portfolio by aggregating servicing rights within one or more risk strata used under paragraph 860-50-35-9 would not necessarily comply with the requirement in paragraph 815-20-25-12(b)(1) for portfolios of similar assets because the risk strata under paragraph 860-50-35-9 can be based on any predominant risk characteristic, including date of origination or geographic location.

Excerpt from ASC 860-50

> Derivatives and Hedging

60-1 For guidance on whether an entity may designate as the hedged item in a fair value hedge a portion of a recognized servicing right asset subsequently measured using the amortization method, see paragraph 815-20-55-65.

Background: For assets or liabilities to be aggregated and hedged as a portfolio, at inception of the fair value hedging relationship and on an ongoing basis, each asset or liability individually needs to: [815-20-25-12(b)(1), 55-16)]

— share the same risk exposure as the risk designated as being hedged; and
— be expected to respond proportionately to the total change in fair value of the hedged portfolio attributable to the hedged risk.

See chapter 7 of KPMG Handbook, Derivatives and hedging, for further discussion.

Interpretive response: No. An entity is not required to have the same stratification criteria for impairment testing that it has for grouping similar assets to be designated as a hedged portfolio in a fair value hedge under Topic 815.

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Topic 860 requires an entity to aggregate servicing assets within a class based on one or more of the predominant risk characteristics of the underlying financial assets for purposes of impairment testing. The aggregation considerations for impairment testing are different from those required for grouping assets for hedging a portfolio in a fair value hedge. The risk characteristics used for stratifying the portfolio for impairment testing may not be sufficient to satisfy the similarity requirements for fair value hedging. [860-50-35-13, 815-20-55-16]

However, if an entity uses different strata in its hedging portfolios as compared to those used for impairment testing, the entity will need to allocate any adjustment from hedging activities to servicing assets before performing its impairment testing. This process may become cumbersome and complex. As a result, an entity may wish to align its impairment testing strata with its fair value hedge groupings to eliminate this complexity.

Question 10.4.100

Is an entity permitted to change the predominant risk characteristics used to identify the strata?

Excerpt from ASC 860-50

> Amortization Method—Measurement of Impairment or Increased Obligation

35-14 Once an entity has determined the predominant risk characteristics to be used in identifying the resulting stratums within each class of servicing assets subsequently measured using the amortization method, that decision shall be applied consistently unless significant changes in economic facts and circumstances clearly indicate that the predominant risk characteristics and resulting stratums should be changed. If a significant change in economic facts and circumstances occurs, that change shall be accounted for prospectively as a change in accounting estimate in accordance with paragraphs 250-10-45-17 through 45-19 and 250-10-50-4.

Interpretive response: Generally, no. Once an entity has determined the predominant risk characteristics to be used in identifying the resulting strata, it applies that decision consistently unless significant changes in economic facts and circumstances clearly indicate that the predominant risk characteristics and resulting strata should be changed.

If a significant change in economic facts and circumstances occurs, that change is accounted for prospectively as a change in estimate under Topic 250 (accounting changes and error corrections). See chapter 4 of KPMG Handbook, Accounting changes and error corrections. [860-50-35-14]

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Question 10.4.110

What are some key assumptions when evaluating a servicing asset for impairment?

Interpretive response: As part of the impairment test, an entity needs to measure the fair value of the servicing asset (Step 2 in Question 10.4.70) even though it has elected the amortization subsequent measurement method and not the fair value subsequent measurement method. We believe some key assumptions an entity should focus on when measuring fair value for impairment purposes include prepayment speeds, especially in periods of declining interest rates, and discount rates.

However, an entity needs to ensure that the assumptions used to estimate fair value as part of the impairment evaluation are consistent with the characteristics of the assets in the pool that it is evaluating. For example, during periods of declining interest rates, borrowers tend to repay or refinance mortgages with greater frequency, which can diminish the value of servicing assets related to those mortgages. An entity needs to evaluate whether decreasing interest rate trends affect the valuation of their servicing assets. [SEC Panel Discussion Part II, 2001 AICPA Conf]

Question 10.4.120

What are the conditions under which an entity writes off a servicing asset?

Interpretive response: Topic 860 does not address when an entity should record impairment of a recognized servicing asset through a valuation allowance versus when it should record a direct writedown. [860-50-35-10]

We believe an entity should establish an accounting policy regarding the conditions under which it will write off a servicing asset and should consistently apply that policy. For example, an entity may establish a policy that it will record a direct writedown of an impaired servicing asset when the likelihood of recovery is remote.

Question 10.4.130

How does an entity account for changes in the fair value of a servicing liability?

Excerpt from ASC 860-50

> Amortization Method—Measurement of Impairment or Increased Obligation

35-11 For servicing liabilities subsequently measured using the amortization method, if subsequent events have increased the fair value of the liability

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above the carrying amount, for example, because of significant changes in the amount or timing of actual or expected future cash flows relative to the cash flows previously projected, the servicer shall revise its earlier estimates and recognize the increased obligation as a loss in earnings. That is, if subsequent events increase the fair value of a stratum of servicing liabilities within a class that an entity has elected to subsequently measure using the amortization method, that increase shall be recognized in earnings as a loss. Similar to the accounting for changes in a valuation allowance for an impaired asset, increases in the servicing obligation may be recovered, but the obligation shall not be reduced below the amortized measurement of the initially recognized servicing liability.

Interpretive response: An entity evaluates whether there are subsequent increases in the fair value of a stratum of servicing liabilities measured using the amortization method. If the fair value increases to an amount greater than the carrying amount, the servicing liability is increased and a loss is recognized in earnings for the difference between the fair value and carrying amount. [860-50-35-11]

Similar to the accounting for changes in the valuation allowance for an impaired servicing asset accounted for using the amortization method, increases in the servicing liability may be recovered. Therefore, subsequent reductions in fair value of the servicing liability are recognized through earnings with a reduction to the servicing liability. However, in a manner similar to a valuation allowance, the servicing liability may not be reduced below the initially recognized servicing liability adjusted for subsequent amortization. [860-50-35-11]

10.5 Sales of servicing rights

10.5.10 Overview

Excerpt from ASC 860-50

> Overall

40-2 The following criteria shall be considered when evaluating whether a transfer of servicing rights qualifies as a sale:

a. Whether the **transferor** has received written approval from the investor if required.
b. Whether the **transferee** is a currently approved transferor-servicer and is not at risk of losing approved status.
c. If the transferor finances a portion of the sales price, whether an adequate nonrefundable down payment has been received (necessary to demonstrate the transferee's commitment to pay the remaining sales price) and whether the note receivable from the transferee provides full **recourse** to the transferee. Nonrecourse notes or notes with limited recourse (such as to the servicing) do not satisfy this criterion.

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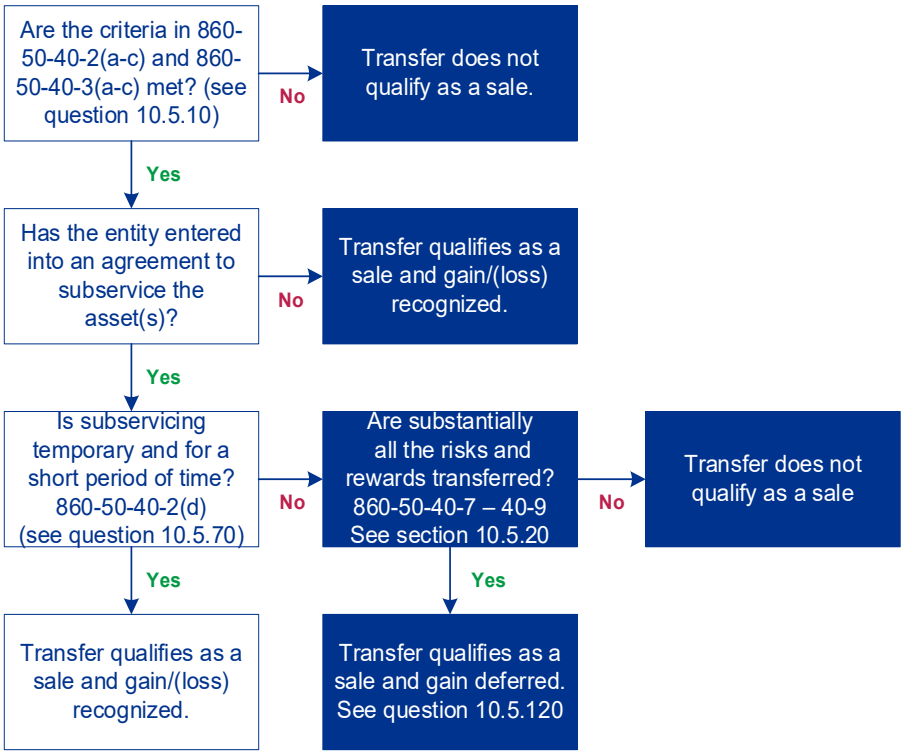
d. Temporary servicing performed by the transferor for a short period of time shall be compensated in accordance with a subservicing contract that provides **adequate compensation**.

40-3 Also, the following additional criteria shall be considered when evaluating whether a transfer of servicing rights qualifies as a sale:

a. Title has passed.
b. Substantially all risks and rewards of ownership have irrevocably passed to the buyer.
c. Any **protection provisions** retained by the **seller** are minor and can be reasonably estimated.

40-5 A temporary subservicing contract in which the subservicing will be performed by the transferor for a short period of time would not necessarily preclude recognizing a sale at the closing date.

The following decision tree summarizes how a transferor analyzes the sale of servicing rights.



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Question 10.5.10

How does an entity evaluate whether a transfer of servicing rights qualifies as a sale with recognition of a related gain/loss?

Interpretive response: For a transfer of servicing rights to a third party to qualify as a sale with recognition of a related gain/loss, we believe the following criteria need to be met: [860-50-40-2 – 40-3]

- the transferor has received written approval from the investor, if required;
- the transferee is a currently approved transferor-servicer and is not at risk of losing approved status;
- if the transferor finances a portion of the sale price for the transferee, the note receivable from the transferee is full recourse and the transferee's down payment is sufficient to demonstrate its commitment to pay the remaining sale price (see Question 10.5.40);
- if temporary servicing will be performed by the transferor for a short period and the transferor will receive adequate compensation under the subservicing contract (see Question 10.5.70);
- title has passed to the transferee;
- substantially all risks and rewards of ownership have irrevocably passed to the transferee; and
- any protection provisions retained by the transferor are minor and can be reasonably estimated (see Question 10.5.50).

However, we believe that if there is a subservicing contract between the transferor and transferee that is not for a short period, further analysis is required to determine if the transfer qualifies as a sale with gain deferred or does not qualify as a sale. See section 10.5.20 for additional guidance.

Question 10.5.20

What unit of account is used to determine whether a transfer of servicing rights qualifies as a sale?

Interpretive response: We believe an entity evaluates whether a transfer of servicing rights qualifies as a sale at the unit of account level. The unit of account for servicing rights is the individual servicing contract. The servicing contract outlines the servicer's rights and obligations and identifies the specific assets that will be serviced.

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Question 10.5.30

Can a transfer of servicing rights that initially does not qualify as a sale later qualify?

Interpretive response: Yes. In certain circumstances, one or more of the factors at the date of initial transfer that resulted in the entity determining that a transaction did not qualify for sale accounting may later cease to exist. At that time, we believe the entity should reevaluate whether the transfer of servicing rights qualifies as a sale. See Example 10.5.20.

Question 10.5.40

What does the entity consider if it finances a portion of the sale price for the transferee?

Interpretive response: If an entity finances a portion of the sale prices for the transferee, it considers whether: [860-50-40-2(c)]

- an adequate nonrefundable down payment has been received (necessary to demonstrate the transferee's commitment to pay the remaining sale price); and
- the note receivable from the transferee provides full recourse to the transferee.

If the above factors are present, the financing would not, in itself, preclude sale accounting.

Question 10.5.50

How does an entity evaluate whether protection provisions are minor and account for such minor provisions?

Excerpt from ASC 860-50

20 Glossary

Protection Provisions

Provisions in some contracts to sell or transfer mortgage servicing rights that could affect the amount ultimately paid to the transferor. For example, the transferor may agree to adjust the sales price for loan prepayments, defaults, or foreclosures that occur within a specified period of time.

