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Chapter 7

What should I know about mortgage servicing rights?

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What is a mortgage servicing right?

The coupon paid by the borrower on an originated mortgage loan includes both compensation for servicing the loan and a reasonable investment return to the lender. If a loan is held for investment by the originator, there is generally no contractual separation of the investment return from the servicing component. However, if the originator decides to sell the loan to another party, that sale can be structured with the servicing either retained or released. If the loan is sold and servicing is released, then the originator will receive a price to compensate them for the full market-based value of the whole loan, including servicing.

Conversely, if the loan is sold and servicing is retained, there is a contractual separation of the mortgage loan coupon into the servicing component and the interest rate paid to the purchaser or new investor of the loan. This results in the potential recognition of a mortgage servicing right (MSR) asset or liability by the originator retaining the servicing component.

Initial recording

An entity must recognize a servicing asset or liability upon execution of a contract to service financial assets. A servicing contract is either: (1) undertaken in conjunction with selling or securitizing the financial assets being serviced or (2) purchased or assumed separately. A servicing asset or liability would be recorded related to this contract to service only when there is a contractual separation of the servicing from the loan. A servicer that also owns the loan would not record a separate servicing asset or liability. Typically, the benefits of servicing are expected to be more than adequate to compensate the servicer for performing the servicing, and the contract results in a servicing asset. However, if the benefits of servicing are not expected to adequately compensate a servicer for performing the servicing, the contract results in a servicing liability. If a servicer is just adequately compensated, no servicing asset or liability should be recorded. Adequate compensation¹ is a market-based factor and does not necessarily consider the servicer's internal costs to service. A servicing asset or servicing liability that requires separate recognition is required to be initially measured at fair value in accordance with ASC 820. Fair value is defined as the price that would be received to sell the asset or would be paid to transfer a liability in an orderly transaction between market participants. The price used must be based on the principal market for the asset or liability, where the principal market is presumed to be the market in which the reporting entity normally transacts. In the absence of a principal market, participants may use the most advantageous market, which is the market that is most advantageous for the transferor, after taking into account transaction costs.

MSRs may be acquired in bulk or flow transactions: either retained as part of the transfer of a loan or through separate acquisition after separation from the related mortgage loan. The fair value recorded

for an MSR retained as part of a loan transfer will impact the gain on sale of the transferred loan as discussed in [chapter 6](#). Separate acquisition of an MSR may also include the acquisition of other related assets, such as servicing advances, delinquent servicing fees, or relationship intangible assets. The transaction price should be allocated to the underlying components acquired in the transaction. The allocation methodology depends on whether all or any of the components will be measured at fair value subsequent to initial recognition. While there are many inputs that the marketplace considers in the fair valuation of an MSR, generally, this value will comprise the net impact of: (1) the cash inflows related to the benefits of servicing, such as the base servicing fee and any float or other ancillary income expected, and (2) the cash outflows related to the obligations of servicing, including cost of funds.

Subsequent measurement

Servicing assets or servicing liabilities can be accounted for subsequent to acquisition, using one of two methods: amortization or fair value.

Different elections can be made for different classes of servicing assets and servicing liabilities. Classes of servicing assets and servicing liabilities are identified based on the availability of market inputs used in determining fair value, as well as an entity's method for managing the risks of its servicing assets or servicing liabilities. For example, a company may choose to categorize its single-family residential mortgage loan servicing in a separate class from its multi-family mortgage loan servicing. Once fair value is elected for a particular class, the fair value election is irrevocable. Servicing assets and liabilities held within an amortized cost class may be transitioned to a fair value class at the beginning of any fiscal year. Subsequent measurement of the servicing assets and servicing liabilities at fair value should 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. 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 cannot not be placed in a class of servicing assets and servicing liabilities that is subsequently measured using the amortization method.

It is important to note, however, that a servicing asset may also become a servicing liability, or vice versa, as a result of changes in the relationship of contractual servicing fees to adequate compensation. Adequate compensation may be impacted by changes in the market-based costs to service loans due to evolution in loan performance as well as other factors.

¹ ASC 860-50-20 defines adequate compensation as: "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."



Amortization method

The MSR is amortized 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). The resulting amortized cost basis of the MSR is assessed periodically for impairment or increased obligation based on fair value at each reporting date.

Stratification

The MSR portfolio is stratified within separate tranches based on one or more predominant risk characteristics of the underlying financial assets. Characteristics may include financial asset type, size, interest rate, date of origination, term, and geographic location. This stratification should be at a granular enough level so that the loans within the stratum generally behave in a similar manner as market risk factors fluctuate.

The stratification decision shall be applied consistently unless significant changes in economic facts and circumstances indicate clearly that the predominant risk characteristics and resulting strata should be changed.

Amortized cost should be calculated for each stratum individually. Additionally, each stratum should be assessed for impairment by comparing the amortized cost to the fair value at the measurement date. If the fair value of any stratum is less than the amortized cost of that stratum, then the differential should be recorded as an impairment. If the impairment is considered temporary, it may be recognized through a valuation allowance. Subsequent changes in the fair value of the stratum may be impacted through the valuation allowance; however, fair value in excess of the carrying amount of servicing assets for that stratum shall not be recognized. If an impairment is considered other than temporary, a direct write-down of the MSR asset may be warranted.

