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Chapter 3

Does my securitization meet
the sales criteria under GAAP?

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When is a securitization accounted for as a sale?

People often describe a securitization as being either a sale or a financing, and the FASB has confirmed that is the intended result of the guidance articulated in ASC 860, *Transfers and Servicing*. More specifically, ASC 860 stipulates that a transfer¹ of an entire financial asset, a group of entire financial assets, or a participating interest in an entire financial asset needs to be evaluated for relinquishment of control over those transferred assets.²

In performing this evaluation, the question to be answered is whether a transferor (including its consolidated affiliates) has surrendered control over the transferred financial assets. Therefore, it is important for the transferor to first complete its analysis with respect to the securitization SPE consolidation prior to evaluating the transfer of financial assets for its conformity with the requirements for sale accounting treatment.

In reaching a determination on whether control over the transferred financial assets has been surrendered, facts such as the transferor's or any of its consolidated affiliates' continuing involvement with the transferred assets must be considered in the analysis. Similarly, the analysis must also consider any other arrangements between the parties to the transaction that were entered into either contemporaneously with, or in contemplation of, the transfer.

Sale accounting criteria

For a financial asset transfer (e.g., a securitization of a financial asset or participating interest in a financial asset) to be accounted for as a sale, the transferor must surrender control over the assets transferred. Control is considered to be surrendered in a securitization only if all three of the following conditions are met:

- The assets have been legally isolated;
- The transferee has the ability to pledge or exchange the transferred assets; and
- The transferor otherwise no longer maintains effective control over the assets.

Legal isolation

The transferred assets have to be isolated—put beyond the reach of the transferor, or any consolidated affiliate of the transferor, and their creditors (either by a single transaction or a series of transactions taken as a whole)—even in the event of bankruptcy or receivership of the transferor or any consolidated affiliate. This is a facts and circumstances determination, which includes:

(1) judgments about the kind of bankruptcy or other receivership into which a transferor or affiliate might be placed, (2) whether a transfer would likely be deemed a true sale at law, and (3) whether the transferor is affiliated with the transferee.

In contrast to the “going concern” determination, the transferor must address the possibility of bankruptcy, regardless of how remote insolvency may appear given the transferor's credit standing at the time of securitization, and irrespective of an entity's credit rating. That said, it is not enough for the transferor merely to assert that it is unthinkable that a bankruptcy situation could develop during the relatively short term of the securitization.

When thinking about the notion of legal isolation, consider an example of the typical two-step securitization structure:

- **Step 1:** The seller/company transfers assets to an SPE that, although wholly owned, is designed in such a way that the possibility that the transferor or its creditors could reclaim the assets is remote. This first transfer is designed to be judged a true sale at law, in part because it does not provide excessive credit or yield protection to the SPE.
- **Step 2:** The SPE transfers the assets to a trust or other legal vehicle with a sufficient increase in the credit and yield protection on the second transfer (provided by a subordinated retained beneficial interest or other means) to merit the high credit rating sought by investors.



1 For accounting purposes, the term “transfer” has a very specific meaning. It relates to non-cash financial assets only and involves a conveyance from one holder to another holder. Examples include selling a receivable, pledging it as collateral for a borrowing, or putting it into a securitization vehicle. The definition excludes transactions with the issuer or maker of the financial instrument (i.e., originating a receivable, collecting it, or restructuring it).

2 The scope of ASC 860 is limited to transfers involving financial assets, which are defined as “[c]ash 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 [or] (b) Exchange other financial instruments on potentially favorable terms with the second entity.” Transactions related to nonfinancial assets (e.g., many “whole-business” or aircraft securitizations) are beyond the scope of ASC 860.

The second transfer may or may not be judged a true sale at law and, in theory, could be reached by a bankruptcy trustee for the SPE. However, the first SPE's charter forbids it from undertaking any other business or incurring any liabilities, thus removing concern about its bankruptcy risk. The charter of each SPE must also require that the company be maintained as a separate concern from the parent to avoid the risk that the assets of the SPE would be substantively consolidated with the parent's assets in a bankruptcy proceeding involving the parent. It is important to note that this structure is often very important to an attorney's analysis.