> Overall

40-4 If a sale is recognized and minor protection provisions exist, a liability shall be accrued for the estimated obligation associated with those provisions. The

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seller retains only minor protection provisions if both of the following conditions are met:

a. The obligation associated with those provisions is estimated to be no more than 10 percent of the sales price.
b. Risk of prepayment is retained for no longer than 120 days.

Background: Protection provisions are provisions in contracts to sell or transfer mortgage servicing rights that could affect the amount that is ultimately paid to the transferor. For example, the transferor may agree to adjust the sale price for loan prepayments, defaults or foreclosures that occur within a specified period. [860-50 Glossary]

Interpretive response: The existence of minor protection provisions does not preclude sale accounting. Protection provisions are considered minor if: [860-50-40-4]

— the obligation associated with them is estimated to be no more than 10% of the sale price; and
— the risk of prepayment is retained for no longer than 120 days.

If the transfer of the servicing rights is accounted for as a sale and minor protection provisions exist, a liability is accrued for the estimated obligation. [860-50-40-4]

Example 10.5.10
Protection provision

Bank transfers servicing rights on previously sold mortgage loans to an unrelated entity for cash. Bank retains the responsibility for representations and warranties relating to underwriting standards on the serviced loans. Upon repurchase of the loans due to a breach of representations and warranties, Bank is obligated to repurchase the related servicing rights at a specified fixed price based on the time since the original transfer of servicing. The repurchase price for the servicing right may not be equivalent to fair value at the time of repurchase.

The above provisions are considered a form of protection for the purchaser because the servicing right may be repurchased at a predetermined price that may be greater than fair value at the time of repurchase. Therefore, Bank evaluates whether the aggregate of all protection provisions retained is less than 10% of the sale price.

Bank determines that the transfer qualifies as a sale, and therefore recognizes a recourse obligation for the estimated repurchase obligation.

Note: If the facts in the example were changed such that the provision required Bank to pay fair value for the servicing rights at the repurchase date, the recourse obligation would be zero – i.e. there would be no protection provision or recourse obligation recognized.

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Example 10.5.20

Ongoing evaluation of sale criteria

Bank transfers servicing rights to a third party and agrees to adjust the sale price for loan prepayments, defaults or foreclosures that occur within a specified period.

Bank's estimate of the obligation for the adjustment is more than 10% of the sale price and the risk of prepayment is retained for longer than 120 days. As a result, Bank may conclude the transfer does not qualify as a sale.

Once the specified time period has lapsed and the obligation is less than 10% of the sale price, Bank reevaluates whether the transfer qualifies as a sale.

Question 10.5.60

How are VA No-Bid provisions evaluated when determining if a transfer of servicing rights qualifies as a sale?

Background: A VA loan is a loan that has been guaranteed by the Department of Veterans Affairs as an incentive for loan originators to grant loans to veterans. Under the program, when foreclosure is imminent, the mortgage servicer is required to make certain notifications to the VA and to the veteran-borrower. If the VA receives notification from the servicer that the net value of the mortgaged property (appraised amount less a specified percentage) exceeds the total indebtedness (outstanding principal plus qualified expenses and uncollected interest), the VA will specify an amount that an entity must bid on the property securing the mortgage at the foreclosure sale. If the servicer is the successful bidder, the property will be conveyed to the VA.

If, on the other hand, the net value of the mortgaged property is less than its total qualified indebtedness, the VA will not specify an amount to bid at the foreclosure sale, resulting in a 'VA No-Bid'. In these cases, the VA will pay only its guaranty, which is determined based on a formula. Payment of only the guarantee amount will result in a loss to the extent the indebtedness (including foreclosure expenses) exceeds the net sale price of the property, less the VA guaranty.

To protect themselves against losses, buyers of mortgage servicing rights may include provisions in their purchase contracts calling for sellers of those mortgage servicing rights to reimburse them for future losses associated with VA loans that become 'No-Bids'. Therefore, the transferor may include a 'VA No-Bid' provision for a certain period.

Interpretive response: We believe the VA No-Bid clause is a protection provision relating to future foreclosures and not a prepayment provision. Therefore, the protection provision is evaluated to determine whether it:

- can be reasonably estimated to be no more than 10% of the sale price when included with other protection provisions; and
- is retained for less than 120 days.

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Question 10.5.70

How does an entity evaluate whether temporary subservicing is performed for a short period?

Background: The transfer of servicing rights often includes temporary subservicing performed by the transferor during the time between when a sale contract is entered into until the time the underlying financial assets are actually delivered. The transferor continues to perform servicing to allow the transition of the servicing to the transferee, including:

- the transferor preparing servicing records and loan files for delivery to the transferee;
- the transferee preparing to commence servicing the assets; and/or
- the underlying borrowers being provided notice of the change

Interpretive response: Temporary subservicing performed by the transferor for a short period does not preclude sale accounting for the servicing rights. We believe a short period is generally three to six months. Section 10.5.20 discusses the sale of servicing rights with a subservicing contract that is not for a short period. [860-50-40-5]

Question 10.5.80

How does an entity account for the transfer of servicing rights that qualify as a sale?

Excerpt from ASC 860-50

> Overall

40-6 The criteria in paragraphs 860-50-40-2 through 40-4 apply to transfers of servicing rights relating to loans previously sold and to transfers of servicing rights relating to loans that are retained by the transferor. The carrying amount of servicing rights sold relating to loans that have been retained shall be allocated at the date of sale between the servicing rights and the loans retained using relative fair values.

Interpretive response: An entity accounts for the transfer of separately recognized servicing assets or liabilities that qualifies as a sale in which it does not hold the related financial assets and does not perform subservicing as follows.

1	Recognizes (a) proceeds received (paid) and (b) a liability for any minor protection provisions.
2	Derecognizes the carrying amount of the servicing assets or liabilities sold.
3	Recognizes a gain or loss on sale for the difference between (1) and (2).

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An entity accounts for the transfer of servicing rights that qualifies as a sale in which it continues to hold the financial assets covered by the servicing rights and does not perform subservicing as follows:

1	Recognizes (a) proceeds received (paid) and (b) a liability for any minor protection provisions.
2	Allocates the carrying amount of the financial assets between the retained portion (e.g. the loans) and the servicing rights that have been sold on a relative fair value basis. Derecognizes the portion of the carrying amount that relates to the servicing rights that have been sold. [860-50-40-6]
3	Recognizes a gain or loss on sale for the difference between (1) and the amount derecognized in (2).

Example 10.5.30
Sale of servicing rights with loan retained

On January 1, Year 1, ABC Corp. originates a group of loans. On December 31, Year 1, ABC enters into an agreement to sell the servicing rights to the loans to a third party for cash of $2 million. The carrying amount of the loans is $104,000,000 and the fair value is $105,000,000, exclusive of servicing rights. ABC determines that the transfer of the servicing rights meets the criteria to be accounted for as a sale.

The following are the relative fair values.

Allocate the carrying amount (based on relative fair value)

Unit	Fair value	Relative fair value %[1]	Allocated carrying value[2]
Loans	$105,000,000	98%	$101,920,000
Servicing rights	2,000,000	2%	2,080,000
Total	**$107,000,000**	**100%**	**$104,000,000**

Notes:
1. Fair value of the unit ÷ total fair value of $107,000,000.
2. Relative fair value % for the unit × total carrying amount of $104,000,000.

ABC records the following journal entry to account for the transfer of the servicing rights.

	Debit	*Credit*
Cash	2,000,000	
Loss on sale	80,000	
Loans		2,080,000
To record transfer of servicing rights on loan retained.		

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Question 10.5.90

How does an entity account for the sale of servicing rights for participation in a future income stream?

Excerpt from ASC 860-50

> Sales of Servicing Rights for Participation in an Income Stream

40-10 The following addresses a situation in which an entity sells the right to service mortgage loans that are owned by other parties. The related mortgage loans have been previously sold, with servicing retained, in a separate transaction. Because of the ability to invest the float that results from payments received from borrowers but not yet passed to the owners of the mortgages, the mortgage servicing rights can be sold for immediate cash or for a participation in the future interest stream of the loans.

40-11 If a transfer of mortgage servicing rights qualifies as a sale under the criteria beginning in paragraph 860-50-40-2 and the sale is for a participation in the future interest income stream, gain recognition is appropriate at the sale date. There are difficulties in measuring the amount of the gain if the sales price is based on a participation in future payments and there is no specified upper limit on the computed sales price. The transferor of mortgage servicing rights shall consider all available information, including the amount of gain that would be recognized if the servicing rights were to be sold outright for a fixed cash price.

Background: An entity transfers servicing rights related to loans that it previously sold on a servicing-retained basis to a third party. Instead of receiving cash consideration, it receives a participation in the future interest income stream from the loans. [860-50-40-10]

Interpretive response: If an entity transfers servicing rights that qualify as a sale and receives a participation in future interest income, it should recognize a gain at the sale date. [860-50-40-11]

However, measuring the amount of the gain to recognize can be complex, particularly if there is no specified upper limit on the sale price. The entity considers all available information in measuring the gain, including the amount of gain that would have been recognized if the servicing rights had been sold outright for a fixed amount of cash. [860-50-40-11]

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Question 10.5.100

How does an entity account for a transfer of loans with servicing retained and a subservicing arrangement with a third party?

Excerpt from ASC 860-50

• • > Subservicing Contracts

55-10 A transferor may transfer mortgage loans in their entirety to a third party in a transfer that is accounted for as a sale and undertake an obligation to service the loans. After the transfer, the transferor enters into a subservicing arrangement with a third party.

55-11 If the transferor's benefits of servicing exceed its obligation under the subservicing contract, that differential shall not be accounted for as an interest-only strip. Rather, the transferor should account for the two transactions separately. First, the transferor should account for the transfer of mortgage loans in accordance with Subtopic 860-20. The obligation to service the loans should be initially recognized and measured at fair value according to paragraph 860-50-30-1 as proceeds obtained from the sale of the mortgage loans. Second, the transferor should account for the subcontract with the subservicer.

Background: An entity transfers loans to a third party in a transaction that is accounted for as a sale and retains the servicing rights. After the transfer of the loans, the entity enters into a contract (subservicing arrangement) with a third party to perform the servicing.

Interpretive response: If the entity's benefits of servicing exceed its obligation under the subservicing contract, the differential is not accounted for as an I/O strip. [860-50-55-11]

Instead, the entity accounts for the transfer of loans with servicing retained and the subservicing arrangement as two separate transactions. [860-50-55-10 – 55-11]

— It accounts for the transfer of loans under Subtopic 860-20. If the transfer qualifies for sale accounting, the entity derecognizes the loans transferred and recognizes any assets acquired and liabilities incurred (including any servicing asset or liability) at fair value. Chapter 7 discusses the accounting for transfers that qualify for sale accounting.

— It accounts for the subservicing contract separately.

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10.5.20 Sale of servicing rights with a subservicing contract

Excerpt from ASC 860-50

> Sales of Servicing Rights with a Subservicing Contract

40-7 A sale of mortgage servicing rights with a subservicing contract shall 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 transferee, as discussed in paragraph 860-50-40-3. Attributes of the transferee (for example, ability to perform servicing) would not be significant to the accounting for the transaction. The risks and rewards associated with a transferor performing purely administrative functions under a subservicing contract would not necessarily preclude sales treatment. A loss shall be recognized currently if the transferor determines that prepayments of the underlying mortgage loans may result in performing the future servicing at a loss.

An entity may transfer servicing rights to an unrelated entity and enter into a subservicing agreement with the transferee because the transferee does not have the facilities or does not want to perform the required servicing functions. The transferor may continue to perform the loan servicing for a fixed-dollar amount per loan that is equal to or greater than its estimated cost of servicing.

Question 10.5.110

What additional analysis is performed if subservicing is not for a short period?

Interpretive response: If the transfer of servicing rights meets the criteria in paragraphs 860-50-40-2(a) – 2(c) and 860-50-40-3 (see Question 10.5.10) but the transferor enters into a subservicing arrangement that is for longer than a short period, we believe an analysis of whether substantially all of the risks and rewards have been transferred is required to determine if the transfer is accounted for as a sale.