Fair value method

An entity can also elect to use the fair value method for a class of servicing assets or servicing liabilities. Under the fair value method, each class of servicing assets or liabilities is adjusted to fair value at the reporting date, and changes in the fair value are recorded in earnings in the period in which the changes occur along with the servicing fee income for the period servicing is performed.

The MSR market has historically never been liquid enough to provide participants with readily available quoted market prices. Trades, if any, are transacted between parties through brokers, rather than through an exchange. Therefore, companies commonly rely on valuation models to estimate the fair value of the asset or liability. Certain significant assumptions within the MSR valuation are unobservable and therefore, under ASC 820, an MSR fair value measurement is typically considered a Level 3 fair value measurement.²

There are robust disclosure requirements in ASC 820 and ASC 860, which include, but are not limited to, requiring information to enable users to assess the valuation techniques and inputs used to develop the fair value of the MSR (for both impairment evaluation under the amortization method and subsequent accounting at fair value) as well as to determine the effect of the measurements on earnings for the period.

Transfers of servicing

Sale accounting versus a financing transaction

When an MSR is transferred between parties, it may be accounted for as either an asset sale or a secured lending (financing) transaction, depending on certain key facts and circumstances.

It is important to note that under US GAAP, MSRs are not considered financial assets. Because of their nature, there is unique guidance to account for transfers of servicing in ASC 860-50-40.



² MSR transaction prices may include elements in addition to the servicing contract (e.g., an intangible relationship asset related to the servicer's ability to solicit the borrower). The FASB's Emerging Issues Task Force added the topic to its agenda at its September 9, 2025, meeting.

Sale accounting criteria

Transferred servicing rights are accounted for as a sale if the following conditions are met by the seller:

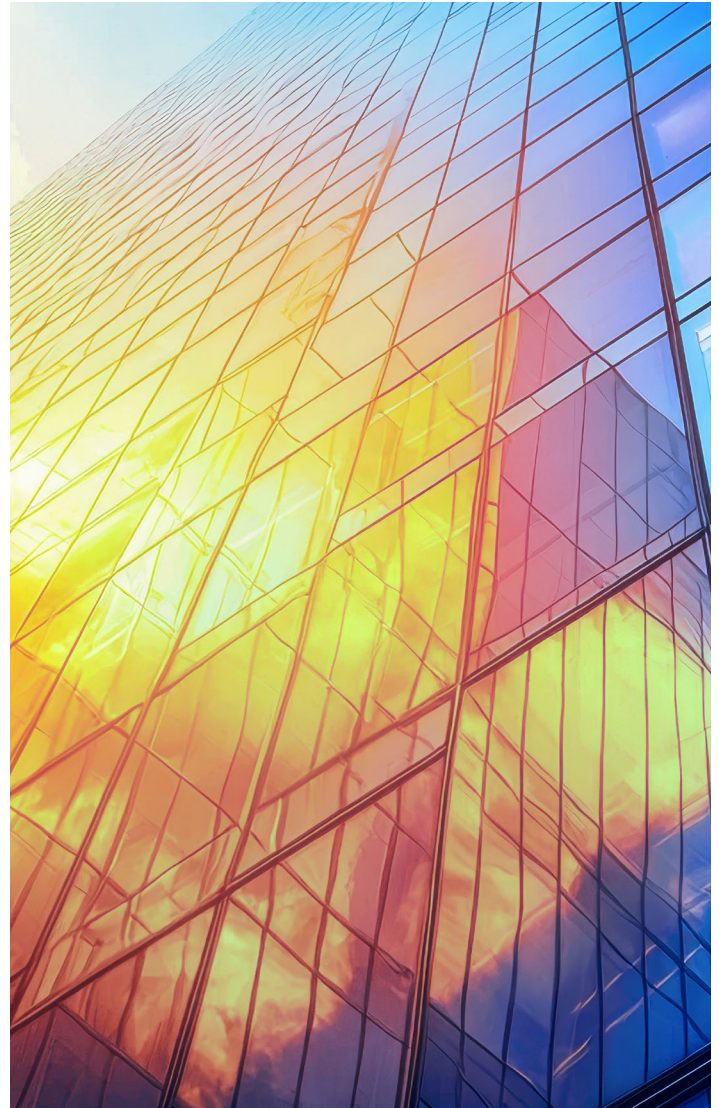
- The transferor has received written approval from the investor, if required.
- The transferee is a currently approved transferor-servicer and is not at risk of losing approved status.
- If the transferor finances a portion of the sales price, an adequate nonrefundable down payment has been received (necessary to demonstrate the transferee's commitment to pay the remaining sales price) and whether the note receivable from the transferee provides full recourse³ to the transferee. Nonrecourse notes or notes with limited recourse (such as to the servicing) do not satisfy this criterion.
- 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.
- Title has passed.
- Substantially all risks and rewards of ownership have irrevocably passed to the buyer.
- Any protection provisions retained by the seller are minor and can be reasonably estimated.

