FDIC
Federal Deposit Insurance Corporation
550 17th Street NW, Washington, DC 20429

Division of Supervision

Inactive

Servicing Assets

FIL-106-96
December 27, 1996

TO: CHIEF EXECUTIVE OFFICER

SUBJECT: *Regulatory Reporting and Capital Treatment of Servicing Assets Under New Accounting Standard*

The Federal Financial Institutions Examination Council (FFIEC) issued the attached press release on December 18, 1996, in order to:

- remind banking organizations about a new accounting rule, Financial Accounting Standards Board (FASB) Statement No. 125, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities" (FAS 125), that takes effect on January 1, 1997, and
- describe its recommendations to the banking agencies regarding interim guidance for the regulatory capital treatment of "servicing assets" and any related "interest-only strips receivable" recorded as assets in accordance with FAS 125.

For purposes of the Reports of Condition and Income (Call Reports), banks must adopt the provisions of FAS 125 for transfers and servicing of financial assets occurring after December 31, 1996, except for any provisions deferred for implementation by the FASB. FAS 125 also applies to servicing contracts in existence before January 1, 1997. This new accounting standard gives accounting recognition to mortgage servicing contracts similar to that prescribed in current accounting rules and extends this recognition to servicing contracts for all types of financial assets. However, FAS 125 eliminates the current distinction between "normal" and "excess" servicing fees and will generally reclassify these cash flows into two new types of assets: "servicing assets" and certain related interest-only financial assets known as "interest-only strips receivable."

Consistent with the agencies' current capital standards, under the FFIEC's recommended interim regulatory capital guidance the aggregate amount of mortgage servicing assets (MSAs) and purchased credit card relationships (PCCRs) that banking organizations may recognize for regulatory capital purposes (i.e., not deduct from assets and capital) would be limited to no more than 50 percent of Tier 1 capital. Banking organizations also would remain subject to the restriction limiting the amount of MSAs and PCCRs that they may recognize for Tier 1 capital purposes to the lesser of 90 percent of fair value or 100 percent of book value (net of any valuation allowance). As with purchased servicing rights related to financial assets other than mortgages under the agencies' current capital standards, the recommended interim guidance would treat all non-mortgage servicing assets as intangible assets and deduct them in full when computing Tier 1 capital. The FFIEC's recommended interim capital guidance addresses the agencies' concerns about excessive concentrations in servicing assets and would remain in place until a final rule amending the agencies' capital standards takes effect.

Please refer to the attached FFIEC issuance for further information on the regulatory reporting and recommended capital treatment of servicing assets and any related interest-only strips receivable. In addition, banks should note that FAS 125 establishes a new accounting approach for distinguishing transfers of financial assets that are reported as sales from transfers that are reported as borrowings. Because this new approach will apply to transfers of financial assets beginning in 1997, including such basic transactions as loan participations, banks are encouraged to consult with their outside accountants concerning the effect of FAS 125 on their asset transfer activities and the actions needed to implement FAS 125.

For more information, please contact Stephen G. Pfeifer, Examination Specialist in the Division of Supervision's Accounting Section, at (202) 898-8904.

Nicholas J. Ketcha Jr.
Director

Attachment
Distribution: Insured Commercial Banks and FDIC-Supervised Savings Banks
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