Question 10.5.130 discusses the accounting for a transfer accounted for as a sale when there is a subservicing arrangement that is for longer than a short period when substantially all of the risks and rewards have been transferred.

If substantially all of the risk and rewards inherent in owning the servicing rights have not been transferred, the transaction is not accounted for as a sale (see Question 10.5.120). However, the risks and rewards associated with a transferor performing purely administrative functions under a subservicing agreement do not necessarily preclude sale treatment. [860-50-40-2, 40-5, 40-7]

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Question 10.5.120

What factors are considered when determining whether substantially all of the risk and rewards have not been transferred?

Excerpt from ASC 860-50

> Sales of Servicing Rights with a Subservicing Contract

40-8 Substantially all the risks and rewards inherent in owning the mortgage servicing rights have not been transferred to the transferee and, therefore, the transaction shall be accounted for as a financing if any of the following factors are present:

a. The transferor-subservicer directly or indirectly guarantees a yield to the transferee. For example, the transferor-subservicer guarantees prepayment speeds or maximum loan default ratios to the buyer.
b. The transferor-subservicer is obligated to advance a portion or all of the servicing fees on a nonrecoverable basis to the transferee before receipt of the loan payment from the mortgagor.
c. The transferor-subservicer indemnifies the transferee for damages due to causes other than failure to perform its duties under the terms of the subservicing contract.
d. The transferor-subservicer absorbs losses on mortgage loan foreclosures not covered by the Federal Housing Administration, Department of Veterans Affairs, or other guarantors, if any, including absorption of foreclosure costs and costs of managing foreclosed property.
e. Title to the servicing rights is retained by the transferor-subservicer.

40-9 The presence of any of the following factors creates a rebuttable presumption that substantially all the risks and rewards inherent in owning the mortgage servicing rights have not been transferred to the transferee and that the transaction shall be accounted for as a financing:

a. The transferor-subservicer directly or indirectly provides financing or guarantees the transferee's financing. Nonrecourse financing, for example, would indicate that risks have not been transferred to the transferee. Topic 450 requires a guarantor to recognize, at inception of the guarantee, a liability for the obligation undertaken in issuing the guarantee.
b. The terms of the subservicing contract unduly limit the transferee's ability to exercise ownership control over the servicing rights or result in the seller's retaining some of the risks and rewards of ownership. For example, if the transferee cannot cancel or decline to renew the subservicing contract after a reasonable period of time, the transferee is precluded from exercising certain rights of ownership. Conversely, if the transferor cannot cancel the subservicing contract after a reasonable period of time, the transferor has not transferred substantially all of the risks of ownership.
c. The transferee is a special-purpose entity without substantive capital at risk.

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Excerpt from ASC 860-10

> SEC Staff Guidance

• > Comments Made by SEC Observer at Emerging Issues Task Force (EITF) Meetings

• • > SEC Observer Comment: Balance Sheet Treatment of a Sale of Mortgage Servicing Rights with a Subservicing Agreement

S99-1 The following is the text of SEC Observer Comment: Balance Sheet Treatment of a Sale of Mortgage Servicing Rights with a Subservicing Agreement.

In accordance with paragraph 860-50-40-7, a sale of mortgage servicing rights with a subservicing contract could be treated as a sale with the gain deferred if substantially all of the risks and rewards have been transferred to the transferree. In the view of the SEC staff, a transaction that, in substance, transfers only a portion of the servicing revenues does not result in transfer of substantially all of the risks and rewards of ownership and the accounting for those transactions should be guided by the guidance in paragraph 470-10-25-1.

Interpretive response: The following table provides examples of factors indicating substantially all risks and rewards have not been transferred to the buyer, including some that create a rebuttable presumption. Factors other than these examples may also indicate that an entity has not transferred substantially all risks and rewards inherent in owning the servicing rights.

Factors indicating substantially all risks and rewards have *not* been transferred [860-50-40-8]	**Factors creating a rebuttable presumption that substantially all risks and rewards have *not* been transferred [860-50-40-9]**
The transferor-subservicer guarantees (directly or indirectly) a yield to the transferee. For example, the transferor-subservicer guarantees prepayment speeds or maximum loan default ratios to the buyer.	The transferor-subservicer provides financing or guarantees the transferee's financing, either directly or indirectly. For example, nonrecourse financing indicates that risks have not been transferred to the transferee. Topic 460 (guarantees) requires a guarantor to recognize – at inception of the guarantee – a liability for the obligation undertaken in issuing the guarantee.
The transferor-subservicer is obligated to advance a portion or all of the servicing fees on a nonrecoverable basis to the transferee before receiving the loan payment from the mortgagor.	The terms of the subservicing contract unduly limit the transferee's ability to exercise ownership control over the servicing rights or result in the seller's retaining some of the risks and rewards of ownership. For example, if the transferee cannot cancel or decline to renew the subservicing contract after a reasonable

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Factors indicating substantially all risks and rewards have ***not*** been transferred [860-50-40-8]	Factors creating a rebuttable presumption that substantially all risks and rewards have ***not*** been transferred [860-50-40-9]
	period, it is precluded from exercising certain rights of ownership. On the other hand, if the transferor cannot cancel the subservicing contract after a reasonable period, it has not transferred substantially all of the risks of ownership.
The transferor-subservicer indemnifies the transferee for damages due to causes other than failure to perform its duties under the terms of the subservicing contract.	The transferee is a special-purpose entity without substantive capital at risk.
The transferor-subservicer absorbs losses on mortgage loan foreclosures not covered by guarantors (e.g. the Federal Housing Administration or VA), including absorption of foreclosure costs and costs of managing foreclosed property.	-
Title to the servicing rights is retained by the transferor-subservicer.	-

The SEC staff believes that a transaction that (in substance) transfers only a portion of the servicing revenues does not result in a transfer of substantially all of the risks and rewards of ownership. The transferor accounts for those transactions based on the guidance in paragraph 470-10-25-1 (sales of future revenues or various other measures of income). [860-10-S99-1]

Question 10.5.130

How does an entity account for the sale of servicing rights with a subservicing contract when substantially all of the risks and rewards have been transferred?

Background: A transfer of servicing rights meets the criteria in paragraphs 860-50-40-2(a) – 2(c) and 860-50-40-3. Additionally, the entity continues to perform subservicing for longer than a short period but it determines that substantially all of the risks and rewards of ownership of the servicing rights have been transferred. [860-50-40-7]

Interpretive response: In the background example, the transfer of servicing rights with a subservicing contract is treated as a sale. Accordingly, the entity derecognizes the servicing rights but defers the gain. The gain is recognized over the term of the subservicing contract. [860-50-40-7]

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If the entity (transferor) determines that prepayments of the underlying financial assets being serviced may result in performing the future servicing at a loss, it recognizes a loss in earnings. [860-50-40-7]

10.6 Presentation

10.6.10 Overview

Excerpt from ASC 860-50

45-1 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.

45-2 To accomplish that separate reporting, an entity may do either of the following:

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
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 (see paragraphs 860-50-35-9 through 35-11) and disclose parenthetically the amount that is subsequently measured at fair value that is included in the aggregate amount.

On the balance sheet, servicing assets and liabilities that are subsequently measured using the fair value measurement method are separated from those subsequently measured using the amortization method. [860-50-45-1]

This may be done in either of the following ways: [860-50-45-2]

— separate line items for the amounts subsequently measured using the fair value measurement method and amounts subsequently measured using the amortization method; or

— one line item with all amounts aggregated with parenthetical disclosure of amounts subsequently measured at fair value.

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11. Disclosures

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11.4.10 Disclosures about collateral

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Questions

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Example

11.4.10 Offsetting of reverse repurchase, repurchase, securities borrowing and securities lending agreements

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11.5 Disclosures about servicing assets and liabilities

Questions

11.5.10 What disclosures are required for all servicing assets and liabilities?

11.5.20 What disclosures are required only for servicing assets and liabilities subsequently measured at fair value?

11.5.30 What disclosures are required only for servicing assets and liabilities subsequently measured at amortized cost?

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11.1 How the standard works

The principal objectives of Topic 860's disclosure requirements are to provide financial statement users with an understanding of:

- a transferor's continuing involvement (if any) with transferred financial assets;
- the nature of restrictions on assets in a transferor's balance sheet;
- how servicing assets and liabilities are reported; and
- how a transfer of financial assets affects a transferor's balance sheet, income statement and statement of cash flows.

The specific disclosures in Topic 860 include those related to:

- sales of financial assets (see section 11.3);
- secured borrowings and collateral (see section 11.4); and
- servicing assets and liabilities (see section 11.5).

These disclosures represent the minimum requirements, and an entity may need to supplement them to achieve Topic 860's disclosure objectives.

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11.2 Disclosure objectives

11.2.10 Overview

Excerpt from ASC 860-10

• > Disclosure Objectives

50-3 The principal objectives of the disclosure requirements of this Topic are to provide financial statement users with an understanding of all of the following:

a. A transferor's **continuing involvement**, if any, with **transferred financial assets**
b. The nature of any restrictions on assets reported by an entity in its statement of financial position that relate to a transferred **financial asset**, including the carrying amounts of those assets
c. How servicing assets and servicing liabilities are reported under Subtopic 860-50
d. For both of the following, how the **transfer** of financial assets affects an entity's financial position, financial performance, and cash flows:
    1. Transfers accounted for as sales, if a transferor has continuing involvement with the transferred financial assets
    2. Transfers of financial assets accounted for as secured borrowings.

50-4 The objectives in the preceding paragraph apply regardless of whether this Topic requires specific disclosures. The specific disclosures required by this Topic are minimum requirements, and an entity may need to supplement the required disclosures depending on any of the following:

a. The facts and circumstances of a transfer
b. The nature of an entity's continuing involvement with the transferred financial assets
c. The effect of an entity's continuing involvement on the transferor's financial position, financial performance, and cash flows.

Disclosures required for a particular form of continuing involvement shall be considered when determining whether the disclosure objectives of this Topic have been met.

> Involvements by Others

50-7 To apply the disclosures required in this Topic, an entity shall consider all involvements by the transferor, its consolidated affiliates included in the financial statements being presented, or its agents to be involvements by the transferor.

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Question 11.2.10

What are the principal objectives of Topic 860's disclosure requirements?

Interpretive response: The disclosure requirements in Topic 860 are designed to meet several principal disclosure objectives. These objectives are to allow for financial statement users to understand the following.

Principal disclosure objectives [860-10-50-3]

- A transferor's continuing involvement with transferred financial assets.
- The nature of restrictions on assets an entity reports in its balance sheet related to transferred financial assets, including the carrying amounts of those assets.
- How servicing assets and servicing liabilities are reported.
- How the following types of transfers of financial assets affect the entity's balance sheet, income statement, and statement of cash flows:
  - Transfers accounted for as sales, if a transferor has continuing involvement with the transferred financial assets; and
  - Transfers of financial assets accounted for as secured borrowings.

Question 11.2.20

Is an entity required to make disclosures beyond those specified in Topic 860?

Interpretive response: It depends on whether additional disclosures are needed to satisfy Topic 860's disclosure objectives (see Question 11.2.10). Although Topic 860 includes several required disclosures, there may be circumstances when supplemental disclosures are needed to satisfy the overall objectives.

An entity evaluates the following factors when deciding whether supplemental disclosures are needed.

Additional factors to consider when determining the need to supplement the minimum required disclosures [860-10-50-4]

- The facts and circumstances of a transfer.
- The nature of an entity's continuing involvement – e.g. as servicer or as an option holder.
- The effect of an entity's continuing involvement on the transferor's financial statements – i.e. its balance sheet, income statement and statement of cash flows.

Certain types of transactions (or forms of continuing involvement) may also require specific disclosures, including disclosures required by Topics other than Topic 860. Those disclosures are considered when determining whether Topic 860's disclosure objectives have been met (see also Question 11.2.30). [860-10-50-4]

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Question 11.2.30

Does the transferor consider the continuing involvement of its consolidated affiliates and agents when providing disclosures?