Based on this guidance, among other things, significant consideration is given to whether the seller is entitled to the risks and rewards of ownership. Rewards of servicing include the right to earn servicing fees and other contractually entitled payments (e.g., ancillary income, float). Rewards can also be earned through the rights to sell the MSRs for a return in the market place. Risks of servicing include the incurrence of the associated costs to service and understanding that those are not fixed but may vary based on the needs of the particular borrower and mortgage loan.

A transfer of MSRs can qualify as a sale only if the transferee has an appropriate license to service the MSRs transferred. The accounting guidance does not specify the type of entity that can retain or acquire an MSR; however, for transactions where servicing is retained, investors will typically require a licensed servicer to be the named servicer. In bulk transactions, the derecognition requirements will be applicable, thus consideration of ownership is critical in determining who records the MSR.

When the requirements for sale accounting have been met, but the transferor establishes a subservicing arrangement with the transferee, the ability to recognize the gain on sale could be impacted and deferral may be required, despite the ability to derecognize the MSR. Special attention should be given to the role the seller may play subsequent to the sales transaction.

³ ASC 860 defines recourse as: "The right of a transferee of receivables to receive payment from the transferor of those receivables for any of the following:
(a) Failure of debtors to pay when due,
(b) The effects of prepayments or
(c) Adjustments resulting from defects in the eligibility of the transferred receivables."



Considerations for a financing transaction

Certain transfers of MSRs will not meet the sale accounting criteria and should be accounted for as a financing or secured borrowing. This would result in a liability recorded by the transferor in the amount of the cash received. This liability should reflect the expected future cash payments that will be passed through to the purchaser of the MSR and would not reduce to zero or be considered extinguished until the last payment is made.

While a transaction may initially be accounted for as a secured borrowing, subsequent facts may change and allow for the transaction to meet the requirements for sale accounting. These facts might include transfer of title and/or approval of the transferee as the servicer by the investor of a loan, among other possible factors.

Other considerations

For servicing liabilities subsequently measured using the amortization method, if subsequent events have increased the fair value of the liability above the carrying amount—for example, because of significant changes in the amount or timing of actual or expected future cash outflows relative to the cash outflows previously projected—the entity shall revise its earlier estimates and recognize the increased obligation as a loss in earnings.

Certain transactions could involve the sale of cash flows related to an MSR or even the sale of excess servicing. The guidance in ASC 860-50-25 provides a definition for excess servicing and guidance for distinguishing servicing from an IO strip. While the sale of cash flows related to the MSR and the base servicing fees would be considered a transfer of nonfinancial assets, an excess servicing strip or IO strip in certain circumstances, could meet the definition of a financial asset and would be considered under the guidance in ASC 860-10. Under the GAAP definition, excess servicing would be considered the “rights to future interest income from the serviced assets that exceed contractually specified servicing fees.” The right to this income is held outside of the servicing contract and may include rights to residual income of a securitization or an actual IO certificate. This form of excess servicing would be considered a financial asset.

Additionally, some transactions may include more than just the transfer of servicing assets, and the acquiring party may need to consider the guidance in ASC 805, *Business Combinations*, to determine whether the acquisition should be accounted for as a business combination.

MSRs under IFRS

GAAP separately identifies an MSR as a unique nonfinancial asset and provides specific guidance with regards to the accounting and valuation of MSRs. IFRS identifies MSRs within the intangible asset guidance in IAS 38, *Intangible Assets*. While the accounting for MSRs

is largely similar under both bodies of accounting standards, there could be some differences, beyond the balance sheet classification, in the application of the accounting guidance. The nuances of specific transactions and structures will be determinative of any differences in conclusions.

IFRS addresses accounting for MSRs in conjunction with the accounting for other intangible assets and does not provide unique accounting for MSRs specifically. Under IFRS, acquired intangible assets should be initially recognized at “relative fair value.” Depending on the structure of the transaction, relative fair value may differ from true market-based fair value.

IFRS requires an intangible asset with a finite useful life to be amortized after initial recognition on a systematic basis over its useful life in accordance with the economic benefits to be derived from the asset. This is very similar to the amortization method under GAAP. IFRS also requires that the MSR be analyzed for impairment; however, it does not require the MSR to be tranching into risk buckets for purposes of this impairment assessment. This approach could result in different carrying amounts of the MSR under GAAP versus IFRS. In addition, IFRS does not allow for the option to measure the MSR at its full fair value subsequent to initial recognition, as does GAAP.

IFRS does not provide specific guidance on MSR transfers. However, guidance does exist in IAS 38 related to transfers of intangible assets. This guidance defers to general revenue recognition concepts under IFRS 15. The application of the IFRS guidance to a transfer of MSRs may result in a similar accounting conclusion; however, the potential does exist for differences. Most notably, the concept of secured financing is not specifically mentioned in IFRS related to transfers of intangible assets. As such, when the derecognition guidance for an intangible asset is not met under IFRS, there could be differences between GAAP and IFRS.



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