The accounting conclusion as to whether the SPEs should be consolidated for financial statement purposes may factor into the attorney's reasoning as to whether the assets have been isolated from a transferor's creditors in the event of transferor bankruptcy but should not be determinative. Thus, it is perfectly acceptable to have the SPE in Step 1 consolidated for accounting purposes, but for the investors to still receive assurance in the form of the attorney's letters that the assets have been sold in a "true sale." Said another way, legal isolation must be determined from the perspective of the transferor and all of its consolidated affiliates. However, consolidated affiliates exclude those entities that are designed to be bankruptcy-remote (i.e., SPEs that have no other business purpose).³ Further, while the legal analysis with respect to legal isolation may evaluate the entities distinctly, the accounting analysis with respect to consolidation still needs to be performed.

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: (1) the transfer is a routine transfer of financial assets that does not result in any continuing involvement by the transferor, or (2) the transferor had experience with other transfers with similar facts and circumstances under the same applicable laws and regulations.

For entities that are subject to other possible bankruptcy, conservatorship, or receivership procedures (e.g., 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 need to be made in relation to the powers of bankruptcy courts or trustees, conservators, or receivers in those jurisdictions.

Ability of transferee to pledge or exchange the transferred assets

When the transferee is a securitization vehicle that is constrained from pledging or exchanging the transferred assets, each third-

party holder of its beneficial interests must have the right to pledge or exchange those beneficial interests.

Any restrictions or constraints on the holder's rights to monetize the cash inflows (the primary economic benefits of financial assets) by pledging or selling those beneficial interests have to be carefully evaluated to determine whether the restriction precludes sale accounting, particularly if the restriction provides more than a trivial benefit to the transferor, which it is presumed to do. As explained in ASC 860, the FASB believes that, in the absence of evidence to the contrary, a condition imposed by a transferor that constrains the transferee presumptively provides more than a trivial benefit to the transferor.

An important factor in the analysis is whether the transferor has continuing involvement in the transferred assets. When Statement of Financial Accounting Standards No. 140 (FAS 140) was written, its Basis for Conclusions stated that "transferred assets from which the transferor can obtain no further benefits are no longer its assets and should be removed from its statement of financial position,"⁴ as would be the case if the transferor has no continuing involvement in the transferred assets. Examples of continuing involvement include:

- Servicing responsibilities;
- Recourse obligations other than standard representations and warranties;
- Management's responsibilities;
- Full or partial equity ownership of the vehicle containing the transferred assets; and
- Other participations in future cash flows.

The assessment of whether the continuing involvement is such that a constraint on the transferee would ultimately provide more than a trivial benefit to the transferor requires judgment. Even if it is not a transferor-imposed constraint, the constraint must be evaluated if the transferor is aware of it.

Holders of an SPE's securities are sometimes limited in their ability to transfer their interests, typically due to a requirement that permits transfers only if the transfer is exempt from the requirements of the Securities Act of 1933. The primary limitation imposed by Rule 144A of the Securities Act, that a potential secondary purchaser must be a sophisticated investor, does not preclude sale accounting, assuming that a large number of qualified buyers exist. Neither does the absence of an active market for the securities.

3 As stated in ASC 860-10-40-5(a): "For multiple step transfers, a bankruptcy-remote entity is not considered a consolidated affiliate for purposes of performing the isolation analysis."

4 FASB Statement of Financial Accounting Standards No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities (a replacement of FASB Statement No. 125) (September 2000).



What about restrictions placed on qualified third-party purchasers (TPPs) used to comply with the Dodd-Frank Act credit risk retention requirements in some CMBS deals?