Interpretive response: Yes. When making disclosures under Topic 860, an entity considers all involvements by the transferor, its consolidated affiliates included in the financial statements being presented, and/or its agents to be involvements by the transferor. [860-10-50-7]

Continuing involvement (including examples) is discussed in section 3.5.20.

11.2.20 Aggregation of disclosures

Excerpt from ASC 860-10

• > Aggregation of Certain Disclosures

50-4A Disclosures required by this Topic may be reported in the aggregate for similar transfers if separate reporting of each transfer would not provide more useful information to financial statement users. A transferor shall both:

a. Disclose how similar transfers are aggregated
b. Distinguish between transfers that are accounted for as secured borrowings and transfers that are accounted for as sales.

50-5 In determining whether to aggregate the disclosures for multiple transfers, the reporting entity shall consider quantitative and qualitative information about the characteristics of the transferred financial assets, including all of the following:

a. The nature of the transferor's continuing involvement
b. The types of financial assets transferred
c. Risks related to the transferred financial assets to which the transferor continues to be exposed after the transfer and the change in the transferor's risk profile as a result of the transfer
d. The guidance in paragraph 310-10-50-25 (for risks and uncertainties) and paragraphs 825-10-55-1 through 55-2 (for concentrations involving loan product terms).

50-6 The disclosures shall be presented in a manner that clearly and fully explains to financial statement users the transferor's risk exposure related to the transferred financial assets and any restrictions on the assets of the entity. An entity shall determine, in light of the facts and circumstances, how much detail it must provide to satisfy disclosure requirements of this Topic and how it aggregates information for assets with different risk characteristics. The entity shall strike a balance between obscuring important information as a result of too much aggregation and excessive detail that may not assist financial statement users to understand the entity's financial position. For example, an entity shall not obscure important information by including it with

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a large amount of insignificant detail. Similarly, an entity shall not disclose information that is so aggregated that it obscures important differences between the different types of involvement or associated risks.

Question 11.2.40

Can disclosures be provided on an aggregated basis for similar transfers?

Interpretive response: Yes, Topic 860 permits disclosures for similar transfers to be aggregated if separate reporting would not provide more useful information to financial statement users. If a transferor chooses to aggregate disclosures, it discloses how transfers are aggregated. [860-10-50-4A]

However, an entity cannot aggregate transfers accounted for as sales with those accounted for as secured borrowings. [860-10-50-4A]

Question 11.2.50

Does Topic 860 specify the level of aggregation or detail that is appropriate?

Interpretive response: No, Topic 860 does not specify levels of aggregation or detail that is appropriate. Instead, it requires the disclosures to provide the financial statements users with a clear and full view of the transferor's remaining exposure to risks associated with the transferred financial assets and any restrictions on the entity's assets. An entity uses its judgment in determining how to aggregate information for assets with different risk characteristics and the appropriate level of detail to provide based on its particular facts and circumstances. [860-10-50-6]

When applying its judgment in providing disclosures, an entity considers the factors summarized in the following table.

Quantitative and qualitative information about the transferred financial assets' characteristics [860-10-50-5]	**Whether important information is obscured by the level of aggregation and detail presented** [860-10-50-6]
— Nature of the transferor's continuing involvement (e.g. as servicer or as an option holder). — Classes of financial assets transferred. — Risks to which the transferor remains exposed after the transfer. — How the transferor's risk profile changed because of the transfer. — The guidance in paragraph 310-10-50-25 for risks and uncertainties and	Important information could be obscured by doing either (or both) of the following: — Over-aggregating information – e.g. aggregating at such a high level that important differences between different types of involvement or associated risks are missing. — Providing excessive detail – e.g. including important information with a large amount of insignificant detail.

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Quantitative and qualitative information about the transferred financial assets' characteristics [860-10-50-5]	Whether important information is obscured by the level of aggregation and detail presented [860-10-50-6]
paragraphs 825-10-55-1 to 55-2 for loan concentrations (excerpted below).	

Excerpt from ASC 310-10

> Risks and Uncertainties

50-25 Certain loans and trade receivables have contractual terms that expose entities to risks and uncertainties that fall into one or more categories, as discussed in paragraph 275-10-50-1. See Section 275-10-50 for disclosure guidance related to those products.

Excerpt from ASC 825-10

• > Concentrations Involving Loan Product Terms

55-1 The terms of certain loan products may increase a reporting entity's exposure to credit risk and thereby may result in a concentration of credit risk as that term is used in this Subtopic, either as an individual product type or as a group of products with similar features. Possible shared characteristics on which significant concentrations may be determined include, but are not limited to, the following:

a. Borrowers subject to significant payment increases
b. Loans with terms that permit negative amortization
c. Loans with high loan-to-value ratios.

55-2 Judgment is required to determine whether loan products have terms that give rise to a concentration of credit risk. Furthermore, an entity may disclose how underwriting procedures are designed to control the credit risk that may arise from future payment increases.

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11.3 Disclosures about transfers accounted for as sales

11.3.10 Overview

Excerpt from ASC 860-20

> All Entities within Scope of Subtopic

50-1 This Section is organized as follows:

a. Disclosures for each income statement presented
b. Disclosures for each statement of financial position presented
c. Sales of loans and trade receivables.

For overall guidance on Topic 860's disclosures, see Section 860-10-50.

50-2 Paragraphs 860-20-50-3 through 50-4 address disclosures for **securitizations**, asset-backed financing arrangements, and similar **transfers** that have both of the following characteristics:

a. The transfer is accounted for as a sale
b. The transferor has continuing involvement with the **transferred financial assets**.

Topic 860 requires an entity that has transferred financial assets in a transaction accounted for as a sale to disclose certain information for each of the situations listed in the following table. More than one situation (and the related required disclosures) may apply to an individual transaction.

Situation	See required disclosures:
Sales with continuing involvement	Section 11.3.20
Sales of loans or trade receivables	Section 11.3.30
Transfers of financial assets with agreements entered into in contemplation of those agreements	Section 11.3.40

11.3.20 Disclosures about sales with continuing involvement

Excerpt from ASC 860-20

50-2 Paragraphs 860-20-50-3 through 50-4 address disclosures for **securitizations**, asset-backed financing arrangements, and similar **transfers** that have both of the following characteristics:

a. The transfer is accounted for as a sale
b. The transferor has continuing involvement with the **transferred financial assets**.

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50-2A If specific disclosures are required for a particular form of a transferor's continuing involvement by other Topics, the transferor shall provide the information required in paragraphs 860-20-50-3(b) through (cc) and 860-20-50-4(a) with a cross-reference to the separate notes to financial statements so a financial statement user can understand the risks retained in the transfer. The entity does not need to provide each specific disclosure required in paragraphs 860-20-50-3(d) and 860-20-50-4 if the disclosure is not required by other Topics and the objectives of paragraphs 860-10-50-3 through 50-4 are met. For example, if the transferor's only form of continuing involvement is a derivative, the entity shall provide the disclosures required in paragraphs 860-20-50-3(b) through (cc) and 860-20-50-4(a) and the disclosures about derivatives required by applicable Topics. In addition, the entity shall evaluate whether the other disclosures in paragraphs 860-20-50-3 through 50-4 are necessary for the entity to meet the objectives in those paragraphs.

Topic 860 requires specific disclosures about transfers of financial assets that are accounted for as sales if the transferor has continuing involvement with the transferred assets (referred to in this section as 'sales with continuing involvement').

Examples of transfers that typically represent sales with continuing involvement include those involving securitizations, asset-backed financing arrangements and similar transfers. See examples of continuing involvement in Question 3.5.50.

The required disclosures about sales with continuing involvement are organized as follows.

Periods/dates for which disclosure required	See required disclosures:	See additional guidance:
Each income statement presented	Question 11.3.10	Question 11.3.20
Each balance sheet presented	Question 11.3.30	Questions 11.3.40 and 11.3.50

Question 11.3.10

What specific disclosures are required for each income statement presented about a sale with continuing involvement?

Excerpt from ASC 860-20

• > Disclosures for Each Income Statement Presented

50-3 For each income statement presented, the entity shall disclose all of the following: …

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b. The characteristics of the **transfer** including all of the following:

   1. A description of the transferor's **continuing involvement** with the transferred financial assets
   2. The nature and initial fair value of both of the following:

      i. The asset obtained as proceeds
      ii. The liabilities incurred in the transfer.

   3. The gain or loss from sale of transferred financial assets.

bb. For the initial fair value measurements in item (b)(2), the level within the fair value hierarchy in Topic 820 in which the fair value measurements fall, segregating fair value measurements using each of the following:

   1. Quoted prices in active markets for identical assets or liabilities (Level 1)
   2. Significant other observable inputs (Level 2)
   3. Significant unobservable inputs (Level 3).

c. For the initial fair value measurements in item (b)(2), the key inputs and assumptions used in measuring the fair value of assets obtained and liabilities incurred as a result of the sale that relate to the transferor's continuing involvement, including quantitative information about all of the following:

   1. Discount rates.
   2. Expected prepayments including the expected weighted-average life of prepayable financial assets. 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.
   3. Anticipated credit losses, including expected static pool losses.

   If an entity has aggregated transfers during a period in accordance with the guidance beginning in paragraph 860-10-50-5, it may disclose the range of assumptions.

cc. For the initial fair value measurements in item (b)(2), the valuation technique(s) used to measure fair value.

d. Cash flows between a transferor and transferee, including all of the following:

   1. **Proceeds** from new transfers
   2. Proceeds from collections reinvested in revolving-period transfers
   3. Purchases of previously transferred financial assets
   4. Servicing fees
   5. Cash flows received from a transferor's interests.

Interpretive response: An entity discloses the following information for each income statement presented.

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Characteristics of the transfer[1] [860-20-50-3(b)]	The characteristics of the transfer, including the following. — Description of the transferor's continuing involvement with the transferred financial assets. — Nature and initial fair value of both the assets obtained and the liabilities incurred in the transfer. — Gain or loss from the sale.
Initial fair value of assets obtained as proceeds and liabilities incurred in the transfer[1] [860-20-50-3(bb) – 50-3(cc)]	— Level within Topic 820's fair value hierarchy of each measurement, separated by level. — Key inputs and assumptions used in measuring the initial fair value, including quantitative information about all of the following (a range can be provided for aggregated disclosures): – discount rates – expected prepayments, including the weighted-average life of prepayable financial assets[2] – anticipated credit losses, including expected losses on static pools. — Valuation technique(s) used to measure the initial fair value. For guidance on fair value measurement, see KPMG Handbook, Fair value measurement.
Cash flows between a transferor and transferee[3] [860-20-50-3(d)]	All cash flows between a transferee and transferor, including the following. — Proceeds from additional transfers. — Reinvested proceeds from revolving-period transfers. — Purchases of financial assets previously transferred. — Servicing fees. — Cash flows from a transferor's interests.

Notes:

1. These disclosures include a cross-reference to any specific disclosures for a particular form of continuing involvement that are required by Topics other than Topic 860. [860-20-50-2A]
2. The weighted-average life of prepayable assets in periods (e.g. 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. [860-20-50-3(c)(2)]
3. An entity is not required to provide each specific disclosure if: [860-20-50-2A]
   – the disclosure is not required by other Topics; and
   – Topic 860's principal objectives are met by other disclosures (see section 11.2.10).

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Question 11.3.20

Are the disclosures for each income statement about a sale with continuing involvement made for all periods with a transfer under a revolving-period securitization?

Interpretive response: Yes, if the transfer is accounted for as a sale and the transferor has continuing involvement with the transferred assets. In revolving-period securitizations, receivables are transferred at inception of the securitization and at various periods throughout a specified reinvestment period (see Question 9.2.60).

When transfers are made in multiple periods, certain of Topic 860's disclosures for each income statement are required for each period in which a transfer is made. For example, gains and losses resulting from both the initial transfer and subsequent transfers during the revolving period are disclosed for each income statement presented. [860-20-50-3(b)(3)]

Question 11.3.30

What specific disclosures about a sale with continuing involvement are required for each balance sheet presented?

