NCUA LETTER TO CREDIT UNIONS
NATIONAL CREDIT UNION ADMINISTRATION
1775 Duke Street, Alexandria, VA 22314

DATE: February 2, 1996
LETTER NO.: 96-CU-1

TO FEDERALLY INSURED CREDIT UNIONS ADDRESSED:

The Financial Accounting Standards Board (FASB) has issued a new standard of which you should be aware -- *Statement of Financial Accounting Standard (SFAS) No. 122, "Accounting for Mortgage Servicing Rights."* Effective for calendar year 1996, the standard will affect credit unions engaging in mortgage banking activities.

NCUA SUPPORTS GAAP. NCUA expects affected credit unions to adopt this new FASB rule. You should seek the counsel of a licensed, independent accountant for specific implementation guidance. The NCUA is persuaded that:

1. SFAS 122 will not have a material impact on the majority of credit unions.
2. Credit unions that have the sophistication to engage in mortgage banking activities have the ability and/or resources to properly measure the activities.
3. It is feasible to measure the fair value of mortgage servicing rights, i.e., generally, fair value is quantifiable.

Federal credit unions are required to follow GAAP unless NCUA grants a regulatory accounting practice (RAP) exemption. Generally, NCUA grants an exemption when it believes to mandate compliance would create a hardship.

SCOPE AND EFFECTIVE DATE. For credit unions, this Statement is effective January 1, 1996, and applies to: (1) transactions in which a credit union sells or securitizes mortgage loans with servicing rights retained, and (2) impairment evaluations of all amounts capitalized as mortgage servicing rights, including those purchased before the adoption of this Statement.

SUMMARY OF RULE REQUIREMENTS. The new rule requires a credit union engaging in mortgage banking activities to:

- Recognize rights to service mortgage loans for others as separate assets.

- Evaluate capitalized mortgage servicing for impairment based on the fair value of those rights.

A credit union that acquires mortgage servicing rights and sells or securitizes those loans while retaining the servicing rights, should allocate the total cost of the mortgage loans between the servicing rights and the loans (without the servicing rights). The allocation should be based on their relative fair values if it is practicable to estimate those fair values.

If the fair values of the mortgage servicing rights and the mortgage loans (without the servicing rights) cannot be estimated, the entire cost of purchasing or originating the loans should be allocated to the mortgage loans, as is currently done.

A credit union should arrange its mortgage servicing rights that are capitalized based on one or more of the predominant risk characteristics of the underlying loans, e.g., loan type, size, note rate, date of origination, term, and geographic location. Impairment should be recognized through a valuation allowance for each impaired category.

ORDERING INFORMATION. Copies of the rule can be obtained from **FASB, Order Department, 401 Merritt 7, P.O. Box 5116, Norwalk, CT 06256-5116, or by telephone (203) 847-0700, ext. 10.** Again, specific implementation guidance should be obtained through consultation with the credit union's licensed, independent accountant.

Karl T. Hoyle

Executive Director