Certain federal financial regulatory agencies, under a Dodd-Frank Act mandate, adopted a rule in 2014 that requires asset-backed securities (ABS) sponsors, including CMBS sponsors, to retain at least 5 percent of the credit risk in a deal (a “risk retention interest”).⁵ The risk retention interest can be structured in various ways (e.g., retaining 5 percent of each class of beneficial interests issued [a “vertical” slice], the most subordinate interests that represent at least 5 percent of the fair value of the interests issued in the deal [a “horizontal” slice], or some combination of the two [an “L-shaped” piece]). See [chapter 12](#) for additional information on risk retention.

In lieu of retaining direct interests, a CMBS sponsor can transfer risk retention interests to a TPP. Among other requirements, the TPP’s ability to transfer the risk retention interests is restricted. ASC 860-10-40-5(b) requires that transferees, including buyers of beneficial interests in a securitization, have the right to pledge or exchange their interests in order for the transferor to achieve sale accounting. Market participants have questioned whether restrictions placed on a TPP cause a deal to not meet the ASC 860-10-40-5(b) transfer requirements. We understand, based on the SEC staff response to a preclearance submission from the Securities Industry and Financial Markets Association, the SEC staff would not object to a conclusion that the restrictions placed on a TPP do not cause a transfer to fail to meet the conditions in ASC 860-10-40-5(b).⁶

Surrender effective control

The transferor, its consolidated affiliates, or its agents cannot effectively maintain control over the transferred assets or third-party beneficial interests related to those transferred assets through:

- An agreement that requires the transferor to repurchase the transferred assets before their maturity (in other words, the agreement both entitles and obligates the transferor to repurchase as would, for example, a forward contract or a repo).
- The ability to unilaterally cause the SPE to return specific assets, other than through a cleanup call, that conveys more than a trivial benefit to the transferor.
- An agreement that permits the transferee to require the transferor to repurchase the transferred assets, which is priced so favorably that it is probable that the transferee will, in fact, require the transferor to repurchase them.

The accounting literature precludes sale accounting if the transferee has any contractual mechanism to require the transferor to take back specific assets on terms that are potentially advantageous through a put option that, when it is written, is deep in the money. In these cases, the transferor maintains effective control because it has priced the transferee’s option on terms so favorable that it is probable that the transferee will require the transferor to repurchase.

What if I fail to comply with the sale criteria?

If the securitization does not qualify as a sale, the proceeds (other than beneficial interests in the securitized assets) are accounted for as a liability—a secured borrowing. The assets will remain on the balance sheet with no change in measurement, meaning that no gain or loss is recognized. The assets should be classified separately from other assets that are unencumbered.

The securities relating to the transferred assets that are legally owned by the transferor or any consolidated affiliate (i.e., the securities that are not issued for proceeds to third parties) do not appear on the transferor’s consolidated balance sheet. They are economically represented as being the difference between the securitization-related assets and the securitization-related liabilities on the balance sheet.

Ongoing accounting for a securitization, even if treated as a financing, requires many subjective judgments and estimates and could still cause volatility in earnings due to the usual factors of prepayments, credit losses, and interest rate movements. After all, the company still effectively owns a residual. Securitizations accounted for as financings are often not that much different economically than securitizations that qualify for sale accounting treatment. Therefore, the excess of the securitized assets (which remain on balance sheet) over the related funding (in the form of recorded securitization debt) is closely analogous economically to a retained residual.

⁵ Credit risk retention requirements issued jointly by the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Securities and Exchange Commission, the Federal Housing Finance Agency, and the Department of Housing and Urban Development under Section 15G of the Securities Exchange Act of 1934, as added by section 941 of the [Dodd-Frank Wall Street Reform and Consumer Protection Act](#).

⁶ Securities Industry and Financial Markets Association (SIFMA), [Letter to SEC re: SIFMA submission for guidance, December 4, 2017](#).



Who is considered to be the transferor in a “rent-a-shelf” transaction?