Excerpt from ASC 860-20

• > Disclosures for Each Statement of Financial Position Presented

50-4 For each statement of financial position presented, regardless of when the transfer occurred, an entity shall disclose all of the following:

a. Qualitative and quantitative information about the transferor's continuing involvement with transferred financial assets that provides financial statement users with sufficient information to assess the reasons for the continuing involvement and the risks related to the transferred financial assets to which the transferor continues to be exposed after the transfer and the extent that the transferor's risk profile has changed as a result of the transfer (including, but not limited to, credit risk, interest rate risk, and other risks), including all of the following:

    1. The total principal amount outstanding
    2. The amount that has been derecognized
    3. The amount that continues to be recognized in the statement of financial position
    4. The terms of any arrangements that could require the transferor to provide financial support (for example, liquidity arrangements and obligations to purchase assets) to the transferee or its beneficial interest holders, including both of the following:

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i. A description of any events or circumstances that could expose the transferor to loss
ii. The amount of the maximum exposure to loss.

5. Whether the transferor has provided financial or other support during the periods presented that it was not previously contractually required to provide to the transferee or its beneficial interest holders, including—when the transferor assisted the transferee or its beneficial interest holders in obtaining support—both of the following:

i. The type and amount of support
ii. The primary reasons for providing the support.

An entity also is encouraged to disclose information about any liquidity arrangements, guarantees, or other commitments by third parties related to the transferred financial assets that may affect the fair value or risk of the related transferor's interest.

aa. The entity's accounting policies for subsequently measuring assets or liabilities that relate to the continuing involvement with the transferred financial assets.
b. The key inputs and assumptions used in measuring the fair value of assets or liabilities that relate to the transferor's continuing involvement including, at a minimum, but not limited to, quantitative information about all of the following:

1. Discount rates
2. Expected prepayments including the expected weighted-average life of prepayable financial assets (see paragraph 860-20-50-3(c)(2))
3. Anticipated credit losses, including expected static pool losses, if applicable. 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.

If an entity has aggregated transfers during a period in accordance with the guidance beginning in paragraph 860-10-50-5, it may disclose the range of assumptions.
c. For the transferor's interest in the transferred financial assets, 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 item (b) of this paragraph independently from any change in another key assumption.
d. A description of the objectives, methodology, and limitations of the sensitivity analysis or stress test.
e. Information about the asset quality of transferred financial assets and any other financial assets that it manages together with them. This information shall be separated between assets that have been derecognized and assets that continue to be recognized in the statement of financial position. This information is intended to provide financial statement users with an understanding of the risks inherent in the transferred financial assets as well as in other financial assets and liabilities that it manages together with transferred financial assets. For example, information for receivables shall include, but is not limited to both of the following: …

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4. Delinquencies at the end of the period
5. Credit losses, net of recoveries, during the period.

Interpretive response: An entity discloses the information in the following table for each balance sheet presented regardless of when the transfer occurred. However, an entity is not required to provide each specific disclosure if the following conditions are met: [860-20-50-2A, 50-4]

— the disclosure is not required by other Topics; and
— Topic 860's principal objectives are met by other disclosures (see section 11.2.10).

Quantitative and qualitative information about the transferor's continuing involvement[1] [860-20-50-4(a)]	Information that provides financial statement users the ability to assess the reasons for the continuing involvement, the risks to which the transferor remains exposed, and the extent that the transferor's risk profile changed as a result of the transfer (including credit, interest rate and other risks). All of the following are disclosed: — Total principal outstanding. — Amount that has been derecognized. — Amount remaining on the balance sheet. — Terms of any arrangements that could require the transferor to provide financial support (e.g. liquidity arrangements or obligations to purchase assets) to the transferee (or its beneficial interest holders), including: – Description of any events and/or circumstances that could expose the transferor to loss. – Maximum amount of exposure to loss. — Whether the transferor provided the transferee or beneficial interest holders with financial or other support (or assisted the transferee or beneficial interest holders in obtaining support) that was not contractually required. If so, entities are: – **Required to disclose** (1) the type and amount of support and (2) the principal reasons for the support. – **Encouraged to disclose** information about third parties who provide liquidity arrangements, guarantees or other commitments that may impact the fair value or risk of the transferor's interest.
Accounting policies [860-20-50-4(aa)]	Entity's accounting policies for subsequently measuring assets or liabilities that relate to the continuing involvement with the transferred financial assets.
Fair value – key assumptions and inputs [860-20-50-4(b)]	Key inputs and assumptions used in measuring the fair value of assets and liabilities that relate to the transferor's continuing involvement, including quantitative information about all of the following. (A range can be provided for aggregated disclosures.)

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	— Discount rates. — Expected prepayments including the weighted-average life of prepayable financial assets.[2] — Anticipated credit losses, including expected static pool losses, if applicable.[3]
Sensitivity analysis or stress testing [860-20-50-4(c) – 50-4(d)]	— Sensitivity analysis or stress test showing the hypothetical effect on the fair value of the transferor's interest in the transferred financial assets (including any servicing assets or servicing liabilities) of at least two unfavorable variations from the expected levels of each key assumption independently from any change in another key assumption. — Description of the objectives, methodology and limitations of the sensitivity analysis or stress test.
Asset quality information [860-20-50-4(e)]	Asset quality information about the transferred financial assets and any other financial assets with which they are managed by the entity. This information is separated between derecognized assets and assets that continue to be recognized. The objective of this requirement is to provide an understanding of the risks inherent in both the transferred assets and the other assets with which they are managed. As an example, for receivables, the asset quality information to be disclosed includes (see also Question 11.3.40): — Delinquencies at period-end. — Credit losses, net of recoveries, during the period.

Notes:

1. These disclosures include a cross-reference to any specific disclosures for a particular form of continuing involvement that are required by Topics other than Topic 860. [860-20-50-2A]
2. The weighted-average life of prepayable assets in periods (e.g. 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. [860-20-50-3(c)(2)]
3. Topic 860 permits (but does not require) expected static pool losses to be calculated by summing the actual and projected future credit losses and dividing the sum by the original balance of the pool of assets. [860-20-50-4(b)(3)]

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Question 11.3.40

How does Topic 860 define 'delinquencies' and 'credit losses' for disclosures about asset quality information?

Interpretive response: Topic 860 requires disclosing information about 'delinquencies' and 'credit losses, net of recoveries' when disclosing asset quality information for receivables (see Question 11.3.30). However, there is no definitional guidance for those terms.

We believe an entity should disclose delinquencies and credit losses based on its existing servicing policies and procedures. It should also disclose the servicing policy that establishes the criteria for determining delinquencies and credit losses.

Question 11.3.50

Does Topic 860 specify the amount of hypothetical changes to be assumed when making sensitivity analysis or stress test disclosures?

Interpretive response: No. Topic 860's sensitivity analysis or stress test disclosures require an entity to show the hypothetical effect on the fair value of the transferor's interest in the transferred financial assets of at least two unfavorable (i.e. adverse) variations from the expected levels of each key assumption. However, they do not provide guidance on the amount of those two unfavorable variations (see Question 11.3.30).

We believe the disclosures should provide investors with transparent information to determine the pro forma effects of a change in market conditions on the other interests that continue to be held by the transferor in securitized assets.

We believe it is acceptable to select hypothetical changes in assumptions as described below.

- **1st adverse change: hypothetical change reflecting reasonably possible near-term changes.** We believe this should generally be at least a 10% adverse change. This is appropriate based on analogy to guidance for disclosing sensitivity analysis under FRR 48. That guidance requires SEC registrants to assume a change in market rates or prices of not less than 10% absent economic justification to the contrary.
- **2nd adverse change: hypothetical change reflecting significant deviation from those year-end market assumptions that are possible** (but not expected) to occur; sometimes referred to as 'outlier assumptions'. This assumption should be sufficiently more pessimistic than the 1st adverse change to illustrate whether that the 2nd adverse change assumption has a linear relationship to the 1st. We believe that this more pessimistic shock (i.e. the 2nd adverse change) should be at least a 20%

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adverse change if an entity uses a 10% adverse change for the 1st adverse change. [2000 AICPA Conf]

Example 11.3.10
Disclosure about sensitivity of key assumptions and inputs

This example illustrates one approach for satisfying the 'sensitivity analysis or stress test' disclosures listed in Question 11.3.30.

Sensitivity of key economic assumptions used in valuing available-for-sale debt securities received as proceeds from transfers of financial assets

(Dollars in millions)

	December 31, Year 2	December 31, Year 1
Carrying amount / Fair value	$XX,XXX	$XX,XXX
Weighted-average life (in years)	X.X	X.X
Discount rate assumption	X.X%	X.X%
Impact on fair value of 10% adverse change	$ XXX	$ XXX
Impact on fair value of 20% adverse change	$ XXX	$ XXX
Prepayment speed assumption	X.X%	X.X%
Impact on fair value of 10% adverse change	$ XXX	$ XXX
Impact on fair value of 20% adverse change	$ XXX	$ XXX
Credit loss assumption	X.X%	X.X%
Impact on fair value of 10% adverse change	$ XXX	$ XXX
Impact on fair value of 20% adverse change	$ XXX	$ XXX

These sensitivities are hypothetical and should be used with caution. As indicated by the figures, changes in fair value based on a given 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.

For purposes of this disclosure, the effect of a variation in a particular assumption on fair value is calculated without changing any other assumption. In reality, changes in one factor may result in changes in another – e.g. increases in market interest rates may result in lower prepayments and increased credit losses – which may magnify or counteract the sensitivities.

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11.3.30 Disclosures about sales of loans or trade receivables

Question 11.3.60

What disclosures are required about a transfer that is a sale of loans or trade receivables?

Excerpt from ASC 860-20

• > Sales of Loans and Trade Receivables

50-5 The aggregate amount of gains or losses on sales of loans or trade receivables (including adjustments to record loans held for sale at the lower of amortized cost basis or fair value) shall be presented separately in the financial statements or disclosed in the notes to financial statements. See Topic 310 on receivables and Topic 326 on measurement of credit losses for a full discussion of disclosure requirements for loans and trade receivables.

Interpretive response: An entity discloses the aggregate amount of gains or losses on the sales (including adjustments to record loans held for sale at the lower of amortized cost or fair value). This disclosure may be made through either: [860-20-50-5]

— separate presentation in the income statement; or
— disclosure in the notes to the financial statements.

As discussed in Question 7.2.50, a transferor must disclose its accounting policy for classifying gains and losses on the sale of financial assets.

11.3.40 Disclosures about transfers of financial assets with agreements entered into in contemplation of those transfers

Question 11.3.70

What are the characteristics of a transfer of financial assets with an agreement entered into in contemplation of the initial transfer for which specific disclosures are required?

Excerpt from ASC 860-20

50-4A The disclosure requirement in paragraph 860-20-50-4D applies to transactions accounted for as a sale that comprise both of the following:

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a. A transfer of financial assets to a transferee
b. An agreement entered into in contemplation of the initial transfer with the transferee that results in the transferor retaining substantially all of the exposure to the economic return on the transferred financial asset throughout the term of the transaction. For purposes of this paragraph, an agreement entered into in contemplation of the initial transfer refers to transactions that depend on the execution of one another and that are entered into for the same business purpose.

50-4B The transactions described in paragraph 860-20-50-4A include both of the following types:

a. Transfers of financial assets with an agreement to repurchase the transferred financial asset (or a substantially-the-same financial asset) before maturity at a fixed or determinable price that will be settled in a form other than the return of the transferred financial asset (for example, the transaction is cash-settled)
b. Transfers of financial assets with an agreement that requires that the transferor retain substantially all of the exposure to the economic return on the transferred financial asset (for example, a sale with a total return swap).

Interpretive response: As detailed in Question 11.3.90, Topic 860 includes specific disclosure requirements for transactions accounted for as sales that have both of the following characteristics: [860-20-50-4A]

— a transfer of financial assets to a transferee; and

— the transferor retains exposure to substantially all of the economic return on the transferred financial assets throughout the transaction's term through an agreement entered into in contemplation of the initial transfer. The phrase 'agreement entered into in contemplation of the initial transfer' refers to two or more transactions that:

  – depend on execution of one another; and
  – are entered into for the same business purpose.

The types of transfers that have both of these characteristics include the following. [860-20-50-4B]

— A transfer of financial assets with an agreement to repurchase the transferred financial assets (or financial assets that are substantially the same) before maturity at a fixed or determinable price that is settled in cash or in another form other than the return of the transferred financial assets. An example is a cash-settled repurchase agreement.

