PENNYMAC
FINANCIAL SERVICES

August 8, 2025

Technical Director
Financial Accounting Standards Board
401 Merritt 7
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Norwalk, CT 06856-5116

Dear Technical Director,

PennyMac Financial Services, Inc. ("we" or "PFSI") is requesting that the Emerging Issues Task Force ("EITF") add a new project to its agenda to clarify the unit of account for mortgage servicing rights ("MSRs"). Specifically, market participants consider the ability to solicit borrowers[1] of the underlying serviced loans for refinancing ("recapture") — an intangible benefit to the servicer beyond cash flows of the servicing contract. We believe that MSR transaction prices reflect recapture rights and U.S. Generally Accepted Accounting Principles ("GAAP") does not clearly indicate whether recapture should be accounted for as part of an MSR or as a separate intangible asset.

Current GAAP

The accounting guidance for MSRs is contained in Accounting Standards Codification Topic 860 – *Transfers and Servicing* ("ASC 860"). ASC 860 requires that MSRs be initially recorded at fair value[2]. Subsequent measurement may be made using either the amortization method or fair value measurement method[3]. Regardless of the subsequent measurement method chosen, fair value must be estimated on a recurring basis to determine the carrying value if the fair value method is applied and for impairment assessment if the amortization method is applied.[4] Regardless of the subsequent measurement method applied, the fair value of MSR must be disclosed and quantitative information regarding inputs that are significant to the estimation of fair value is also required to be disclosed.[5]

ASC 860 provides limited guidance on the measurement of fair value of MSRs. The approach in ASC 860 is consistent with the guidance in ASC 820, *Fair Value Measurements* ("ASC 820"), which emphasizes that fair value is a market-based rather than an entity-specific measurement. Therefore, a fair value measurement of a MSR is determined based on the assumptions that market participants would use in pricing an MSR. Under ASC 820, a reporting entity is required to maximize the use of relevant observable inputs and minimize the use of unobservable inputs to meet the objective of a fair value measurement[6]. Although MSRs are not actively traded, sales of such assets do occur. Therefore, entities must consider relevant observable transactions involving sales of MSRs.

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[1] Servicing contracts may explicitly permit or prohibit solicitation of borrowers of the underlying loans for refinancing. In addition, some servicing contracts may be silent on such solicitation.
[2] ASC 860-50-30-1
[3] ASC 860-50-35-1
[4] ASC 860-50-50-4.b
[5] ASC 820-50-50-2.bbb.2
[6] ASC 820-10-35-16AA

In addition, we acknowledge (1) the counterparties to the mortgage loan (borrower) and MSR (investor) are different and (2) ASC 860 considers those separate contractual relationships in the subsequent measurement guidance for amortizing MSR assets and precludes a reporting entity from considering estimated future net servicing income from the "new" mortgage loan (i.e., recapture) when determining how to amortize any capitalized cost associated with the MSR asset for the current mortgage loan[7]. However, the initial recognition guidance in ASC 860 does not indicate whether recapture should be accounted for as part of an MSR or as a separate intangible asset.

MSRs and Recapture

We believe that the ability in a mortgage servicing agreement to recapture mortgages in refinancing transactions is broadly recognized by market participants as a source of cash flows that is inextricably tied to the related mortgage servicing arrangements. That is, while the underlying mortgage is held with a separate counterparty than the servicing agreement, the contractual ability to recapture mortgages is viewed as an extension of the servicing agreement (i.e., another ancillary benefit of servicing). Further, based on our historical experience and available market data, we also believe that:

- MSR market participants consider recapture in determining the transaction price they pay (entry price) or demand (exit price) in a sale of an MSR; and
- MSR trade data reflecting recapture is available for market participants to use for financial reporting purposes.

Current Practice

We understand there is little to no diversity in practice in accounting for the initial recognition and measurement of an **acquired** MSR. Broad industry practice is to initially recognize and measure an acquired MSR at the purchase price, which inherently includes any value that a market participant would place on recapture (i.e., no Day 1 loss is recognized, nor is a separate intangible asset recognized). We understand a potential alternative view is to separately recognize and measure an intangible asset for recapture rights upon acquiring an MSR (i.e., the acquisition includes multiple intangible asset elements — the MSR and recapture). We are unaware of any registrants applying this approach and believe such accounting would be costly and of little benefit to investors. For example, intangible assets are subsequently measured at cost and amortized.