Often, a commercial or investment bank will “rent” its SEC shelf registration statement to an unseasoned securitizer that does not have one. The loan originator first sells the loans to a depositor, which is typically a wholly owned, bankruptcy-remote, special purpose corporation established by the commercial or investment bank. The depositor immediately transfers the loans to a special purpose trust that issues the securities sold to the investors. The loan originator often takes back one or more (usually subordinated) tranches.

In this situation, even though the depositor subsidiary of the commercial or investment bank transferred the loans to the trust issuer, it was doing so more as an accommodation to the loan originator and was not taking the typical risk as a principal. If the securitization transaction with outside investors for some reason failed to take place, the depositor would not acquire the loans from the originator. Accordingly, it is the loan originator that would be considered the transferor for purposes of applying the sale criteria to the securitization.

ASC 860 emphasizes the role of an agent in evaluating transactions. As defined, an agent is a party that acts for and on behalf of another party; thus, in the preceding scenario, the depositor would be acting as an agent. Generally speaking, in transactions involving a third-party intermediary acting as agent on behalf of a debtor, the actions of the intermediary shall be viewed as those of the debtor in order to determine whether there has been an exchange of debt instruments or a modification of terms between a debtor and a creditor. On the other hand, commercial or investment banks often purchase whole loans from one or more loan originators (sometimes servicing retained) and accumulate those loans to be securitized using the dealer’s shelf when and how the dealer chooses. In that situation, the commercial or investment bank would be considered the transferor for purposes of applying the sale criteria to the securitization.

When trying to determine whether an entity is acting as a principal or an agent in a transaction, securitizers may wish to consider the principal/agent guidance on debt modifications and revenue recognition by analogy.



If you don't put it to me, can I call it from you?

The accounting rules governing puts are easier than those that govern calls. It's interesting (and to some, counterintuitive) that options allowing investors to put their bonds back to the transferor generally do not preclude sale treatment (but be sure to check with legal counsel, as put options complicate the legal true sale analysis). The rules here are consistent with the theory that the seller has relinquished control over the transferred assets and the transferee has obtained control, even if only temporarily. But a put option that is sufficiently deep in the money when it is written, causing it to be probable that the transferee will exercise it, is problematic. These puts are viewed as the economic equivalent of a forward contract or repurchase agreement.

Put options have been used successfully in transactions to create guaranteed final maturities of short-term tranches to achieve "liquid asset" treatment for thrifts or "money market" treatment for certain other classes of investors, but a number of detailed accounting requirements must be considered. Also, hybrid adjustable rate mortgages have been securitized with a put exercisable at the point when the loans turn from a fixed rate to an adjustable rate. When a securitization with a put feature is accounted for as a sale, the transferor has to record a liability equal to the fair value of the written put.

Analyzing call options continues to be the area that probably is the most conceptual, confusing, and prone to misinterpretation. ASC 860 describes several types of calls, with each potentially having a different effect on the sale versus financing determination:

- **Attached calls** are call options held by the transferor that become part of and are traded with the transferred asset or beneficial interest.
- **Embedded calls** are issuer call options held by the maker of a financial asset included in a securitization that is part of and trades with the financial asset. Examples are call options embedded in corporate bonds and prepayment options embedded in mortgage loans. A call might also be embedded in a beneficial interest issued by an SPE.
- **Freestanding calls** are calls that are neither embedded in nor attached to an asset subject to that call. For example, a freestanding call may be written by the transferee and held by the transferor of an asset but not travel with the asset. Freestanding calls (other than cleanup calls) are not commonly found in securitization transactions.
- **Conditional calls** are call options that the holder does not have the unilateral right to exercise. The right to exercise is conditioned on the occurrence of some event (not merely the passage of time) that is outside the control of the transferor, its affiliates, and its agents.
- **Cleanup calls** are options held by the servicer or its affiliate (which may be the transferor) to purchase the remaining transferred financial assets if the amount of outstanding assets or beneficial interests falls to a specified level at which the cost of servicing those

assets or beneficial interests becomes burdensome in relation to the benefits of servicing. Note that some market participants think that "10 percent" is synonymous with a cleanup call. However, the amount 10 percent does not appear anywhere in the ASC 860 glossary definition of a cleanup call. That said, this analysis should be performed when the servicing arrangement commences and should focus on when servicing is burdensome.