— A transfer of financial assets with an agreement that requires the transferor to retain substantially all exposure to the transferred financial asset's economic return. An example is a sale with a total return swap.

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Question 11.3.80

What transactions are not subject to the disclosures about transfers of financial assets with agreements entered into in contemplation of those transfers?

Excerpt from ASC 860-20

50-4C The following items are not subject to the requirements in paragraph 860-20-50-4D:

a. Transfers of financial assets with an agreement to purchase another financial asset that is not substantially the same as the initial transferred financial asset in accordance with paragraph 860-10-40-24(a), for example, a dollar roll transaction accounted for as a sale because the financial asset to be purchased is not substantially the same as the initially transferred financial asset in accordance with paragraph 860-10-40-24(a)
b. Transactions described in paragraph 860-20-50-2 that are subject to the disclosures in paragraphs 860-20-50-3 through 50-4.

Interpretive response: The following transactions are not subject to those disclosure requirements. [860-20-50-4C]

— A transfer of financial assets with an agreement to purchase another financial asset that is not substantially the same as the initial transferred financial asset. An example is a dollar roll transaction accounted for as a sale because the asset to be repurchased is not substantially the same as the initially transferred asset.

— A transfer accounted for as a sale with continuing involvement that is subject to the specific disclosures in section 11.3.20.

Question 11.3.90

What are the required disclosures about transfers of financial assets with an agreement entered into in contemplation of the initial transfer?

Excerpt from ASC 860-20

50-4D To provide an understanding of the nature of the transactions, the transferor's continuing exposure to the transferred financial assets, and the presentation of the components of the transaction in the financial statements, an entity shall disclose the following for outstanding transactions at the reporting date that meet the scope guidance in paragraphs 860-20-50-4A through 50-4B by type of transaction (for example, **repurchase agreement**, securities lending transaction, and sale and total return swap) (except for those

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transactions that are excluded from the scope, as described in paragraph 860-20-50-4C):

a. The carrying amount of assets derecognized as of the date of derecognition:

    1. If the amounts that have been derecognized have changed significantly from the amounts that have been derecognized in prior periods or are not representative of the activity throughout the period, a discussion of the reasons for the change shall be disclosed.

b. The amount of gross cash proceeds received by the transferor for the assets derecognized as of the date of derecognition.
c. Information about the transferor's ongoing exposure to the economic return on the transferred financial assets:

    1. As of the reporting date, the fair value of assets derecognized by the transferor.
    2. Amounts reported in the statement of financial position arising from the transaction (for example, the carrying value or fair value of forward repurchase agreements or swap contracts). To the extent that those amounts are captured in the derivative disclosures presented in accordance with paragraph 815-10-50-4B, an entity shall provide a cross-reference to the appropriate line item in that disclosure.
    3. A description of the arrangements that result in the transferor retaining substantially all of the exposure to the economic return on the transferred financial assets and the risks related to those arrangements.

Interpretive response: For the transactions that meet the characteristics described in Question 11.3.80, the disclosures in the following table are required to provide the users of the financial statements with: [860-20-50-4D]

— an understanding of the nature of the transactions;
— the transferor's continuing exposure to the transferred financial assets; and
— the presentation of the transaction's components in the financial statements.

The disclosures are required to be made by transaction type – e.g. repurchase agreement, securities lending transaction, or sale and total return swap. [860-20-50-4D]

Disclosures as of derecognition date	Disclosures as of reporting date
— Carrying amount of assets derecognized. – When those amounts have changed significantly compared to prior periods or are not representative of the activity throughout the period, an entity also discloses the reasons for the change.	The following information about the transferor's continuing exposure to the economic return of the transferred financial assets — Fair value of assets derecognized. — Amounts reported in the balance sheet arising from the transaction – e.g. the carrying value or fair value of forward repurchase agreements or swap contracts.[1]

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Disclosures as of derecognition date	Disclosures as of reporting date
— Gross cash proceeds received by the transferor in exchange for the assets derecognized.	— Description of the arrangements (and the related risks) that result in the transferor retaining exposure to substantially all of the economic return of the transferred assets.
Note: 1. To the extent these amounts are captured in disclosures required by paragraph 815-10-50-4B (derivatives and hedging), this disclosure provides a cross-reference to the appropriate line item in that disclosure.	

Subtopic 860-20's Example 11 (reproduced below) illustrates the disclosure requirements for transfers of financial assets entered into in contemplation of the transfer.

Excerpt from ASC 860-20

• > Example 11: Disclosure of Certain Transfers of Financial Assets Accounted for as Sales with Agreements That Result in the Transferor Retaining Substantially All of the Exposure to the Economic Return on the Transferred Financial Asset

55-108 This Example illustrates one approach for satisfying the quantitative disclosure requirements in paragraph 860-20-50-4D.

Transfers of Financial Assets Accounted for as Sales
(Dollars in millions)

	At the Date of Derecognition for Transactions Outstanding		At the Reporting Date		
Type of Transaction	**Carrying Amount Derecognized**	**Gross Cash Proceeds Received for Assets Derecognized**	**Fair Value of Transferred Assets**	**Gross Derivative Assets Recorded [a] [b]**	**Gross Derivative Liabilities Recorded [a] [b]**
Repurchase agreements	$ XX	$ XX	$ XX	$ XX	XX
Sale and a total return swap	XX	XX	XX	XX	XX
Securities lending	XX	XX	XX	XX	XX
Total	$ XX	$ XX	$ XX	$ XX	XX

(a) Balances are presented on a gross basis, before the application of counterparty and cash collateral offsetting.
(b) $XX of gross derivative assets and $XX of gross derivative liabilities are included as interest rate contracts in note X on derivative disclosures. $XX of gross derivative assets and $XX of gross derivative liabilities are included as credit risk contracts in note X on derivative disclosures.

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11.4 Disclosures about transfers accounted for as secured borrowings and collateral

11.4.10 Disclosures about collateral

Question 11.4.10

What disclosures are required for collateral related to transfers accounted for as secured borrowings?

Excerpt from ASC 860-30

50-1A An entity shall disclose all of the following for **collateral**:

a. If the entity has entered into **repurchase agreements** or securities lending transactions, it shall disclose its policy for requiring collateral or other security.
b. As of the date of the latest statement of financial position presented, both of the following:
    1. The carrying amount and classifications of both of the following:
        i. Any assets pledged as collateral that are not reclassified and separately reported in the statement of financial position in accordance with paragraph 860-30-25-5(a)
        ii. Associated liabilities.
    2. Qualitative information about the relationship(s) between those assets and associated liabilities; for example, if assets are restricted solely to satisfy a specific obligation, a description of the nature of restrictions placed on those assets.
c. If the entity has accepted collateral that it is permitted by contract or custom to sell or repledge, it shall disclose all of the following:
    1. The fair value as of the date of each statement of financial position presented of that collateral
    2. The fair value as of the date of each statement of financial position presented of the portion of that collateral that it has sold or repledged
    3. Information about the sources and uses of that collateral.

For overall guidance on Topic 860's disclosures, see Section 860-10-50.

Interpretive response: An entity provides the following disclosures for collateral. [860-30-50-1A]

Scenario	Required disclosures
Entity (whether transferor or transferee) has entered into repurchase	Policy for requiring collateral or other security.

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Scenario	Required disclosures
agreements or securities lending transactions	
Transferor that has **not** reclassified and separately reported transferred financial assets pledged because the transferee does not have the right (by contract or custom) to sell or repledge the collateral (see Question 8.3.20)	As of the date of the latest balance sheet presented: — Carrying amount and classifications of any assets pledged as collateral and associated liabilities. — Qualitative information about the relationship(s) between those assets and associated liabilities – e.g. if assets are restricted solely to satisfy a specific obligation, a description of the nature of restrictions placed on those assets.
Transferee that has accepted collateral that it is permitted by contract or custom to sell or repledge	— As of the date of each balance sheet presented: – Fair value of that collateral. – Fair value of the portion of that collateral that the entity has sold or repledged. — Information about the sources and uses of that collateral.

Question 11.4.20

What disclosures are required for SEC registrants with assets subject to lien?

Excerpt from S-X Rule 4-08

General notes to financial statements

If applicable to the person for which the financial statements are filed, the following shall be set forth on the face of the appropriate statement or in appropriately captioned notes. The information shall be provided for each statement required to be filed, except that the information required by paragraphs (b), (c), (d), (e) and (f) of this section shall be provided as of the most recent audited balance sheet being filed and for paragraph (j) of this section as specified therein. When specific statements are presented separately, the pertinent notes shall accompany such statements unless cross-referencing is appropriate. …

d. *Assets subject to lien*. Assets mortgaged, pledged, or otherwise subject to lien, and the approximate amounts thereof, shall be designated and the obligations collateralized briefly identified.

Interpretive response: An SEC registrant discloses assets mortgaged, pledged or otherwise subject to lien, and the approximate amounts associated, along with the collateralized obligations. [S-X Rule 4-08(b)]

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11.4.20 Disclosures about repurchase agreements, securities lending transactions, and repurchase-to-maturity transactions

Excerpt from ASC 860-30

> Disclosures for Repurchase Agreements, Securities Lending Transactions, and Repurchase-to-Maturity Transactions

50-7 To provide an understanding of the nature and risks of short-term collateralized financing obtained through **repurchase agreements**, securities lending transactions, and **repurchase-to maturity transactions**, that are accounted for as secured borrowings at the reporting date, an entity shall disclose the following information for each interim and annual period about the collateral pledged and the associated risks to which the transferor continues to be exposed after the transfer:

a. A disaggregation of the gross obligation by the class of collateral pledged. An entity shall determine the appropriate level of disaggregation and classes to be presented on the basis of the nature, characteristics, and risks of the collateral pledged.

    1. Total borrowings under those agreements shall be reconciled to the amount of the gross liability for repurchase agreements and securities lending transactions disclosed in accordance with paragraph 210-20-50-3(a) before any adjustments for offsetting. Any difference between the amount of the gross obligation disclosed under this paragraph and the amount disclosed in accordance with paragraph 210-20-50-3(a) shall be presented as reconciling item(s).

b. The remaining contractual maturity of the repurchase agreements, securities lending transactions, and repurchase-to-maturity transactions. An entity shall use judgment to determine an appropriate range of maturity intervals that would convey an understanding of the overall maturity profile of the entity's financing agreements.

c. A discussion of the potential risks associated with the agreements and related collateral pledged, including obligations arising from a decline in the fair value of the collateral pledged and how those risks are managed.

Pending Content

Transition Date: (P) June 30, 2027; (N) June 30, 2027 | Transition Guidance: 105-10-65-7

> Disclosures for Repurchase Agreements, Securities Lending Transactions, and Repurchase-to-Maturity Transactions

50-7 …

d. For a **public business entity**, the weighted-average interest rate of the repurchase liability and the related repurchase liability.

50-8 A reporting entity also shall disclose the information required by paragraphs 210-20-50-1 through 50-6 for both of the following that are either

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offset in accordance with Section 210-20-45 or subject to an enforceable master netting arrangement or similar agreement:

a. Recognized **repurchase agreements accounted for as a collateralized borrowing** and **reverse repurchase agreements accounted for as a collateralized borrowing**
b. Recognized securities borrowing and securities lending transactions.

Pending Content

Transition Date: (P) June 30, 2027; (N) June 30, 2027 | Transition Guidance: 105-10-65-7

> Disclosures for Counterparty Risk for Repurchase Agreements, Securities Lending Transactions, and Repurchase-to-Maturity Transactions

50-9 If as of the date of the most recent statement of financial position the amount at risk under repurchase agreements or the amount at risk under reverse repurchase agreements with any individual counterparty or group of related counterparties exceeds 10 percent of stockholders' equity, an entity shall disclose the name(s) of those counterparties or group of related counterparties, the amount at risk with each, and the weighted-average maturity of the repurchase agreements or reverse repurchase agreements with each.