In contrast, we have recently observed diversity in practice in the treatment of recapture in subsequently measuring the fair value of MSRs. For example, we have observed that when subsequently determining fair value measurements of MSRs, companies either:

- Exclude recapture entirely from recurring fair value measurements.
- Include recapture as an explicit valuation input.
- Include recapture as an implicit valuation input (e.g., through calibration of the discount rate).

This diversity in practice results in inconsistency and creates uncertainty in financial reporting that is a cost borne by investors and other users of financial statements. The subsequent discussion further explores these different views.

[7] ASC 860-50-35-17

View A (exclude recapture)

Under this view, a reporting entity excludes recapture from subsequently measuring MSRs at fair value based on the following guidance in ASC 860-50-30-6 and 35-17, which state:

> *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.*** *[Emphasis added.]*

> *When an entity that is servicing mortgage loans refinances a mortgage loan that is being serviced (resulting in prepayment of the old mortgage loan and origination of a new mortgage loan),* ***the entity shall not consider the estimated future net servicing income (that is, servicing revenue in excess of servicing costs) from the new mortgage loan in determining how to amortize any capitalized cost related to acquiring the mortgage servicing asset for the old mortgage loan. The mortgage servicing asset represents a contractual relationship between the servicer and the investor in the mortgage loan, not between the servicer and the borrower****. [Emphasis added.]*

Based on this guidance, proponents of this view believe that recapture rights are ultimately between the servicer and the borrower — not part of the contract between the servicer and the investor and therefore a separate unit of account from the MSR. Proponents observe that while the initial recognition guidance in ASC 860 is silent on the unit of account treatment for recapture, the subsequent measurement guidance in paragraph 35-17 strongly suggests the MSR unit of account does not include recapture. Accordingly, proponents of this view argue recapture should be neither implicitly nor explicitly included in the fair value of MSRs. However, opponents of this view acknowledge (1) the initial recognition guidance in ASC 860 is silent on the unit of account treatment for recapture and (2) the inherent inconsistency with View A and the initial recognition and measurement treatment for **acquired** MSRs where practice neither (a) separately recognizes an intangible asset for recapture rights upon acquiring an MSR, nor (b) recognizes a Day 1 loss when acquiring MSRs. Opponents of View A do not believe that separate recognition of recapture would be meaningful to an investor.

View B (include recapture)

Under this view, recapture and the MSR are treated as a single unit of account and recapture is either implicitly or explicitly included in the subsequent measurement of MSRs at fair value. In addition to the "opponent" view expressed above in View A, the basis of this view considers the following factors:

- MSR trade data reflects the rights to cash flows under both (a) the current servicing contract and (b) future servicing contracts resulting from the servicer's ability to pursue recapture. In effect, the ability to recapture mortgages is viewed as an extension of the servicing agreement.
- Under ASC 820-10-35-16AA, a reporting entity is required to maximize the use of relevant observable inputs and minimize the use of unobservable inputs to meet the objective of a fair value measurement.
- Therefore, an entity should consider any observable MSR trade data (which may include recapture rights, as applicable) to not only determine the fair value of the servicing assets but also to calibrate its valuation technique for its MSRs[8].

[8] ASC 820-10-35-24C

View B also acknowledges that if market participants believe they are precluded from including recapture as an explicit valuation input (for example, based on the unit of account guidance in ASC 860-50-35-17 noted in View A), such participants may compensate by adjusting other valuation inputs (e.g., discount rate) to calibrate their fair value estimates with observed transactions, thereby reducing transparency and creating uncertainty in financial reporting due to diversity in practice. Opponents of this view counter with View A. Those opponents specifically observe that transaction prices that include multiple elements (i.e., MSR and recapture) provide an observable price for the basket — not the individual elements — and therefore do not reflect fair value of only the MSR.

Request

While we appreciate the technical distinctions between the value of an agreement with an investor and the value of access to a prospective borrower, we believe recognition of a separate intangible asset for MSRs provides limited to no decision useful information to financial statement users.

We therefore ask that the EITF address this question to forestall the developing diversity in practice and incongruence created when we believe marketplace servicing rights transactions reflect recapture. Specifically, we believe that a technical improvement should be made to U.S. GAAP to include recapture as an additional ancillary benefit of servicing, and therefore, an input (explicit or implicit) in the fair value measurement of MSRs when a servicer is not contractually prohibited in a servicing agreement from soliciting borrowers of the underlying loans for refinancing.

We appreciate the opportunity to discuss this issue with the EITF. Please call me at (818) 224-7136 or email me at Dan.Perotti@pennymac.com with any questions.

Thank you for your consideration,

Daniel S Perotti
Chief Financial Officer
PennyMac Financial Services, Inc.