- **In-substance call options** are deemed to exist when the transferor has the right to cause the transferee to sell the assets and (1) has a right (such as a right of first refusal) to obtain the assets, or (2) has some economic advantage providing it, in-substance, with the practical right to obtain the asset because it is not penalized by paying more than the fair value of the asset. Examples of such advantages include ownership of the residual interest and a total return swap with the transferee.
- **Removal of accounts provisions (ROAPs)** permit the transferor to reclaim assets, subject to certain restrictions. In revolving deals, exercise of a ROAP often does not require payment of any consideration, other than reduction of the transferor's received interest (the seller's interest). ROAPs are commonly, though not exclusively, used in revolving transactions involving credit cards.

Calling all calls?

As previously discussed, rights or obligations to reacquire specific transferred assets or beneficial interests that both constrain the transferee and provide more than a trivial benefit to the transferor preclude sale accounting. Consider, for example, a transaction in which the beneficial interest holders agree to sell their interests back to the transferor at the transferor's request for a price equal to the holders' initial cost plus a stated return. In the absence of evidence to the contrary, a condition imposed by a transferor that constrains the transferee presumptively provides more than a trivial benefit to the transferor. Here, the transferor has the ability to reacquire the assets from the transferee at an amount potentially below current fair value; therefore, any such arrangement would be viewed as providing more than a trivial benefit to the transferor. On the other hand, if the call option's strike price was set equal to fair market value on the date of exercise, it is less likely that the transferor would be viewed as retaining more than a trivial benefit. Other facts and circumstances may further impact this analysis—for example, if the assets are not readily obtainable, the transferee may be constrained.

Further, if the transferor holds a fixed-price call option to repurchase any loans it chooses from the portfolio transferred, then sale accounting is precluded for the transfer of the entire portfolio (even if the option is subject to some specified limit, assuming all loans in the pool are smaller than such limit). This conclusion is based on the fact that the transferor can unilaterally remove specific assets at its sole election, and thus control has not been transferred.

How “conditional” must a conditional call be?

ASC 860 makes a distinction between call options that are unilaterally exercisable by the transferor and call options for which the exercise by the transferor is conditioned upon an event outside its control. If the conditional event is outside its control, the transferor is not considered to have retained effective control. An example of a conditional call would be a right to repurchase defaulted loans. Another example would be a right to call the remaining beneficial interests subject to a put option, which is exercisable only in the event that holders of at least 75 percent of the securities put their interests. Once the condition is met and if there is more than a trivial benefit to the transferor, the assets under option are to be brought back on balance sheet, regardless of the transferor’s intent, until the option expires. When the assets under option are brought back on balance sheet, the transferor treats them as if they were newly purchased.

While later codified in ASC 860, *FASB Implementation Guide Q&A 140—A Guide to Implementation of Statement 140 on Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* did not directly provide any guidance regarding the impact on sale accounting of a call option that is conditioned upon an event that is outside the transferor’s control but is likely to occur. As a result, ASC 860 remains without an on-point example.