50-10 As used in this Subtopic, the amount at risk under repurchase agreements is the excess of the carrying amount (or market value, if higher than the carrying amount or if there is no carrying amount) of the securities or other assets sold under agreement to repurchase, including accrued interest plus any cash or other assets on deposit to secure the repurchase obligation, over the amount of the repurchase liability (adjusted for accrued interest).

50-11 As used in this Subtopic, the amount at risk under reverse repurchase agreements is the excess of the carrying amount of the reverse repurchase agreements over the market value of assets delivered in accordance with the agreements by the counterparty to an entity (or to a third-party agent that has affirmatively agreed to act on behalf of the entity) and not returned to the counterparty, except in exchange for their approximate market value in a separate transaction.

50-12 If the aggregate carrying amount of reverse repurchase agreements exceeds 10 percent of total assets as described in paragraph 860-30-45-2A, an entity shall disclose whether there are any provisions to ensure that the market value of the underlying assets remains sufficient to protect the entity in the event that the counterparty defaults and, if so, the nature of those provisions.

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Excerpt from ASC 210-20

> Offsetting of Derivatives, Repurchase Agreements, and Securities Lending Transactions

50-2 An entity shall disclose information to enable users of its financial statements to evaluate the effect or potential effect of netting arrangements on its financial position for recognized assets and liabilities within the scope of the preceding paragraph. This includes the effect or potential effect of **rights of setoff** associated with an entity's recognized assets and recognized liabilities that are in the scope of the preceding paragraph.

50-3 To meet the objective in the preceding paragraph, an entity shall disclose at the end of the reporting period the following quantitative information separately for assets and liabilities that are within the scope of paragraph 210-20-50-1:

a. The gross amounts of those recognized assets and those recognized liabilities
b. The amounts offset in accordance with the guidance in Sections 210-20-45 and 815-10-45 to determine the net amounts presented in the statement of financial position
c. The net amounts presented in the statement of financial position
d. The amounts subject to an enforceable master netting arrangement or similar agreement not otherwise included in (b):
    1. The amounts related to recognized financial instruments and other derivative instruments that either:
        i. Management makes an accounting policy election not to offset.
        ii. Do not meet some or all of the guidance in either Section 210-20-45 or Section 815-10-45.
    2. The amounts related to financial collateral (including cash collateral).
e. The net amount after deducting the amounts in (d) from the amounts in (c).

50-4 The information required by the preceding paragraph shall be presented in a tabular format, separately for assets and liabilities, unless another format is more appropriate. The total amount disclosed in accordance with paragraph 210-20-50-3(d) for an instrument shall not exceed the amount disclosed in accordance with paragraph 210-20-50-3(c) for that instrument.

50-5 An entity shall provide a description of the rights of setoff associated with an entity's recognized assets and recognized liabilities subject to an enforceable master netting arrangement or similar agreement disclosed in accordance with paragraph 210-20-50-3(d), including the nature of those rights.

50-6 If the information required by paragraphs 210-20-50-1 through 50-5 is disclosed in more than a single note to the financial statements, an entity shall cross-reference between those notes.

When an entity has entered into repurchase agreements, securities lending transactions or repurchase-to-maturity transactions that are accounted for as

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secured borrowings, it must meet two disclosure objectives specific to these types of agreements and transactions (i.e. incremental to the objectives in section 11.2):

— **First objective.** Provide an understanding of the nature and risks of those agreements and transactions. [860-30-50-7]

— **Second objective.** Provide information about those agreements and transactions to enable financial statements users to evaluate the (potential) effect of related netting arrangements on its balance sheet, including the (potential) effect of rights of setoff. [210-20-50-2]

Question 11.4.30

What disclosures are required to provide an understanding of the nature and risks of repurchase agreements and securities lending transactions?

Interpretive response: To meet the first objective, the disclosures in the following table are made for each interim and annual period about the collateral pledged and the associated risks to which the transferor continues to be exposed after the transfer.

Required disclosure	Additional guidance
A disaggregation of the gross obligation by the class of collateral pledged. [860-30-50-7(a)]	— An entity determines the appropriate level of disaggregation and classes to be presented on the basis of the nature, characteristics and risks of the collateral pledged. [860-30-50-7(a)] — Total borrowings under those agreements are reconciled to the amount of the gross liability for repurchase agreements and securities lending transactions disclosed under paragraph 210-20-50-3(a) (see Question 11.4.40) before any adjustments for offsetting; any such difference is presented as reconciling item(s). [860-30-50-7(a)(1)]
The remaining contractual maturity. [860-30-50-7(b)]	An entity uses judgment to determine an appropriate range of maturity intervals that convey an understanding of the overall maturity profile of its financing agreements. [860-30-50-7(b)]
A discussion of the potential risks associated with the agreements and related collateral pledged [860-30-50-7(c)]	An entity's disclosure includes: [860-30-50-7(c)] — Obligations arising from a decline in the fair value of the collateral pledged. — How those risks are managed.

Subtopic 860-30's Example 2 (reproduced below) illustrates these disclosures.

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Excerpt from ASC 860-30

• > Example 2: Disclosures for Repurchase Agreements, Securities Lending Transactions, and Repurchase-to-Maturity Transactions Accounted for as Secured Borrowings

55-4 This Example illustrates one approach for satisfying the quantitative disclosure requirements in paragraph 860-30-50-7.

Repurchase Agreements, Securities Lending Transactions, and Repurchase-to-Maturity Transactions Accounted for as Secured Borrowings
(Dollars in millions)

	20XX				
	Remaining Contractual Maturity of the Agreements				
	Overnight and Continuous	Up to 30 days	30-90 days	Greater Than 90 days	Total
Repurchase agreements and repurchase-to maturity transactions					
U.S. Treasury and agency securities	XXX	$ XXX	XXX	$ XXX	$ XXX
State and municipal securities	XXX	XXX	XXX	XXX	XXX
Asset-backed securities	XXX	XXX	XXX	XXX	XXX
Corporate securities	XXX	XXX	XXX	XXX	XXX
Equity securities	XXX	XXX	XXX	XXX	XXX
Non-U.S. sovereign debt	XXX	XXX	XXX	XXX	XXX
Loans	XXX	XXX	XXX	XXX	XXX
Other	XXX	XXX	XXX	XXX	XXX
Total	XXX	XXX	XXX	XXX	XXX
Securities lending transactions					
U.S. Treasury and agency securities	XXX	XXX	XXX	XXX	$XXX
State and municipal securities	XXX	XXX	XXX	XXX	XXX
Corporate securities	XXX	XXX	XXX	XXX	XXX
Equity securities	XXX	XXX	XXX	XXX	XXX
Non-U.S. sovereign debt	XXX	XXX	XXX	XXX	XXX
Loans	XXX	XXX	XXX	XXX	XXX
Other	XXX	XXX	XXX	XXX	XXX
Total	XXX	XXX	XXX	XXX	XXX
Total borrowings	XXX	$ XXX	XXX	$ XXX	$ XXX
Gross amount of recognized liabilities for repurchase agreements and securities lending in note X					$ XXX
Amounts related to agreements not included in offsetting disclosure in note X					$ XXX

Pending Content

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55-4 This Example illustrates one approach for satisfying the quantitative disclosure requirements in paragraph ~~860-30-50-7~~ 860-30-50-7(a) through (b). …

[Table in Example was unchanged and, therefore, not reproduced.]

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Question 11.4.40

What disclosures are required to enable financial statement users to evaluate the actual or potential effect of related netting arrangements?

Interpretive response: To meet the second objective, the following quantitative information is disclosed at the end of each reporting period for repurchase agreements (or reverse repurchase agreements) and securities borrowing (or lending) transactions. [210-20-50-3 – 50-5]

Required disclosures	Additional guidance
— Gross amounts of the recognized assets and liabilities. — Amounts offset to determine the net amounts presented in the balance sheet. — Net amounts presented in the balance sheet. — Amounts subject to an enforceable master netting arrangement or similar agreement that are not offset in determining the net amounts in the balance sheet: – This includes amounts that management elects not to offset or that are not eligible to be offset. It also includes amounts related to financial collateral (including cash collateral). – The total amount for an instrument cannot exceed the net amount presented in the balance sheet for that instrument. — Net amounts after deducting the amounts that are not offset from the net amounts presented in the balance sheet.	These disclosures must be presented in tabular format, separately for assets and liabilities, unless another format is more appropriate.
Description of the rights of setoff associated with its recognized assets and liabilities that are subject to an enforceable master netting arrangement or similar agreement, including the nature of those rights.	

If these disclosures are disclosed in more than a single note to the financial statements, the entity provides cross-references between those notes. [210-20-50-6]

Example 11.4.10

Offsetting of reverse repurchase, repurchase, securities borrowing and securities lending agreements

This example illustrates one approach for satisfying the disclosure requirements that are required to be provided in tabular format as listed in Question 11.4.40.

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Offsetting of reverse repurchase, securities borrowing, repurchase and securities lending agreements *(Dollars in millions)*		
	Year 2	**Year 1**
Assets – reverse repurchase and securities borrowing agreements		
Gross amounts recognized	$ XX	$ XX
Amounts offset	(XX)	(XX)
Net amount recognized	XX	XX
Amounts subject to enforceable master netting (or similar) arrangements not offset	(XX)	(XX)
Net amount after considering amounts not offset	**XX**	**XX**
Liabilities – repurchase and securities lending agreements		
Gross amounts recognized	$ XX	$ XX
Amounts offset	(XX)	(XX)
Net amount recognized	XX	XX
Amounts subject to enforceable master netting (or similar) arrangements not offset	(XX)	(XX)
Net amount after considering amounts not offset	**XX**	**XX**

Question 11.4.50

What additional presentation and disclosures are required for SEC registrants with repurchase and reverse repurchase agreements?

Excerpt from S-X Rule 4-08

General notes to financial statements

If applicable to the person for which the financial statements are filed, the following shall be set forth on the face of the appropriate statement or in appropriately captioned notes. The information shall be provided for each statement required to be filed, except that the information required by paragraphs (b), (c), (d), (e) and (f) of this section shall be provided as of the most recent audited balance sheet being filed and for paragraph (j) of this section as specified therein. When specific statements are presented separately, the pertinent notes shall accompany such statements unless cross-referencing is appropriate. …

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(m) *Repurchase and reverse repurchase agreements.*

(1) Repurchase agreements (assets sold under agreements to repurchase).

(i) If, as of the most recent balance sheet date, the carrying amount (or market value, if higher than the carrying amount or if there is no carrying amount) of the securities or other assets sold under agreements to repurchase (repurchase agreements) exceeds 10% of total assets, disclose separately in the balance sheet the aggregate amount of liabilities incurred pursuant to repurchase agreements including accrued interest payable thereon.

(ii)

(A) If, as of the most recent balance sheet date, the carrying amount (or market value, if higher than the carrying amount) of securities or other assets sold under repurchase agreements, other than securities or assets specified in paragraph (m)(1)(ii)(B) of this section, exceeds 10% of total assets, disclose in an appropriately captioned footnote containing a tabular presentation, segregated as to type of such securities or assets sold under agreements to repurchase (e. g., U.S. Treasury obligations, U.S. Government agency obligations and loans), the following information as of the balance sheet date for each such agreement or group of agreements (other than agreements involving securities or assets specified in paragraph (m)(1)(ii)(B) of this section) maturing (1) overnight; (2) term up to 30 days; (3) term of 30 to 90 days; (4) term over 90 days and (5) demand:

(i) The carrying amount and market value of the assets sold under agreement to repurchase, including accrued interest plus any cash or other assets on deposit under the repurchase agreements; and

(ii) The repurchase liability associated with such transaction or group of transactions and the interest rate(s) thereon.

(B) For purposes of paragraph (m)(1)(ii)(A) of this section only, do not include securities or other assets for which unrealized changes in market value are reported in current income or which have been obtained under reverse repurchase agreements.

(iii) If, as of the most recent balance sheet date, the amount at risk under repurchase agreements with any individual counterparty or group of related counterparties exceeds 10% of stockholders' equity (or in the case of investment companies, net asset value), disclose the name of each such counterparty or group of related counterparties, the amount at risk with each, and the weighted average maturity of the repurchase agreements with each. The amount at risk under repurchase agreements is defined as the excess of carrying amount (or market value, if higher than the carrying amount or if there is no carrying amount) of the securities or other assets sold under agreement to repurchase, including accrued interest plus any cash or other assets on deposit to secure

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the repurchase obligation, over the amount of the repurchase liability (adjusted for accrued interest). (Cash deposits in connection with repurchase agreements shall not be reported as unrestricted cash pursuant to rule 5–02.1.)