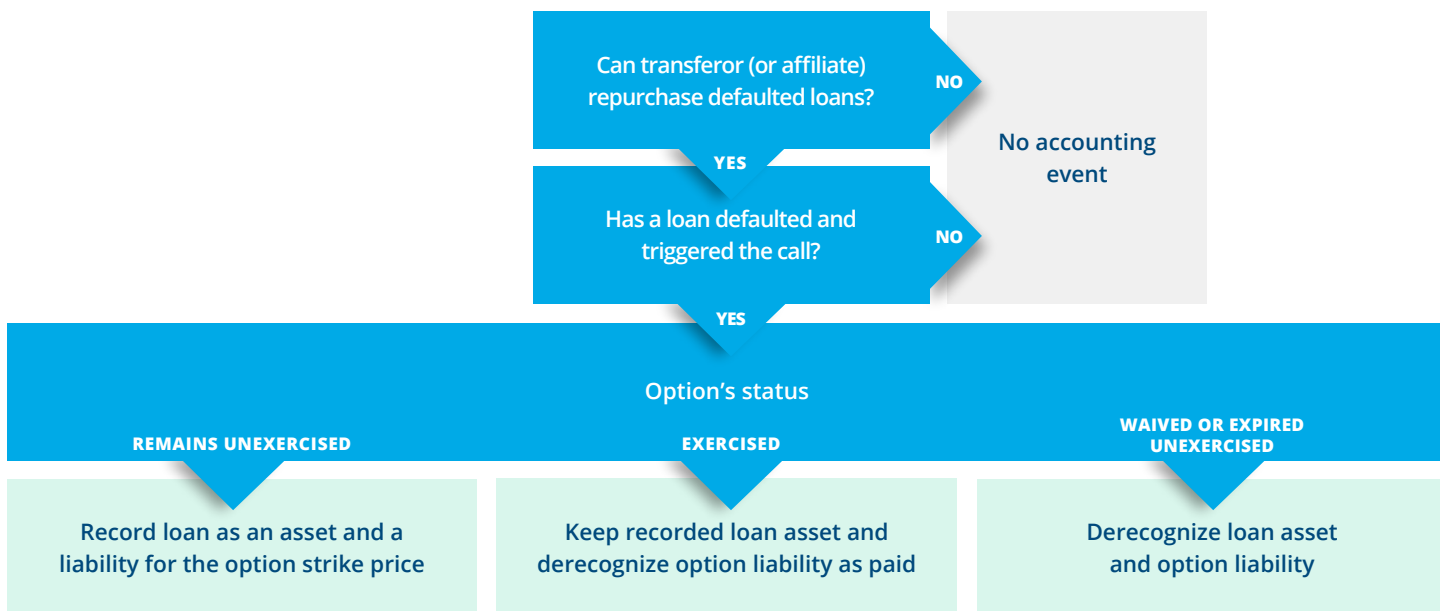
A hypothetical example follows: A transferor sells beneficial interests to third parties but retains the right to reacquire those beneficial interests if the Secured Overnight Financing Rate

(SOFR) increases at any time during the life of the beneficial interests. Although the transferor has no control over the future level of SOFR, it is highly likely that the call will become exercisable sometime during the life of the beneficial interests, perhaps very soon. Thus, most accountants would likely object to sale accounting because the contingency is not substantive. In contrast, depending on what level of SOFR is set as the strike price, the option could be considered a conditional call because there is less certainty about whether the strike price will ever be reached. Separately, those types of options may also impact the views of the lawyers.

And batting cleanup

A transferor that is not the servicer is not permitted to hold the cleanup call. The underpinning for this is the notion that only a servicer is burdened when the amount of outstanding assets falls to a level at which the cost of servicing the assets becomes excessive—the defining condition of a cleanup call. Any other party would be motivated by some other economic incentive in exercising a call. A servicer cleanup call on beneficial interests is permitted because the same sort of burdensome costs versus benefits may arise when the beneficial interests fall to a small portion of their original level. It should be noted, however, that the threshold test for this type of cleanup call is still the burden, or cost, to the servicer, not the benefit of keeping the transaction outstanding; presumably, the cost to the servicer in servicing the transaction differs from the costs associated with the servicing of the assets.

Accounting for default call options



Can I still hold on to the ROAPs?

ROAPs permit the transferor to reclaim assets, subject to certain restrictions. In revolving deals, exercise of a ROAP often does not require payment of any consideration, other than reduction of the seller's interest. As a general rule, a ROAP for random removal of excess assets is permitted if the ROAP is sufficiently limited so that the transferor cannot remove specific assets (e.g., the ROAP is limited to the amount of the transferor's interest and to one removal per month).

ROAPs are used for a variety of business reasons. A bank might have an affinity relationship with an organization—say, the Association of Friends and Families of Overworked Accountants (AFFOA). If the bank securitizes member balances, it might become necessary to remove them from the deal if the bank loses the relationship with AFFOA. The balances would then be transferred to the credit card originator and then on to the new bank that holds the affinity relationship. The effect of such an arrangement on derecognition of the member balances is dependent on the specific facts and circumstances of the arrangement.

Can I account for a transaction as part sale/part financing?

ASC 860 makes it clear that the effective control criteria apply to transfers of:

- Entire financial assets;
- A group of entire financial assets; and
- Participating interests.

Consequently, if there is not a transfer of effective control over the entire pool of receivables placed into a securitization transaction, then the entire transaction is accounted for as a financing. Additionally, transferors must transfer a pool in its entirety; they may receive beneficial interests in the transferred assets, but only if the interests are issued by an unconsolidated transferee.

What about participations?

Banks often issue participations in loans that they have originated, and the requirements for the appropriate accounting for those transactions have always looked to the application of the guidance governing transfers of financial assets. Only participating interests, as defined below, are eligible for sale accounting:

a) Pro rata ownership interest

From the date of the transfer, the participation represents a proportionate (pro rata) ownership interest in an entire financial asset. The percentage interest held by the transferor may vary over time, while the entire underlying financial asset remains outstanding as long as the resulting portions held by the transferor 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) Proportionate division of cash flows

From the date of the transfer, all cash flows—including both principal and interest—received from the underlying financial asset are divided proportionately among the participating interest holders in an amount equal to their share of ownership.

Compensation for services performed, such as servicing, shall not be included in this determination, provided those cash flows are not subordinate to the proportionate cash flows of the participating interest and are not significantly above an amount that would be considered market rate. These fees should include the profit that would be demanded in the marketplace. Finally, any cash flows received by the transferor as proceeds of the transfer of the participating interest shall be excluded from the determination of proportionate cash flows, 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) No subordination

The rights of each participating interest holder, including the transferor in its role as a participating interest holder, have the same priority, and no one interest holder's interest is subordinated to another's. That priority may 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 may have no recourse to the transferor (or its consolidated affiliates or its agents) or to each other, other than 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 setoff benefits received by any participating interest holder. No participating interest holder is entitled to receive cash before any other participating interest holder under its contractual rights as a participating interest holder. If one of the participating interest holders is the servicer of the asset, and that entity receives cash first in that role as compensation, it would not violate this requirement.

d) Disposition of the underlying asset

No party has the right to pledge or exchange the underlying financial asset unless all participating interest holders agree to pledge or exchange the underlying financial asset. If the transferor transfers an entire financial asset in portions that do not individually meet the participating interest definition, sale accounting criteria shall only be applied to the entire financial asset once all portions have been transferred.

One might wonder how a third-party guarantee affects the evaluation of a participating interest. The transfer of a portion of a financial asset represents a participating interest if, among other things, the participating interest holders do not have recourse to any other participating interest holder (other than standard representations or warranties, as defined in ASC 860, and obligations to service, administer, and share in setoff benefits). ASC 860 indicates that cash flows subject to a third-party guarantee do not fail the analysis of a participating interest because the third-party guarantee is considered a “separate unit of account.” The FASB’s conclusion is based on its belief that a third-party guarantee represents a separate arrangement in which the guarantor will assume ownership of the participation in the event of default (i.e., upon default, the third-party guarantee no longer exists, because the guarantor assumes the ownership of the participation and the rights and obligations of the other participation holders do not change).