(2) *Reverse repurchase agreements (assets purchased under agreements to resell).*

(i) If, as of the most recent balance sheet date, the aggregate carrying amount of "reverse repurchase agreements" (securities or other assets purchased under agreements to resell) exceeds 10% of total assets:

(A) Disclose separately such amount in the balance sheet; and

(B) Disclose in an appropriately captioned footnote:

(1) The registrant's policy with regard to taking possession of securities or other assets purchased under agreements to resell; and

(2) Whether or not there are any provisions to ensure that the market value of the underlying assets remains sufficient to protect the registrant in the event of default by the counterparty and if so, the nature of those provisions.

(ii) If, as of the most recent balance sheet date, the amount at risk under reverse repurchase agreements with any individual counterparty or group of related counterparties exceeds 10% of stockholders' equity (or in the case of investment companies, net asset value), disclose the name of each such counterparty or group of related counterparties, the amount at risk with each, and the weighted average maturity of the reverse repurchase agreements with each. The amount at risk under reverse repurchase agreements is defined as the excess of the carrying amount of the reverse repurchase agreements over the market value of assets delivered pursuant to the agreements by the counterparty to the registrant (or to a third party agent that has affirmatively agreed to act on behalf of the registrant) and not returned to the counterparty, except in exchange for their approximate market value in a separate transaction.

Interpretive response: An SEC registrant presents and/or discloses additional information if certain quantitative thresholds are exceeded. Those requirements (with related thresholds) are presented in the following table. [S-X Rule 4-08(m)(1)]

Threshold computation	Requirement
Repurchase agreements *(assets sold under agreements to repurchase)*	
Carrying amount (or market value if higher) of the securities or other assets sold under repurchase agreements exceeds 10% of total assets as of the most recent reporting date.	Present aggregate amount of liabilities incurred pursuant to repurchase agreements, including related accrued interest payable, separately in the balance sheet.

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Threshold computation	Requirement
Carrying amount (or market value if higher) of the securities or other assets sold under repurchase agreements, with certain exclusions[1], exceeds 10% of total assets as of the most recent reporting date.	Disclose in tabular format:[1] — Carrying amount and market value of the assets sold under agreements to repurchase, including accrued interest plus any cash or other assets on deposit under the repurchase agreements. — Repurchase liability associated with such transaction or group of transactions and the interest rate(s) thereon. This information is segregated by type of securities or assets sold for each repurchase agreement or group of agreements maturing: — Overnight — Term up to 30 days — Term of 30-90 days — Term over 90 days — On demand.
Amount at risk[2] under repurchase agreements with any individual counterparty (or group of related counterparties) exceeds 10% of stockholders' equity[3] as of the most recent reporting date.	Disclose for each counterparty (or group of counterparties): — Name. — Amount at risk. — Weighted-average maturity of the repurchase agreements.
Reverse repurchase agreements *(assets purchased under agreements to resell)*	
Carrying amount of the reverse repurchase agreements exceeds 10% of total assets as of the most recent reporting date.	— Present the aggregate carrying amount separately in the balance sheet. — Disclose: – Registrant's policy for taking possession of securities or other assets purchased under agreements to resell. – Whether there are any provisions to ensure that the market value of the underlying assets remains sufficient to protect the registrant in the event the counterparty defaults and, if so, the nature of those provisions.
Amount at risk[4] under reverse repurchase agreements with any individual counterparty (or group of related counterparties) exceeds 10% of stockholders' equity[3] as of the most recent reporting date.	Disclose for each counterparty (or group of counterparties): — Name. — Amount at risk. — Weighted-average maturity of the reverse repurchase agreements.

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Notes:

1. The following securities or other assets are excluded from the threshold computation and from the disclosure (if required):
   - those for which unrealized changes in market value are reported in current earnings; and
   - those obtained under reverse repurchase agreements.
2. The 'amount at risk' for repurchase agreements is the excess of the carrying amount (or market value if higher) of the securities or other assets sold under repurchase agreements (including accrued interest plus any cash or other assets on deposit to secure the repurchase obligation) over the amount of the repurchase liability (adjusted for accrued interest).
3. For investment companies, 10% of net asset value.
4. The 'amount at risk' for reverse repurchase agreements is the excess of the carrying amount of the reverse repurchase agreements over the market value of assets delivered pursuant to the agreements by the counterparty to the registrant (or to a third party agent that has affirmatively agreed to act on behalf of the registrant) and not returned to the counterparty, except in exchange for their approximate market value in a separate transaction.

11.5 Disclosures about servicing assets and liabilities

Excerpt from ASC 860-50

> All Entities within the Scope of Subtopic

50-1 This Section is organized as follows:

a. All servicing assets and servicing liabilities
b. Servicing assets and servicing liabilities subsequently measured at fair value
c. Servicing assets and servicing liabilities subsequently amortized
d. Servicing assets and servicing liabilities for which subsequent measurement at fair value is elected as of the beginning of the fiscal year.

For overall guidance on Topic 860's disclosures, see Section 860-10-50.

Question 11.5.10

What disclosures are required for all servicing assets and liabilities?

Excerpt from ASC 860-50

• > All Servicing Assets and Servicing Liabilities

50-2 For all servicing assets and servicing liabilities, all of the following shall be disclosed:

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a. Management's basis for determining its classes of servicing assets and servicing liabilities.
b. 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.
c. The amount of **contractually specified servicing fees**, late fees, and ancillary fees recognized for each period for which results of operations are presented, including a description of where each amount is reported in the statement of income.
d. Quantitative and qualitative information about the assumptions used to estimate fair value (for example, discount rates, anticipated credit losses, and prepayment speeds).

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. An entity that provides such quantitative information is also encouraged, but not required, to disclose quantitative and qualitative information about the assumptions used to estimate the fair value of those instruments. Section 235-10-50 provides guidance on disclosures of accounting policies.

Interpretive response: Entities are required to provide the following disclosures for all servicing assets and liabilities: [860-50-50-2]

— Basis for determining the class of servicing assets and liabilities.

— Description of the risks inherent in servicing assets and liabilities and, if applicable, the instruments used to mitigate the income statement effect of changes in fair value of the servicing assets and liabilities.

— Amount of contractually specified servicing fees, late fees and ancillary fees recognized for each period the income statement is presented, and a description of where they are reported in the income statement.

— Quantitative and qualitative information about the assumptions used to measure fair value – e.g. discount rates, anticipated credit losses and prepayment speeds.

An entity is also encouraged to disclose quantitative information about the instruments used to manage the risks inherent in servicing assets and liabilities, including the fair value of those instruments at the beginning and end of the period, and quantitative and qualitative information about the assumptions used to estimate the fair value of those instruments. [860-50-50-2]

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Question 11.5.20

What disclosures are required only for servicing assets and liabilities subsequently measured at fair value?

Excerpt from ASC 860-50

• > Servicing Assets and Servicing Liabilities Subsequently Measured at Fair Value

50-3 For servicing assets and servicing liabilities subsequently measured at fair value, the following shall be disclosed:

a. 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:

   1. The beginning and ending balances
   2. Additions through any of the following:

      i. Purchases of servicing assets
      ii. Assumptions of servicing obligations
      iii. Recognition of servicing obligations that result from **transfers** of **financial assets**.

   3. Disposals
   4. Changes in fair value during the period resulting from either of the following:

      i. Changes in valuation inputs or assumptions used in the valuation model
      ii. Other changes in fair value and a description of those changes.

   5. Other changes that affect the balance and a description of those changes.

• > Servicing Assets and Servicing Liabilities for Which Subsequent Measurement at Fair Value Is Elected as of the Beginning of the Fiscal Year

50-5 If an entity elects under paragraph 860-50-35-3(d) to subsequently measure a class of servicing assets and servicing liabilities at fair value at the beginning of the fiscal year, the amount of the cumulative-effect adjustment to retained earnings shall be separately disclosed.

Interpretive response: An entity is required to disclose the following information for servicing assets and liabilities subsequently measured at fair value [860-50-50-3]

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Rollforward of the balance of servicing assets and liabilities for each income statement presented	The rollforward is by class and includes at a minimum: — Balance of servicing assets and liabilities at the beginning of the period; — Additions to servicing assets and liabilities through: – Purchases of servicing assets – Assumptions of servicing liabilities – Recognition of servicing rights that result from transfers of financial assets. — Disposals. — Changes in fair value during the period that result from: – Changes in the valuation inputs or assumptions used in the valuation model; or – Other changes in fair value and a description of those changes. — Balance of servicing assets and liabilities at the end of the period.
Additional required disclosures	An entity is also required to disclose: — A description of where changes in fair value are reported in the income statement for each income statement presented. [860-50-50-3(a)] — The cumulative-effect adjustment to retained earnings if the entity elects to change its subsequent measurement method from amortized cost to fair value. [860-50-50-5]

Question 11.5.30

What disclosures are required only for servicing assets and liabilities subsequently measured at amortized cost?

Excerpt from ASC 860-50

• > Servicing Assets and Servicing Liabilities Subsequently Amortized

50-4 For servicing assets and servicing liabilities measured subsequently under the amortization method in paragraph 860-50-35-1(a), all of the following shall be disclosed:

a. 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:

1. The beginning and ending balances
2. Additions through any of the following:

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i. Purchases of servicing assets
ii. Assumptions of servicing obligations
iii. Recognition of servicing obligations that result from transfers of financial assets.

3. Disposals
4. Amortization
5. Application of valuation allowance to adjust carrying value of servicing assets
6. Other-than-temporary impairments
7. Other changes that affect the balance and a description of those changes.

b. 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. …
d. The risk characteristics of the underlying financial assets used to stratify recognized servicing assets for purposes of measuring impairment in accordance with paragraph 860-50-35-9. If the predominant risk characteristics and resulting stratums are changed, that fact and the reasons for those changes shall be included in the disclosures about the risk characteristics of the underlying financial assets used to stratify the recognized servicing assets in accordance with this paragraph.
e. For each period for which results of operations are presented, the activity by class in any valuation allowance for impairment of recognized servicing assets, including all of the following:

1. Beginning and ending balances
2. Aggregate additions charged and recoveries credited to operations
3. Aggregate write-downs charged against the allowance.

Interpretive response: An entity is required to disclose the following information for servicing assets and liabilities subsequently measured at amortized cost. [860-50-50-4]

Rollforward of the balance of servicing assets and liabilities for each income statement presented	The rollforward is by class and includes at a minimum: — Balance of servicing assets and liabilities at the beginning of the period: — Additions to servicing assets and liabilities through: – Purchases of servicing assets – Assumptions of servicing liabilities – Recognition of servicing rights that result from transfers of financial assets. — Disposals. — Amortization. — Changes in the valuation allowance for servicing assets. — Other-than-temporary impairments. — Other changes that affect the balance and a description of the reason for the changes. — Balance of servicing assets and liabilities at the end of the period.

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A rollforward of the valuation allowance for each income statement presented	The rollforward is by class and includes at a minimum: — Balance of the valuation allowance at the beginning of the period. — Aggregate additions charged and recoveries credited. — Aggregate writedowns charged against the allowance. — Balance of the valuation allowance at the end of the period.
Additional required disclosures	An entity is also required to disclose: — Fair value at the beginning and end of the period for each class of servicing assets and liabilities. — Risk characteristics of the underlying financial assets used to stratify recognized servicing assets for purposes of measuring impairment, including facts and reasons for any changes to the predominant risk characteristics or strata. See section 10.4.20 for guidance on measuring impairment.

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Index of changes

This index lists the significant additions and changes made in this edition to assist you in locating recently added or updated content. New Questions and Examples added in this edition are identified throughout the Handbook with ** and items that have been significantly updated or revised are identified with #.

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3. Sale criteria: Overview

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3.4.125 Is a servicing fee that includes a variable incentive component consistent with the second participating interest characteristic? **

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- Credit impairment
- Debt and equity financing
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