Many securitizations of trade receivables traditionally relied on a structure in which a company transferred a pool of receivables to a bankruptcy-remote entity, which then issued a senior undivided beneficial interest in the pool to a multiseller commercial paper conduit. The bankruptcy-remote entity is part of the transferor’s consolidated group. Consequently, using the criteria set forth above, the undivided beneficial interest issued in the pool to the conduit needs to be evaluated to see if it meets the definition of a participating interest. Because the interest is “senior,” the undivided beneficial interest would not meet the definition of a participating interest. Because ASC 860 mandates that only transfers of entire assets, a pool of entire assets, or participating interests be subjected to the sale criteria, sellers of trade receivables using this structure would be precluded from accounting for their transactions as sales. Of course, one alternative would be to sell the pool of entire assets in exchange for the same amount of cash and some sort of receivable from the conduit. See [chapter 5](#) for an illustrative example.

What is an entire financial asset?

The emphasis in ASC 860 that the requirements for sale accounting must be applied only to a financial asset in its entirety, a pool of financial assets in its entirety, or participating interests highlights that, inherent in this concept, is that a financial asset (or pool of assets) may not be divided into components prior to transfer unless all of the components meet the definition of a participating interest. What, then, is an entire financial asset—what is the unit of account?

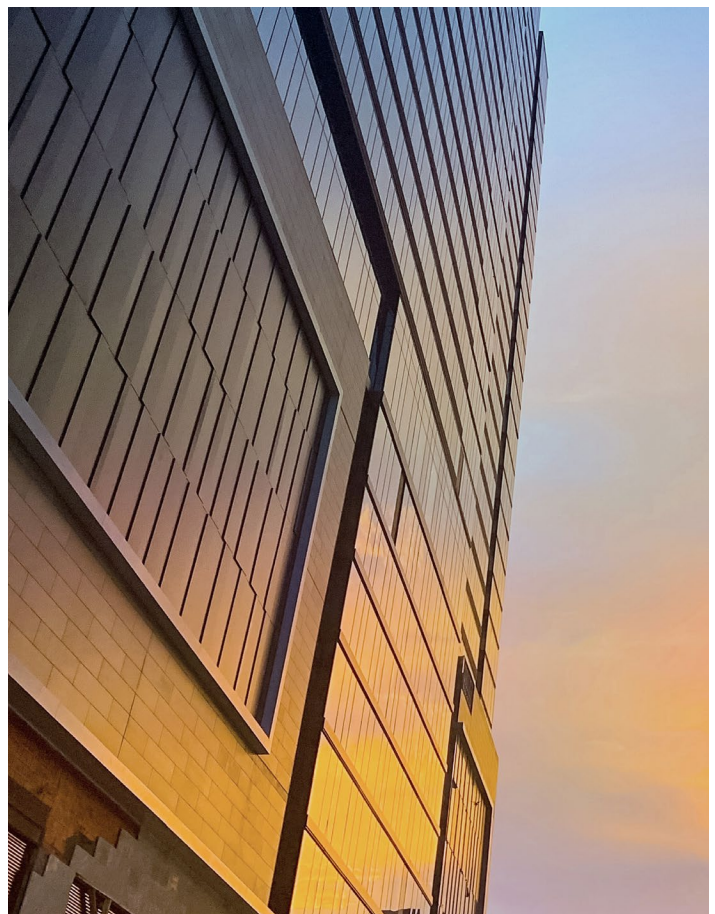
Here are some examples:

- A loan to one borrower in accordance with a single contract that is transferred to a securitization entity 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 a transaction in which the transferor creates an interest-only (IO) strip from a loan and then transfers the IO strip, the IO strip does not meet the definition of an entire financial asset.
- In contrast, if an entire financial asset is transferred to a securitization entity that the transferor does not consolidate and the transfer meets the conditions for sale accounting, the transferor may obtain an IO strip as proceeds from the sale. An IO 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.

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 financial asset if the advance retains its identity, does not become part of a larger loan balance, and is transferred in its entirety. However, if the advances lose their separate identity as part of a larger loan balance, then a participating interest in that larger balance may be eligible for sale accounting; however, the advances themselves would not be eligible for sale accounting.

Overall, the legal form of the asset and what the asset conveys to its holders are the principal considerations in determining what constitutes an entire asset.



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